



# Contemporary Chinese Legal System

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**Spring Semester, 2016-2017**

# Schedule

| Week | Date     | Topic  |
|------|----------|--|
| 1    | Feb 23   | No Class   |
| 2    | March 2  | Topic 1: Chinese legal system in general-Chinese Legal Culture and Traditions                                  |
| 3    | March 9  | Topic 1 Chinese legal system in general - Experience of Law in PRC   |
| 4    | March 16 | Topic 2: Chinese Constitutional Law & Rule of Law-Chinese Constitution   |
| 5    | March 23 | Topic 2: Chinese Constitutional Law & Rule of Law-Legal Institutions and the Administration of Justice and Law |
| 6    | March 30 | Topic 2: Chinese Constitutional Law & Rule of Law-Sources of Law and Law-making                                |
| 7    | April 6  | No class   |
| 8    | April 13 | Topic 3: Chinese laws in operation-public law  |
| 9    | April 20 | Topic 3: Chinese laws in operation- Foreign Trade & Investment law   |
| 10   | April 27 | Internship: Visit the legal department of a multinational company in Shanghai                                  |
| 11   | May 4    | Topic 3: Chinese laws in operation- civil law (IP)   |
| 12   | May 11   | Topic 3: Chinese laws in operation- contract law   |
| 13   | May 18   | Topic 4: Dispute Resolutions   |
|      | May 26   | Topic 5-Implementation and Enforcement of Law  |

# Basic framework of China's foreign investment laws and policies

## Legislation

- Three investment laws
- Regulations of the three investment laws
- Implementing regulations

## Guiding Catalogue

- nationwide
- Central-western

## Policies Five-year Plan

# Basic framework of China's foreign investment laws and policies

Three Investment Laws:

- the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures ( 'Law of Equity Joint Ventures') promulgated in 1979.<sup>2</sup>
- the Law of the People's Republic of China on Foreign-Capital Enterprises (hereinafter 'Law of Foreign-Capital Enterprises'), in 1986,<sup>3</sup>
- the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures (hereinafter 'Law of Contractual Joint Ventures'), in 1988.<sup>4</sup>

the Regulations of the Three Investment Laws

the 2005 Company Law (2013 amendment)

# Foreign Investment Enterprises

- 1. Overview
- 2. Foreign investment enterprise laws
- 3. How to establish an FIE
- 4. Other ways for foreign investment

# 1. Overview

- Characteristics of **China's foreign-investment related law**
  - 1. **Separate systems** for foreign and domestic businesses
    - covering organisational form, contract, tax and industrial relation etc
    - Reasons:
      - 1. Foreign investment was permitted with the very specific goal of bringing into china much-needed resources
      - 2. At that time, the legal framework for domestic businesses was underdeveloped
      - 3. Socialist legislative philosophy:
        - Ownership-based
    - Strengths:
      - Set up a legal framework specifically tailored to foreign investment
      - Easier for the government to control
    - Weaknesses:
      - Conflicts between the two legal systems
      - Increase regulatory costs

# Overview (cont)

## ❑ 2. Enterprise-based (except for SOE)

### ■ Historical product:

- ❑ enabled China to quickly open its door against its socialist background at a time when Company Law did not exist

### ■ Problems:

- ❑ Unclear as to the legal status
- ❑ Increasingly conflict with domestic business law which is being reformed to be in line with international practice
  - Domestic business law: Company law, partnership law, sole proprietorship law
  - Subject to both sets of laws
  - If conflicts arise, the enterprise laws prevail

# Overview (cont)

- ❑ 3. An *ad hoc* and fragmented approach
  - A large number of laws, regulations and rules issued by different legislatures and regulators
  - Reasons:
    - ❑ 1. the experimental nature of the economic reform
    - ❑ 2. the problem of growing too fast
  - Strengths:
    - ❑ 1. the government is able to effectively adapt elements of its regulatory framework to meet the needs of the ever-changing situation
    - ❑ 2. provides flexibility to foreign investors
  - Weaknesses:
    - ❑ 1. difficult to apply
    - ❑ 2. conflicts exist amongst those documents



## ■ The way forward...

- the dual systems of FIE regulation will converge in near future
  - A single regime to facilitate compliance
  - Level playing field for all
  - Reduce regulatory costs
  - Have a relatively complete domestic business law system
- PRC Foreign Investment Law Sept. 3, 2016
  - Draft consultation ended 17 Feb 2015
    - All FIEs will be required to convert to modern business forms such as companies, partnerships (modern business law system) within 3 years of the law
    - National treatment & negative list

## 2. Foreign investment enterprise laws

- Three types of FIE:
  - Equity Joint Venture (EJV)
  - Contractual Joint Venture (CJV)
  - Wholly Foreign Owned Enterprise (WFOE)

- EJV:
  - Main laws governing EJV:
    - Law of the PRC on Chinese-foreign Equity Joint Ventures (promulgated by NPC in 1979, revised in 1990 and in 2001)
      - The first law regulating FIEs in China: 16 articles
    - Implementing Regulation of the Law of the PRC on Chinese-foreign Equity Joint Venture (promulgated by State Council in 1983, revised in 1986, 1987 and 2001)
      - 16 chapters and 105 articles
  - Features of EJV:
    - The first enterprises allowed for foreign investors

# The First EJV (with a HK investor)



Beijing Air Catering Co., Ltd. (BACL, 北京航空食品有限公司), officially opened its business on May 1, 1980. After 30 years of development, BACL has become a modern air-catering company with a daily catering capacity of 80,000 meals, providing air-catering services to nearly 400 airplanes from over 50 airlines at home and abroad.

# FIE laws (cont)

- ❑ EJV should take the form of limited liability Co and become a Chinese legal person
- Legal implications:
  - ❑ Contributions of capital become the property of the EJV
  - ❑ The business of the EJV is to be managed by a board of directors
- Note: Some local regulations have permitted venture capital EJV to use the form of limited liability partnership 【LLP】 (in high-tech science part)

- ❑ The foreign investor's investment should not be less than 25% of the EJV's registered capital(no enjoy preferential treatment)
- Encourage foreign investors to contribute
- Is there an **upper limit**?: Generally NO
  - ❑ BUT: some administrative regulations have fixed an upper limit in some specified industries
    - *Catalogue for the Guidance of Foreign Investment Industries* (2011): also relevant to M&A
    - Notice of Relevant Policies on Foreign Investment in Civil Aviation (1994): no more than 35%

# FIE laws (cont)

- ❑ Distribution of profits:
  - The venturers' profit share is determined in accordance with their share of the equity
- ❑ Scope of investor
  - Foreign investors may be companies, enterprises, other economic organizations and individuals
  - Chinese investors include all the above except individuals: BUT
    - ❑ The easy way to get around it is for the Chinese partner to form a domestic enterprise (one person company)
    - ❑ Provisional Rules on Acquisition of Domestic Enterprises by Foreign Investors (2003) effectively permits Chinese individuals to be a party

- ❑ Operation period:
  - Shall be determined by all the parties
  - Normally between 10 to 30 years but can be extended
- ❑ Volkswagen: in 1984 set up an EJV for a term of 25 years and in 2002 extended the term to year 2030





# FIE laws (cont)

- CJV:
  - Main governing laws:
    - **Law of** the PRC on Chinese-foreign Contractual Joint Ventures (promulgated in 1988, amended in 2000)
    - Detailed Rules for the **Implementation** of the Law of the PRC on Chinese-foreign Contractual Joint Venture (promulgated in 1995)

## □ Features of CJV

- Similarities between an **EJV and a CJV** Scope of foreign investors and scope of Chinese investors
  - Both are Chinese economic organizations
    - If they set up a new enterprise, the latter will not enjoy the status of a FIE (registered in china 是中国公司, 再建立 subsidiary 也是中国公司, 不享有 status of FIE)



But: Provisions on the Establishment of Investment Companies by Foreign Investors (1995, recently amended in 2006, special investment companies can set up FIEs); Provisional Rules on the Domestic Investment by FIEs (2000, investment in the middle or western regions of China)

- Hewlett Packard: the first Sino-US high-tech EJV (1985)---set up investment Co (1995)

# FIE laws (cont)

- Differences between an EJV (based on equity )and a CJV(contract)
  - CJV is established and managed based on a joint venture contract while EJV is managed according to the shareholding structure
  - 1. Organisational form
    - EJV: legal person, limited liability Co
    - CJV: can be either legal person or non-legal-person ( can be anything freedom of contract )
      - If legal person, then take the form of LLC
  - 2. Profit distribution
    - EJV: in accordance with the ratio of shareholding
    - CJV: based on a joint venture contract which can be freely negotiated(anything )
  - 3. Type of investment
    - EJV: cash, materials, industrial properties and land use rights
    - CJV: In addition to the above, “other property rights”(more broader)
      - Unclear, but may include services, business reputation etc

# FIE laws (cont)

- ❑ 4. **ownership** of assets
  - EJVs: belong to the company
  - CJVs: **negotiable**
    - ❑ May belong to the Co
    - ❑ May remain in the hands of the parties and the **Co only has the right to use the assets**
- ❑ 5. **Return of investment**
  - **EJV: only upon winding up of the Co**
  - **CJV: negotiable (even before the termination of the company)**
    - ❑ It is possible that a foreign party may get back its investment **before termination of the CJV**
- ❑ 6. **Management structure**
  - **EJV: the board of directors (no shareholder meeting)**
  - **CJV: (flexible)**
    - ❑ If legal person, it can be managed by either a board of directors or a joint management committee
    - ❑ If non-legal person, a joint management committee

Table 4.6.1

## Equity versus co-operative joint ventures

|                                       | Equity JV   | Co-operative JV   |
|---------------------------------------|---|---|
| Legal basis                           | Sino-Foreign Equity JV Law (March 2001)<br>Implementing Rules (July 2001)                               | Sino-Foreign Co-operative JV Law (July 2000)<br>Implementing Rules (not updated since 1995)   |
| Form                                  | Legal person status with limited liability;   | Legal person status with limited liability; or non-legal person status without limited liability  |
| Financing                             | Capital contributions.<br>(both cash and in-kind)   | Capital contributions (both cash and in-kind); and<br>"co-operation conditions" (assets made available to the JV but not legally contributed) |
| Profit distribution                   | Profits are distributed in accordance with agreed terms, and each partner's respective share in the JV. | The foreign party may recoup its investment during the term of the project  |
| Management                            | Highest organ of authority of an EJV is its board of directors  | Board of directors; or joint management committee   |
| Dissolution                           | Unanimous board resolutions are required in order to apply for approval to dissolve the JV.             | In the event of breach of the joint venture contract by one party, any other party may unilaterally apply for approval to dissolve the JV.    |
| Source: Stephenson, Harwood & Lo; EIU |   |   |

# FIE laws (cont)

- Remarks:
  - CJV is unique to China in terms of its generous treatment for foreign investors
    - Not only enjoy the benefit of limited liability, but also have enormous freedom in relation to profit sharing, ownership and management
    - Encourage foreign investment, but it has been criticized as being too generous to foreign investors at the cost of Chinese parties and creditors

In practice:

- ❑ At the early stage of FIE, CJV significantly outnumbered EJV
- ❑ Now, **CJV is the least favoured form**
  - **Chinese parties have more bargaining powers** with less need to sacrifice to attract foreign investment
  - Significant costs of contract-making and contract-enforcing
  - Generally regarded as a transitional form and the government takes a restrictive approach

# FIE laws (cont)

## ■ WFOE(外商独资企业):

### □ Main governing laws:

- Law of the PRC on Foreign Capital Enterprises (promulgated in 1986, amended in 2000)
- Implementing Rules of the Law of the PRC on Wholly Foreign-owned Enterprises (promulgated in 1990, amended in 2001)

### □ Features of WFOE:

- Established and managed solely by foreign investors
  - Excluding the branches foreign enterprises establish in China
- Legal status:
  - Can take the form of LLC OR (in practice , most LLC)
  - other forms upon approval



# FIE laws (cont)

- ❑ Advantages:
    - Enjoy exclusive management control of the business
      - ❑ Avoid difficulties in dealing with Chinese partners
      - ❑ Less interference from the Chinese government
    - Will not nurture a potential competitor
      - ❑ Particularly important to multinational Cos
  - ❑ Disadvantages:
    - Run more risks than EJV and CJV
      - ❑ Particularly when unfamiliar with the investment environment
      - ❑ Need to start from scratch
        - factory; land; marketing network
        - In China, connections are crucially important
    - Will not always be able to set up a WFOE (Foreign Investment catalogue prohibits WFOE for certain sectors)
- 
- ❑ *Catalogue for the Guidance of Foreign Investment Industries (2011 ed)*

# Statistics of FIEs

| Types of FIE | EJV   | CJV  | WFOE  |
|--------------|-------|------|-------|
| 1983         | 107   | 331  | 15    |
| 1984         | 741   | 1089 | 26    |
| 1990         | 4091  | 1317 | 1860  |
| 1991         | 8395  | 1778 | 2795  |
| 1996         | 12618 | 2841 | 9053  |
| 2002         | 10380 | 1595 | 22173 |

- Source: Yumei Wang, *Research on China's FDI Law* (Law Press, 2003)
- In July 1997, WFOE outnumbered EJV
- In 2001, the number of WFOE **surpassed** that of EJV and CJV combined for the first time; in 2008, WFOE accounted for 81% of the total number of FIEs
- Panasonic: 1987 (set up its first EJV)---2002 (convert to WFOE)

# Foreign Investment Statistics in China in 2009

| The Mode of Utilizing Foreign Investment | Approved Foreign Investment This Year |                           |                            | Realized FDI Value |                           |                            |
|--|---------------------------------------|---------------------------|----------------------------|--------------------|---------------------------|----------------------------|
|  | Number of Projects                    |                           |                            |                    |                           |                            |
|  | This Year                             | The Same Period Last Year | Change from Previous Year% | This Year          | The Same Period Last Year | Change from Previous Year% |
| Total                                    | 23435                                 | 27514                     | -14.83                     | 918.04             | 952.53                    | -3.62                      |
| I.Foreign Direct Investment              | 23435                                 | 27514                     | -14.83                     | 900.33             | 923.95                    | -2.56                      |
| Equity Joint Venture                     | 4283                                  | 4612                      | -7.13                      | 172.73             | 173.18                    | -0.26                      |
| Contractual Joint Venture                | 390                                   | 468                       | -16.67                     | 20.34              | 19.03                     | 6.85                       |
| Wholly Foreign_Owned Enterprise          | 18741                                 | 22396                     | -16.32                     | 686.82             | 723.15                    | -5.02                      |
| Share Company with Foreign Investment    | 21                                    | 38                        | -44.74                     | 20.44              | 8.59                      | 137.86                     |
| Joint Exploration                        | 0                                     | 0                         |                            | 0                  | 0                         |                            |
| Others                                   | 0                                     | 0                         |                            | 0                  | 0                         |                            |
| II.Others Foreign Investment             | 0                                     | 0                         |                            | 17.71              | 28.58                     | -38.02                     |
| Stock Issuance                           | 0                                     | 0                         |                            | 1.62               | 0.77                      | 110.27                     |
| International leasing                    | 0                                     | 0                         |                            | 2.3                | 1.44                      | 59.72                      |
| Compensation Trade                       | 0                                     | 0                         |                            | 0.13               | 0.52                      | -75.01                     |
| Processing & Assembling                  | 0                                     | 0                         |                            | 13.66              | 25.85                     | -47.14                     |

# Statistics of Cumulative FDI by Form as of (截止) 2010

Unit: US\$ 100 million

| Form                            | No.of Projects | Share % | Realized FDI Value | Share % |
|---------------------------------|----------------|---------|--------------------|---------|
| Total                           | 710747         | 100     | 11078.58           | 100     |
| Equity Joint Venture            | 292154         | 41.11   | 3245.47            | 29.29   |
| Contractual Joint Venture       | 59856          | 8.42    | 1005.20            | 9.07    |
| Wholly Foreign-owned Enterprise | 358053         | 50.38   | 6099.83            | 55.06   |
| FDI Shareholding Inc.           | 355            | 0.05    | 77.23              | 0.70    |
| Joint Exploration               | 191            | 0.03    | 75.07              | 0.68    |
| Others                          | 138            | 0.02    | 575.78             | 5.20    |

| 利用外资方式   | 新设外商投资企业数 |      |       | 实际使用外资金额 |        |        |
|----------|-----------|------|-------|----------|--------|--------|
|          | 本年累计      | 去年同期 | 比去年%  | 本年累计     | 去年同期   | 比去年%   |
| 总 计      | 6383      | 5956 | 7.17  | 338.12   | 354.15 | -4.53  |
| 一、外商直接投资 | 6383      | 5956 | 7.17  | 338.12   | 354.15 | -4.53  |
| 中外合资企业   | 1853      | 1402 | 32.17 | 73.86    | 100.36 | -26.4  |
| 中外合作企业   | 21        | 35   | -40   | 3.06     | 2.38   | 28.18  |
| 外资企业     | 4485      | 4502 | -0.38 | 241.03   | 223.76 | 7.72   |
| 外商投资股份制  | 24        | 17   | 41.18 | 20.17    | 27.65  | -27.07 |
| 合作开发     | 0         | 0    | 0     | 0        | 0      | 0      |
| 其它       | 0         | 0    | 0     | 0        | 0      | 0      |
| 二、外商其它投资 | 0         | 0    | 0     | 0        | 0      | 0      |
| 对外发行股票   | 0         | 0    | 0     | 0        | 0      | 0      |
| 国际租赁     | 0         | 0    | 0     | 0        | 0      | 0      |
| 补偿贸易     | 0         | 0    | 0     | 0        | 0      | 0      |
| 加工装配     | 0         | 0    | 0     | 0        | 0      | 0      |

<http://www.fdi.gov.cn/CorpSvc/Temp/T3/Product.aspx?idInfo=10000499&idCorp=1800000121&iproject=33&record=8076>



### 3. How to establish a FIE (general picture)

- 1. finding a Chinese partner in the case of joint venture
  - Through the governmental channel
    - Chinese government: Ministry of Commerce
    - Australian government: Austrade
    - Chinese Embassies and Consulates
  - Through an intermediary
    - China International Trust and Investment Company
      - Semi-official
    - Associations: Australia-China Business Council etc.
    - Other market agents
  - Attend trade fairs
    - Eg., Twice a year, the government organizes national trade fairs in Guanzhou City, known as “Chinese Export Commodities Fair”
  - Other ways:
    - Your personal connections

# How to establish (cont)

- 2. Categories of projects
  - Provisions on Guiding Foreign Investment Direction 《指导外商投资方向规定》 (2002)
  - Industrial Catalogue for the Guidance of Foreign Investment 《外商投资产业指导目录》 (1995, amended in 1997, 2002, 2004, 2007, 2011, 2014 , issued and effective on Dec. 12, 2016)
  - Types of projects:
    - Permitted,
    - Encouraged,
    - restricted and
    - Prohibited

- 
- Relationship between different categories & restrictions
    - No direct relationship
      - An “encouraged” FIE project is easier to get approved, but can be subject to shareholding restrictions.
      - WFOE can be allowed for a “restricted” FIE project



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■ Note:

1. Foreign Investment Catalogue is not exhaustive
2. Other industry-specific (特定行业的) and location-specific regulations may impose additional restrictions

### ■ 3. Procedures

#### 1. Verification and approval for project

- **NDRC**（国家发展和改革委员会，national development and reform commission）；  
**MOFCOM**(商务部); industry-specific approval

#### 2. Approval for establishment of FIE（which type of business vehicle you want to use）

- **joint venture contract**, articles of association
- MOFCOM; authorized provincial governments or departments of State Council

#### 3. Registration

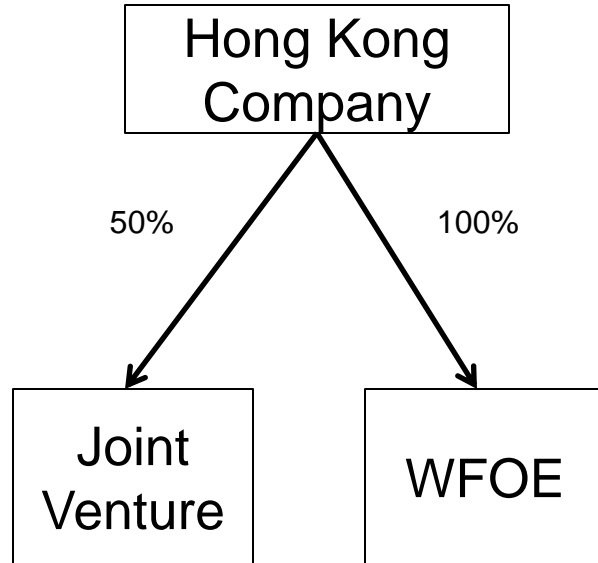
- State Administration for Industry and Commerce（工商行政管理局）

#### 4. Other matters

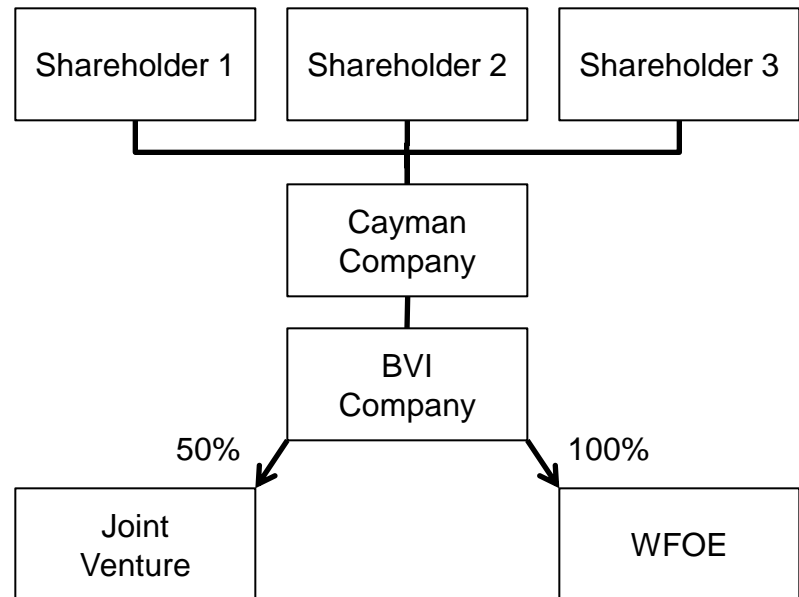
- Tax registration
- Apply for the **official seal**（公章），etc

# Structure

## ■ Old offshore structure



## Typical present structure



## ■ Reasons: government approval; tax etc

## 4. Other ways for foreign investment

- 1. Representative offices (first step to invest in chinese market )
  - Have a commercial presence in China, but generally are not meant to engage in business activities
  - Usually the first step to enter China
    - Motorola: 1987 (set up a representative office in Beijing)—1992 (set up a WFOE in Tianjing)
    - NYSE: 2007 in Beijing

## ■ 2. Branch offices

- Treated as foreign legal entity and not Chinese legal person
- May conduct business (usual in insurance and banking industry) (因为没有足够的钱不能建立公司 capital requirement, 建立 subsidiary 需要 sufficient capital; branch 不用看 company 有多少钱)
- But lack implementing regulations
  - Regulations on Administration of Foreign-funded Insurance Companies (2001)
  - Regulations of the PRC on the Administration of Foreign-Funded Banks 中华人民共和国外资银行管理条例 (2006)
- Note: Foreign law firm:
  - 1992: branch office 关于外国律师事务所在中国境内设立办事处的暂行规定 (issued by Ministry of Justice etc)
  - 2002: representative office 外国律师事务所驻华代表机构管理条例 (issued by State council)

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- 3. Foreign-invested joint stock company (foreigner, u acquire share in listed company in china, specific law for this )
  - 4. Build-operation-transfer (BOT)
  - 5. Foreign-invested partnership
    - New development

## ■ 6. M&A

### □ An alternative

- Instead of establishing a new FIE, foreign investors can acquire a domestic business and then convert it into a FIE

### □ In practice

- Increasingly common, as it offers ready access to the Chinese market

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# Summary

- Geographic areas expanded
- Investment field broadened
- Organizational forms increased
- Approval process improved
- Super-national treatment phased out
- Sub-national treatment reduced
- Free-trade zone