

Northwestern Journal of International Law & Business

Volume 14
Issue 1 *Fall*

Fall 1993

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Recommended Citation

Preston M. Torbert, China's Evolving Company Legislation: A Status Report, 14 Nw. J. Int'l L. & Bus. 1 (1993-1994)

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PERSPECTIVE

China's Evolving Company Legislation: A Status Report

*Preston M. Torbert**

I. INTRODUCTION

The traditional Communist country with a planned economy and state-owned enterprises had no need for a company law. In the Soviet Union and other Communist countries, factories were organized as state enterprises owned by the state and administered by managers appointed by the government department that supervised the enterprise's activities. The same was true for China.¹ Although China did have "companies" that were administrative subdivisions below the ministries and above the factories or conducted foreign trade activities,² it did not have any public company law that governed the establishment and operation of such entities. There was no need for such legislation because almost all industrial entities were state-owned and were covered by legislation on state enter-

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¹ See GENE TIDRICK & CHEN JIYUAN, CHINA'S INDUSTRIAL REFORM 277-312 (1987).

² *Id.* at 294. Since 1979, the government started the experimental transformation of state enterprises into the "companies" or "corporations." These companies or corporations, also called "general factories" or "technical cooperation centers" are composed of related enterprises. By 1981, 19,336 enterprises (15% of the total state enterprises) were incorporated into 1,983 companies or corporations. The goal of this transformation was to enhance the efficiency and the economies of scale of the industries. See Briefing Conference on Reform of Industrial Managerial Institution convened by the National Economic Commission and the State Council, March 14, 1981, in I COLLECTION OF LEGAL DOCUMENTS ON CHINA'S ECONOMIC & MANAGERIAL REFORM 43, 47 (1985).

prises.³ In China, as in other Communist countries, private enterprises have existed, but have only assumed a significant role in China's national economy since the economic reforms starting in 1979. For the most part, private enterprise has been limited to small scale businesses in the form of "individual businesses" in accordance with the Certain Policy Regulations of the State Council on the Township Non-Agricultural Individual Economy issued on July 7, 1981 or of "private enterprises" in accordance with the Provisional Regulations of the PRC on Private Enterprise issued on June 25, 1988.⁴ Though state-owned enterprises employ 75% of China's urban labor force, they provide for only half of the nation's industrial output.⁵

As China's economic reforms have progressed, however, the need for a company law has become apparent. The two principal reasons are, first, the need to reform existing state-owned enterprises and, second, the need to create a means for foreign investment in reformed state-owned enterprises. For political reasons, there appears to be no perceived need for the company law to encourage larger privately-owned enterprises.

In one sense, China has had a company law since 1979, but only one that applied to joint ventures between foreign and Chinese entities. This is the Law of the PRC on Sino-Foreign Joint Venture Enterprises (the "Joint Venture Law").⁶ Since this law applies only to closely held enterprises formed by Chinese and foreign parties, it could not serve as appropriate company legislation for all of China's state-owned enterprises.

China's economic reform policy has emphasized the need for greater efficiency in state-owned enterprises, which constitute the largest employer in the economy.⁷ To date, efforts to increase the efficiency of state-owned enterprises have emphasized the separation of management from ownership.⁸ In most cases, this has meant the retention of state

³ The major laws on the reform of state enterprise management include the Regulations for Worker & Staff Conference of the Industrial Enterprises Owned by the Whole People of 1981, the Regulations for the Work of the Directors of the Industrial Enterprises Owned by the Whole People of 1986, and the Regulations for the Industrial Enterprises Owned by the Whole People of 1988. Provisional Regulations of State-Owned Industrial Enterprises, in II CHINA LAWS FOR FOREIGN BUSINESS (CCH) ¶¶ 16,541-81 (1993).

⁴ COMPILATION OF ECONOMIC AND COMMERCIAL LAWS AND REGULATIONS OF THE PRC 542-43 (F. Xue ed., 1983); see also II CHINA LAWS FOR FOREIGN BUSINESS (CCH) ¶¶ 13,546(7)-(48) (1993).

⁵ Sheryl WuDunn, *For Sale: Creaky Gears of Chinese Communism*, N.Y. TIMES, May 2, 1993, § 4, at 7.

⁶ I CHINA LAWS FOR FOREIGN BUSINESS (CCH) ¶¶ 7801-09 (1993). Since 1986, the Regulations on Foreign-Related Companies in the Special Economic Zones in Guangdong Province have existed, but these have rarely been used. *Id.* at ¶¶ 82,740-825.

⁷ For an overview of the reforms, see JAMES M. ETHRIDGE, CHANGING CHINA 78-140 (1988).

⁸ See Decision of the Central Committee of the Communist Party of China on the Economic

ownership, but management by factory directors who enjoy greater authority to make decisions regarding the enterprise's activities without interference from state planning or other supervisory authorities.⁹ China has also allowed, on an experimental basis, changes in ownership to include the acquisition of shares in state-owned enterprises by employees and, in some cases, by third parties.¹⁰ The creation of the stock markets in Shanghai and Shenzhen in the last two years is evidence of this experimentation in changes in ownership.¹¹

Until 1992, the transformation of Chinese state-owned enterprises into companies and the issuance of shares to employees or third parties was done on an *ad hoc* basis.¹² Last year, however, saw the publication of three regulations on companies, one at the national level and two at the local level. The national regulation is the Regulatory Opinion on Joint Stock Companies of May 15, 1992 issued by the State Economic Institutional Reform Committee (the "Regulatory Opinion").¹³ The two local regulations are the Provisional Regulations of Shenzhen Municipality Concerning Joint Stock Companies promulgated by the Shenzhen Municipal Government on March 17, 1992 (the "Shenzhen Regulations"),¹⁴ and the Provisional Regulations of Shanghai Municipality Concerning Joint Stock Companies promulgated by the Shanghai Municipal Government on May 18, 1992 (the "Shanghai Regulations").¹⁵ (These separate regulations are referred to collectively hereinafter as the "Company Legislation.")

Institutional Reform, October 20, 1984, in I COLLECTION OF LEGAL DOCUMENTS ON CHINA'S ECONOMIC & MANAGERIAL REFORM 5-6 (1985).

⁹ The government did allow some small state enterprises to be sold to individuals. See Provisional Measures for Selling the Titles of State Owned Small Enterprises (1989) (in author's possession).

¹⁰ Jia Zhao & Qian Li, *Trading Stocks in China: Development, Regulation, Issues and Prospects*, E. ASIAN EXECUTIVE REP., June 1992, at 8.

¹¹ The People's Bank of China views the stock exchanges established in Shanghai and Shenzhen as experiments and the financial assets traded in the exchanges will principally be treasury and company bonds. See The Office of People's Bank of China on Development of China's Securities Market, PEOPLE'S DAILY (overseas edition), June 20, 1992.

¹² Until 1987 state owned enterprises were not allowed to issue stocks. Only collective enterprises could issue stocks upon approval. See The Directive of the State Council on Reinforcement of Administration on Stocks and Bonds, March 28, 1987, in Zhao & Li, *supra* note 10. Upon special permission of the central government, the first stock issued by state owned enterprises was made possible in 1988 for the Shenyang Jinbei (Gold Cup) Auto Industrial Shareholding Corporation. *Id.*

¹³ *The Regulatory Opinion on Joint Stock Companies*, SHENZHEN SPECIAL ZONE NEWSPAPER June 19, 1992, at 2 (in author's possession).

¹⁴ *The Provisional Regulations of Shenzhen Municipality Concerning Joint Stock Company*, SHENZHEN SPECIAL ZONE NEWSPAPER, March 18, 1992, at 5 (in author's possession).

¹⁵ *The Provisional Regulations of Shanghai Municipality Concerning Joint Stock Company*, SHENZHEN SPECIAL ZONE NEWSPAPER (no date or pagination available) (in author's possession).

These regulations are generally similar and all seem to provide an adequate basis for establishing companies in China. It appears, however, that they are viewed primarily as experimental, because there are reports that a new national company law is being drafted and may be presented to the National People's Congress as early as this year.¹⁶ Given past experience and the volatility of China's political situation, however, it is possible that the proposed new national legislation will be delayed for some time. This article, therefore, examines the existing legislation both as being of interest in and of itself, and as being the possible precursor of future legislation.

II. GENERAL CHARACTERISTICS OF THE COMPANY LEGISLATION

The Company Legislation addresses a company form familiar in many capitalist countries: a company limited by shares. The basic characteristics of the joint stock company as provided for in the Company Legislation are as follows:

The number of promoters and shareholders is limited to a minimum of 3 (in the Regulatory Opinion and the Shanghai Regulations) or a minimum of 5 (in the Shenzhen Regulations).¹⁷

The promoters generally must be legal persons (excluding wholly foreign-owned enterprises or Chinese private enterprises) or authorized government departments.¹⁸

The company is liable for its obligations to the extent of all of its assets and its shareholders bear liability for the company's debts to the extent of the shares they have subscribed to.¹⁹

The initial purchase of shares can be made with cash, tangible or intangible property.²⁰

The minimum registered capital of a company is 10 million Renminbi (approximately US\$1,750,000 at the current official exchange rate) (5 million Renminbi under the Shenzhen and Shanghai Regulations) or for a company with foreign investment 30 million Renminbi.²¹

Both common and preferred shares are permitted. Preferred shares receive dividends at a fixed rate.²²

Shareholders are subject to certain restrictions on the transfer of their shares (e.g., a promoter may not transfer its shares in the first year of the

¹⁶ The draft of the Joint Stock Company Law and the draft of the Limited Liability Company Law were presented to the National People's Congress on February 15, 1993. These drafts were to be reviewed during the 30th session of the Standing Committee of the National People's Congress. See *WORLD DAILY*, February 20, 1993 (in Chinese).

¹⁷ *Supra* note 13, art. 9; note 15, art. 14; note 14, art. 11.

¹⁸ *Supra* note 13, art. 10; note 14, art. 12; note 15, art. 13.

¹⁹ *Supra* note 13, art. 1; note 14, art. 3; note 15, art. 2.

²⁰ *Supra* note 13, art. 22; note 14, art. 50; note 15, art. 32.

²¹ *Supra* note 13, art. 12; note 14, arts. 13, 41; note 15, art. 17.

²² *Supra* note 13, art. 23; note 14, art. 51; note 15, art. 36.

company under the National Regulations or 2 years under the Shenzhen Regulations).²³

The shareholders meeting is the highest authority of a company. Special resolutions (those on certain specified issues) must be adopted by a two-thirds majority vote at a shareholders meeting with a two-thirds quorum requirement. Other resolutions may be adopted by a simple majority of votes at a shareholders meeting with a simple majority quorum. Each share has one vote; there are no cumulative voting procedures.²⁴

The board of directors consists of no less than 5 directors and the total number of directors must be an odd number under the Regulatory Opinion (in Shanghai and Shenzhen the minimum number is 3 and there is no requirement for an odd number). Decisions by the board of directors on certain specified issues require a greater than two-thirds majority vote, while others only require a simple majority vote. The chairman has a casting vote in the event of a deadlock.²⁵

Under the Shanghai and Shenzhen Regulations, the company must also establish a supervisory board to represent the employees and the shareholders to supervise the activities of management and the board (the establishment of such a board appears to be optional under the Regulatory Opinion).²⁶

In general, the joint stock company contemplated under the Company Legislation is similar to corporate forms found in both civil and common law as well as former Communist jurisdictions in the former Soviet Union and Eastern Europe.²⁷

III. SPECIAL CHARACTERISTICS OF THE COMPANY LEGISLATION

While the joint stock company contemplated by the Company Legislation shares many characteristics with similar company forms in other jurisdictions, it also possesses certain special characteristics determined by China's situation. China is a socialist country ruled, in effect, by a Communist party,²⁸ but with an interest in transforming its state enterprises and with a growing private sector and free market economy.

²³ *Supra* note 13, art. 30(4); note 14, arts. 56, 58, 59; note 15, art. 44.

²⁴ *Supra* note 13, arts. 39, 43, 46, 47; note 14, arts. 98, 103, 104, 106; note 15, arts. 61, 64-67.

²⁵ *Supra* note 13, arts. 52, 55; note 14, arts. 109, 112; note 15, arts. 70, 78 (the Shanghai Regulations do not provide for a casting vote by the Chairman).

²⁶ *Supra* note 13, art. 63; note 14, art. 126; note 15, art. 89.

²⁷ See, e.g., COMPANY LAW, A COMPILATION OF THE LAWS OF THE REPUBLIC OF CHINA 331-466 (1971); Illinois Business Corporation Act, 805 ILCS 5/1.01 et seq. (1983); SP SSSR, No. 601 (Dec. 25, 1990) (Statute on Joint Stock Corporations, approved by Russian Soviet Federated Socialist Republic Council of Ministers Decree No. 601); Joint Stock Companies Act of the Czechoslovak Federated Republic, zákon c.104/1990 Sb.

²⁸ The Preamble to the Constitution of the People's Republic of China provides that the Communist Party of China will continue to be the leading force of China in the socialist construction (Preamble). See Constitution of the People's Republic of China, in I CHINA LAWS FOR FOREIGN BUSINESS (CCH) ¶¶ 5301-83 (1983).

China is also a country which must address the question of how to treat people of Chinese heritage currently living in Hong Kong or Taiwan. The Company Legislation reflects these characteristics in several respects as noted below.

A. Reorganization of Existing State-Owned Enterprises

China's economic reforms address many issues common to the countries of the former Soviet Union and Eastern Europe. China, however, has not used the term "privatization" to describe its policies toward state-owned enterprises. Instead, it refers to the "reorganization" of existing state enterprises into companies. Thus, the Company Legislation provides that a preexisting state enterprise, when being reorganized into a company, must invest all of its assets into the company and become a promoter of the company. If the preexisting enterprise is not a promoter, the owner of the assets of the preexisting enterprise is to be the promoter.²⁹

The primary reasons for transforming an existing state-owned enterprise into a company are to increase its economic efficiency and to eliminate continuing losses that state-owned enterprises are incurring. The Company Legislation, however, does not address clearly the issue of the preexisting debts of a transformed enterprise. It states that upon its reorganization, the debts of a preexisting state enterprise are liquidated.³⁰ But it also provides that the company established through reorganization assumes the debts of the preexisting enterprise.³¹ It is unclear whether the reorganized entity starts with a clean slate.

B. Government Supervision over the Company

Since the land and other major assets of existing state enterprises in China are owned by the state, it is reasonable for the state to exercise supervision to protect its property. The Company Legislation reflects this interest in supervision in the following ways:

Competent government industrial and commercial authorities must review and approve the establishment of a company.³²

In applying for the establishment of a company, proof of the creditworthiness of the promoters is required.³³

²⁹ *Supra* note 13, art. 11; note 14, arts. 35, 38. The Shanghai Regulations do not have any specific provisions on the reorganization of state owned enterprises into joint stock companies, but they seem to contemplate the contribution of existing assets as capital; *see supra* note 15, art. 19(2).

³⁰ *Supra* note 13, art. 11; note 14, art. 15(2).

³¹ *Supra* note 13, art. 11; note 14, art. 35.

³² *Supra* note 13, art. 13(1); note 14, art. 14; note 15, art. 19.

³³ *Supra* note 13, art. 15(6).

Special approval is required from the institutional reform authority and the People's Bank for the recall or withholding of stock.³⁴

The company must also observe national industrial policy and industrial and regional development programs in increasing its capital.³⁵

Certain individuals are precluded from acting as a director or president of a company including those who are disqualified from assuming such positions under "the policy of the state."³⁶

The uses of the legal profit reserve fund and the capital reserve fund are limited to certain purposes including "other uses required [or stipulated] by the state."³⁷

Provisions subject to a two-thirds majority vote of the shareholders meeting (e.g., changes in the company's business scope or the total volume of shares) require approval from the institutional reform authority.³⁸

For a merger of the enterprise, a merger application must be filed with the original authority in charge of the company's industry as well as from the authorized government department.³⁹

A common complaint by managers of state enterprises in China is that they have too many "mothers-in-law" (i.e., government departments which interfere in their work).⁴⁰ From the Company Legislation, it appears that a joint stock company will also have several "mothers-in-law." These include the State Administration of Industry and Commerce, the financial and tax authorities, the institutional reform authority and the People's Bank of China. The State Administration may impose penalties on a company for failure to process various prescribed items or meet time limits established by the Regulatory Opinion.⁴¹ The financial or tax authorities may also impose penalties on a company for violations of provisions on the termination and reporting on remuneration for directors, false record keeping and failure to use reserve funds in compliance with

³⁴ *Supra* note 13, art. 32. For similar requirements concerning reduction of capital in the Shenzhen Regulations and Shanghai Regulations, *see supra* note 14, art. 74; note 15, arts. 54, 51(5).

³⁵ *Supra* note 13, art. 35; note 14, art. 62(4); note 15, art. 46(3).

³⁶ *Supra* note 13, art. 61(6); note 14, art. 123(7); note 15, art. 72(4) (director only).

³⁷ *Supra* note 13, art. 72(3); note 14, art. 136(3); note 15, art. 103(3).

³⁸ *See generally* note 13, art. 83; note 14, art. 161(4) (amendment of articles of association); note 15, art. 126(3).

³⁹ *Supra* note 13, arts. 89, 94; note 14, art. 144 (municipal government and People's Bank of China); note 15, arts. 117, 123.

⁴⁰ "In the past, the central and local governments, on the one hand, took too much responsibility in managing many things that the government should not control. On the other hand there were many things that the government should control but failed to do so. The governments messed up their administrative functions with enterprise operations. The enterprises thus became the attachment of the governments. The difficult situation of enterprises became even worse because of the bureaucracy created by the division of administrative power among industrial departments and those between the central government and local authorities." Provisional Measures for Selling the Titles of State Owned Small Enterprises, in *I COLLECTION OF LEGAL DOCUMENTS ON CHINA'S ECONOMIC & MANAGERIAL REFORM 6* (1985).

⁴¹ *Supra* note 13, art. 104.

the Regulatory Opinion.⁴² The institutional reform authority may impose penalties on the company if documents submitted by promoters contain false statements, if the company fails to operate according to its articles of association and for other specified reasons.⁴³ The People's Bank may also impose penalties if the promoters, staff or workers of a company hold shares in violation of the provisions of the Regulatory Opinion, or if the company issues shares without approval and in other specified cases.⁴⁴ The Shenzhen Regulations have similar provisions; the Shanghai Regulations have a broad reference to supervision and control by government departments.⁴⁵

Companies in other jurisdictions are subject to requirements of the securities and tax authorities. The proposed level of government supervision in the company legislation in China, however, particularly the requirement of approval for certain activities by government authorities, seems to exceed that in jurisdictions with free market economies. This appears to be due to the need in China for the state to protect its property in the form of state-owned enterprises reorganized into companies.

C. Restrictions on Shareholders' Freedom of Action

The Company Legislation restricts the shareholders' freedom of action in a number of respects. While some of these restrictions may not be substantial or apply in the ordinary case, they may in other cases unduly limit the shareholders' freedom of action.

A number of the restrictions concern the establishment of the company. Under the Regulatory Opinion, the company must, for example, have at least 3 promoters and, as noted above, a certain minimum registered capital.⁴⁶ Further, of the registered capital, generally no more than 20% may be paid for with intangible assets.⁴⁷ Also, the shares subscribed by the promoters through public offering may not be less than 35% of the registered capital.⁴⁸ The Shanghai and Shenzhen regulations impose similar restrictions.⁴⁹

Other limitations concern transfers of shares. An enterprise holding more than 10% of the shares of another company cannot purchase

⁴² *Supra* note 13, art. 105.

⁴³ *Supra* note 13, art. 106.

⁴⁴ *Supra* note 13, art. 107.

⁴⁵ *Supra* note 14, arts. 174-76; note 15, art. 8.

⁴⁶ *Supra* note 13, arts. 9, 12.

⁴⁷ *Supra* note 13, art. 22.

⁴⁸ *Supra* note 13, art. 8.

⁴⁹ *Supra* note 14, art. 11 (five promoters and 35% subscribed by them through public offering); note 15, arts. 10, 14 (3 promoters, 30% subscribed by promoters through public offering).

shares of that company.⁵⁰ Shares subscribed by the staff and workers of a company cannot exceed 10% of the total shares issued to the public.⁵¹ The promoters may not transfer their shares during the first year of the company's existence, and a director or president cannot transfer his shares for 3 years during his term.⁵² Further, an individual wishing to acquire more than 10% of the shares of a public issuance company must obtain approval from the People's Bank and the institutional reform authority.⁵³

Restrictions also apply to certain financial aspects of the company. For example, the time interval between increases of capital through the offering of new shares is 12 months, and no more shares may be offered if dividends on preferred shares have not been paid for 2 consecutive years.⁵⁴

Perhaps the restrictions that will most affect a company's normal operations are those on voting at shareholders and board meetings. The quorum and majority vote requirements noted above for both shareholders and board meetings appear to be mandatory.⁵⁵ Thus, they may not be altered by the parties by providing otherwise in the articles of association. While these requirements may be appropriate in the case of large publicly held entities, they may be prejudicial to the interests of investors in companies with a small number of shareholders. For example, the requirement in the Regulatory Opinion for a casting vote by the chairman may allow one party in a closely held company to override the wishes of the other party or parties.⁵⁶

Limitations on the shareholders' freedom of action are not unusual in company laws. In this case, however, the restrictions seem to be greater than in many other jurisdictions.⁵⁷ This may be due to the government's interest in protecting the shareholders from their own well-intentioned but misguided actions, as well as from manipulation by other

⁵⁰ *Supra* note 13, art. 24(2); note 14, art. 75.

⁵¹ *Supra* note 13, art. 24(3); note 14, art. 75.

⁵² *Supra* note 13, arts. 30(4), 30(6); note 14, arts. 58, 125 (2 year restriction on directors); note 15, art. 34 (2 year restriction on promoters).

⁵³ *Supra* note 13, art. 31.

⁵⁴ *Supra* note 13, arts. 36, 38.

⁵⁵ *Supra* note 13, arts. 46, 47; note 14, arts. 103-105; note 15, arts. 65-67.

⁵⁶ *Supra* note 13, arts. 52, 55. *But see* note 14, arts. 109, 112: Shenzhen requires that the minimum number of board members is five and an odd number is not required. *See also* note 15, arts. 70-83: Shenzhen requires five board members as the minimum and an odd number is not required. *See also* note 15, arts. 70-83. Shanghai requires a minimum of three board members but the chairman does not have a casting vote.

⁵⁷ *See, e.g.,* representative sources cited *supra* note 27.

shareholders. The price for such protection, however, is a higher level of inconvenience and inefficiency in the use of this corporate form in China.

D. Protection of Employees

One would expect China, as a socialist country, to provide some measures in the Company Legislation to protect employees. This is particularly true for existing state-owned enterprises that are being reorganized into companies. As a general matter, the government supervisory departments noted above will probably exercise some degree of protection for workers. In addition, specific provisions in the Company Legislation seek to protect the interests of the workers. For example, the Regulatory Opinion limits the assignment of stock warrants held by internal staff and workers among themselves in closely held companies and prohibits the transfer of any shares a company has allocated to its internal staff and workers (except those that have left the company or died) within 3 years after the allocation.⁵⁸ In addition, at least one-third or more of the supervisors, but no more than one-half, are to be representatives of the company's employees and are to be appointed and dismissed by the employees.⁵⁹ Further, the company must establish a collective benefit fund for the welfare of the employees and allocate profits to it before paying any dividends. There is, however, no requirement as to the size or amount of this fund.⁶⁰

While these provisions may be more protective of the employees than those in some jurisdictions, they do not provide as much protection as might be expected. For example, when an existing state-owned enterprise is transformed into a company, there is no requirement as there is in some East European legislation⁶¹ that the employees receive shares in the company free of charge or at preferential prices. The Company Legislation does not require the obligatory issuance gratis to workers and employees of stock in a reorganized state enterprise and limits the shares subscribed by internal staff and workers of a designated issuance company to 20% of the total shares of the company (or 10% of the total shares of a public issuance company).⁶² It appears, therefore, that the

⁵⁸ *Supra* note 13, arts. 30(1), 30(5). *See also* arts. 30(1), 59 of the Shenzhen Regulations, *supra* note 14.

⁵⁹ *Supra* note 13, art. 64. *See also* note 14, art. 127; note 15, art. 90. Both the Shenzhen Regulations and the Shanghai Regulations provide that the percentage of supervisors elected by the staff and workers is one-third.

⁶⁰ *Supra* note 13, art. 74. For Shanghai Regulations, *see supra* note 15, art. 105.

⁶¹ ROMAN FRYDMAN ET AL., *THE PRIVATIZATION PROCESS IN CENTRAL EUROPE* 29-30, 137-38 (1993) (Bulgaria).

⁶² *Supra* note 13, art. 24(3). The Shenzhen Regulations also prohibit a company from gratui-

provisions in the Company Legislation protecting employees should not pose a significant burden for the companies or a substantial disincentive for prospective foreign investors.

IV. IMPLICATIONS FOR FOREIGN INVESTORS

The Company Legislation imposes a number of restrictions on foreign investors. The Regulatory Opinion provides, for example, that a wholly foreign-owned enterprise may not be a promoter of a company and that Chinese foreign joint ventures acting as promoters may not exceed one-third of the total promoters.⁶³ As noted above, the minimum registered capital for a company with foreign investment is 3 times that of a company without foreign investment (\$30 million RMB as opposed to \$10 million RMB).⁶⁴ Further, foreign investors and investors from the Hong Kong, Macao and Taiwan areas of China may not purchase or trade stock shares denominated in RMB (called "A shares").⁶⁵ They may only purchase special shares of stock denominated in Renminbi (called "B shares") which are issued only with the approval of the People's Bank. The transfer of B shares must comply with "applicable national regulations" which are established under other legislation.⁶⁶

Foreign investment in a company raises the question of whether such a company constitutes a "joint venture" or "foreign invested enterprise" under China's existing legislation. The answer depends on the percentage of foreign investment. A company in which foreign investment accounts for more than 25% of the total shares must obtain after its establishment an approval certificate from the Ministry of Foreign Economic Relations and Trade.⁶⁷ Since Article 4 of China's Joint Venture Law provides that in general the foreign party's share in a joint ven-

tously issuing shares to staff and workers purchased with the collective welfare and other funds. *See supra* note 14, art. 56.

⁶³ *Supra* note 13, art. 10.

⁶⁴ *Supra* note 13, art. 12. In the Shenzhen Regulations and the Shanghai Regulations, the corresponding figures are 30 million and 5 million. *See supra* note 14, arts. 13, 41; note 15, art. 17.

⁶⁵ *Supra* note 13, art. 19. For similar provisions in the Shenzhen Regulations *see supra* note 14, art. 43.

⁶⁶ *Supra* note 13, art. 30(3). For local legislation see the Provisional Measures of Shenzhen Municipality for Administration of Special Renminbi-Denominated Shares, December 16, 1991, and the Provisional Measures of Shanghai Municipality for Administration of Special Renminbi-Denominated Shares, November 25, 1991 (in author's possession).

⁶⁷ *Supra* note 13, art. 13(5). *See* Requirement for Approval of Chinese-Foreign Joint Stock Company in Shenzhen Regulations, *supra* note 14, arts. 42, 43 and similar requirement in Shanghai Regulations, *supra* note 15, art. 19. Further, the issuance of B-shares can only be made by an approved joint stock company which has government permission for foreign investment or which is being reorganized into a foreign investment enterprise. *See* art. 9 of Shanghai B-Share Rules, and art. 7 of Shenzhen B-Share Rules (in author's possession).

ture should be 25% or greater, it appears that this provision means that such an enterprise will be treated as a joint venture (or, if appropriate, a wholly foreign-owned enterprise) under other Chinese legislation.⁶⁸ The Regulatory Opinion does not expressly state this, but it does provide that a company with a certificate from the Ministry must comply with the Regulatory Opinion, as well as the laws, rules and regulations applicable to "foreign invested enterprises."⁶⁹ It seems likely that a company established under the Regulatory Opinion with more than 25% foreign ownership would both enjoy the rights and privileges of, and bear the responsibilities of, "foreign invested enterprises" under China's legislation. To the extent that China's legislation on joint ventures and wholly-foreign owned enterprises cannot be applied literally or directly to companies established under the Regulatory Opinion due to the different corporate forms used in these separate legislative acts, it will probably be applied *mutatis mutandis* or indirectly. Thus, how existing Chinese legislation on foreign invested enterprises will apply to companies established under the Regulatory Opinion with over 25% foreign investment is not very clear.

The situation under the Shenzhen and Shanghai Regulations is clearer. Under the former, a Chinese-foreign joint stock limited company must have at least 25% foreign participation and such a company will be granted the treatment accorded to Chinese-foreign equity joint ventures under China's joint venture legislation.⁷⁰ The Shenzhen Regulations also provide that any tax exemption or reduction granted to a foreign invested enterprise will not be recalculated if it is restructured into a company.⁷¹ The Shanghai Regulations state that any company with a foreign investment share of 25% or more can enjoy the preferential treatment available to Chinese-foreign joint ventures under China's joint venture legislation.⁷²

Another issue that the Company Legislation poses for foreign investors is: who is a foreign investor? The Regulatory Opinion does not define the term "foreign investor," but it is clear it includes U.S., European and Japanese investors. But does it include investors of the Hong Kong, Macao or Taiwan areas of China? In three places the Regulatory Opinion refers to both foreign investors and investors of the Hong Kong, Ma-

⁶⁸ *Supra* note 6. See also Law of the PRC on Wholly Foreign-Owned Enterprises (in author's possession).

⁶⁹ *Supra* note 13, art. 115.

⁷⁰ *Supra* note 14, arts. 45, 46.

⁷¹ *Supra* note 14, art. 46.

⁷² *Supra* note 15, art. 139.

cao or Taiwan areas of China.⁷³ In other Articles, reference is only made to "foreign investors."⁷⁴ It is unclear in the latter case whether the investors of Hong Kong, Macao or Taiwan area of China are intended to be included. For example, does the requirement of Article 12 that a company with foreign investment have a registered capital of not less than RMB \$30 million apply to companies with Hong Kong investment? Now? After July 1, 1997? The answers are not clear.

The provisions in the Company Legislation on government supervision, shareholders' freedom of action, the protection of state property and the restrictions on foreign ownership will be disincentives for foreign investment in companies organized in accordance with it.

V. CONCLUSION

The current status of China's evolving legislation on corporations reflects contradictions in China's changing economy. Since the start of the economic reform in 1979, China has changed from a planned economy to a "socialist commodity economy" and is now a "socialist market economy."⁷⁵ These changes require adjustments to the organization of state-owned enterprises which still remain the backbone of the Chinese economy. The Company Legislation was designed to provide a legal basis for state-owned enterprises in this new economic environment. Thus, the Company Legislation limits the rights of private enterprises and foreign enterprises in the new companies.

Previously, China had three separate forms of corporate enterprises, state-owned enterprises, private enterprises and foreign-invested enterprises, each of which had its own special legal regime. The Company Legislation is a tentative first step in what will probably be a long term process of unifying China's legislation on companies. It is possible to perceive a tendency in Chinese legislation over the last several years to apply the same rules to foreign and domestic enterprises. At present, this process is only in a formative stage and is confronting many contradictions. One of these can be seen in the application of existing joint venture legislation to the Regulatory Opinion.

The Company Legislation provides foreign investors with a new means of investing in China. Most foreign corporations interested in ac-

⁷³ *Supra* note 13, arts. 29, 24(3), 24(4).

⁷⁴ *Supra* note 13, arts. 13(3), 13(5), 30(3).

⁷⁵ The concept of the "socialist commodity economy" was officially established in the Decision on the Economic Institutional Reform. See *supra* note 8, at 7-8. The concept of "socialist market economy" has replaced the "socialist commodity economy" after the first session of the National People's Congress earlier this year. See *WORLD DAILY*, February 7, 1993 (in author's possession).

tive management of their investments in China will prefer joint ventures under existing Chinese joint venture legislation. Foreign investors interested in passive investment, however, may find the opportunities provided by the new Company Legislation to be attractive.