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Foreign Investment Companies Limited By Shares: The Latest Chinese Organization For Major International Ventures

Jim Jinpeng Zhang^{*} & *Jung Y. Lowe*^{**}

SYNOPSIS:

Foreign Investment Companies Limited By Shares (“FICLBS”) is one of the most important recent innovations in the People’s Republic of China’s (“China”) foreign-invested enterprises law. Since January 10, 1995, China has authorized use of the FICLBS and, for the first time, it more closely resembles major corporate organizations used by international foreign investors.¹ So far over eighteen FICLBS have been approved for operation through 1999, with combined actual foreign investment of USD

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¹ See Provisional Regulations on Several Issues Concerning the Establishment of Foreign Investment Companies Limited by Shares 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-405, at 16,331 (1993) [hereinafter Provisional Regulations on Several Issues] (This regulation was attached to Number 1, Commend, 1995 Annual by Ministry of Foreign Trade and Economic Cooperation of the PRC (MOFTEC), promulgated and entered into effect on Jan. 10, 1995).

1.2 billion.² FICLBS has the potential to be the ideal organization for major international investment in China after it joins the World Trade Organization. The FICLBS can issue freely transferred or traded public stock both inside and outside of China. FICLBS regulations encourage establishment of technologically advanced production-type companies.³ Although the statutes that regulate the FICLBS are entirely new to China's body of civil law, they have similar characteristics to company laws of industrialized countries. That is not to say such statutes would result in similar outcomes in regulating the FICLBS compared to company laws of industrialized countries that regulate their respective public stock companies. Our analyses of the FICLBS reveal significant varying interpretations of particular regulations by different Chinese agencies, due to its legal characterization as a special kind of Foreign-Invested Enterprise with various novel categories of stock shares. FICLBS has genuine progressive features but they need to be improved and refined to attract more foreign investors to use this relatively new legal enterprise form.

I. CHINA'S ECONOMIC DEVELOPMENT EXPERIENCE WITH ITS FOREIGN INVESTMENT ORGANIZATIONS AND NEED FOR THE NEW FICLBS

A. Development of Foreign Investment Enterprises in China

The People's Republic of China ("China") has achieved remarkable success in opening its doors to international trade and encouraging foreign investment in recent years. Since the government enacted its first statute governing foreign investment in 1979,⁴ by the end of June 1998, China had approved an aggregate of 314,533 Foreign-Invested Enterprises ("FIEs"), contracting foreign investment of USD 545.4 billion, of which USD 242.3 billion had been paid up.⁵ There were 60,000 FIEs canceled or terminated for a variety of reasons, so about 250,000 are now operating.⁶

² See *Utilization of Foreign Capital Simplified Statistics of Foreign Investment in China (1997, 1998, 1999)*, available at <http://www.moftec.gov.cn> (Aug. 17, 2000) [hereinafter *Utilization of Foreign Capital*].

³ See Provisional Regulations on Several Issues, *supra* note 1, art. 4.

⁴ See *Sino-Foreign Equity Joint Venture Law of the PRC*, RENMIN RIBAO PEOPLE'S DAILY, July 1, 1979, at 1 (adopted by the Fifth National People's Congress of China on July 1, 1979). This law was revised by the National People's Congress on Apr. 4, 1990. See 1 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 6-550, at 7,801 (1993).

⁵ See Hu Zhaoqing, Spokesman for MOFTEC, *A Steady Growth Continues -- An Overview of China's Foreign Trade and Economic Cooperation in the First Half of 1998*, available at http://www.moftec.gov.cn/moftec_en/ldjh/ldjh-002_en.html (July 24, 1998).

⁶ See *id.*

Since the United States established diplomatic relations with China,⁷ U.S. investors have established many enterprises in China. By the end of 1997, the number of U.S. investment projects in China had reached 24,366 with contractual investment amounting to USD 40 billion and actually realized investment of USD 5 billion.⁸ United States investment projects in China cover the fields of machinery, metallurgy, telecommunications, petroleum, chemical products, textiles, agriculture, pharmaceuticals, light industry, food and real estate as well as finance, foreign trade, insurance and accounting sectors opened to foreign involvement on a pilot basis.⁹ Many of these enterprises have enjoyed sound business performance and have expanded with additional investment.¹⁰

These FIEs include Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, wholly foreign-owned enterprises, and the relatively new FICLBS. This rapid influx of overseas investment capital to China is the result not only of China being a vast and fast growing market in the world, but also because of the various legal measures it has enacted to promote international investment and trade. By permitting the FICLBS, China has clearly shown its intention to accommodate U.S. and foreign investors by adapting its economic law to conform closer to their familiar legal framework of business organizations, and offering more investment options. However, since China has a very strong cultural and historical background, and China is in the midway of economic reformation, the FICLBS has certain "Chinese characteristics" that are crucially different from its U.S. counterparts. The statutes that regulate the FICLBS are also entirely new to China's body of civil law.

B. Need For New FICLBS To Accelerate Economic Development and Attract More Sophisticated Major Foreign Investors.

Chinese laws, generally, authorize a company limited by shares with total capital divided equally amongst shares of equivalent value to offset its total assets against responsibility assumed for company debt.¹¹ More recently, the FICLBS refers to an enterprise with corporate status established pursuant to the provisions of certain regulations; whose total capital is composed of the equivalent value of stock, whose shareholders assume an

⁷ See Joint Communique on the Establishment of Diplomatic Relations between the United States of America and the People's Republic of China, 18 I.L.M. 274 (1979).

⁸ See Interview by Xinhua News Agency with Vice Minister Sun Zhenyu, at http://www.moftec.gov.cn/moftec_en/lejh/ldjh-004_en.html.

⁹ See *id.*

¹⁰ See *id.*

¹¹ See Company Law of the PRC, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-518, art. 3, at 16,733 (1993) [hereinafter Company Law] (Company Law was adopted on Dec. 29, 1993 by the 5th Session of the Standing Committee of the 8th National People's Congress and entered into effect since Jan. 1, 1994).

amount of liability equal to the amount of shares purchased which offsets its total assets against responsibility assumed for company debts, and whose company shares that are jointly held by Sino-foreign shareholders and shares purchased and held by foreign shareholders constitute more than 25 percent of the company's registered capital.¹²

The legislative purpose of China for the FICLBS was to further expand international economic and technological cooperation and exchange, introduce foreign capital and promote the development of the socialist commodity economy.¹³ However, there are some current practical reasons for China to promote use of the FICLBS.

1. Allowing the FICLBS would increase China's competitive ability to attract foreign investment. The Chinese government views the FICLBS as a way to provide further incentives to absorb foreign capital. This is reflected in the fact that all FICLBS are increasingly used as necessary vehicles for certain types of major foreign investment in China. During the seventeen years of "opening door" policy to foreign investment and economic reform before China officially allowed establishment of the FICLBS, China generally set up a framework of market-oriented economics and roughly established a set of legal systems to accommodate it. China had also obtained some experience in allowing Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, wholly foreign-owned enterprises, and domestic stock companies, as well as a few experimental FICLBS in Shanghai and Shenzhen.¹⁴ However, many international companies with large economic resources to invest in mid-term and long-term projects have the capabilities to issue stock inside and outside of China and they would have a need to establish the FICLBS. China believes that the present time is generally ripe to formally promote the FICLBS form to foreign investors.

2. Allowing the FICLBS is to respond to international competition by other countries to attract foreign investment. More and more countries, especially many other developing Asian countries and areas, have successfully adopted some effective measures to attract scarce international investment and to advance their economic development by increased foreign investment in their regions.¹⁵ After experiencing initial success at attracting foreign investment, China was concerned that international investment capital would go to other countries. Stock companies are generally used in the international investment community, hence China decided to create the FICLBS to compete in an intensive international economic en-

¹² See Provisional Regulations on Several Issues, *supra* note 1, art. 2.

¹³ See *id.* art. 1.

¹⁴ See *The First China-Foreign Joint Venture in Guangdong Reorganized as A Stock Company*, THE CHINA PRESS, Jan. 9, 1993, at 4.

¹⁵ See Huilian Du, *The Future of China Absorbing Foreign Investment*, 6 INT'L CON. COOPERATION 10, 13 (1995).

vironment. During the recent Southeast Asian financial crisis, it was important for China to receive more investments in hard currencies, especially because China did not devalue its Renminbi. Besides, China needed to anticipate the United States' impending review of the Most Favored Nation treatment status and thereby tried to improve the mutual relationship of bilateral trade and economic cooperation, as well as the negotiations for China to participate in the World Trade Organization.

3. Allowing the FICLBS would give investors more options than in previous simple investment vehicles in China. FICLBS may issue publicly owned stock to increase capital creation. There are no qualifications to limit the number of shareholders. Anyone can become a shareholder by purchasing stock whether for one share or a controlling amount of the shares of a FICLBS. Both domestic and overseas investors may become the promoters and a FICLBS may issue public stock both inside and outside of China. Therefore, China can accommodate both small and large investment from both domestic and overseas investors. FICLBS investors can buy, sell, give, or receive any amount of shares both inside and outside of China, and shareholders' liability remains limited only to the amount of shares owned. Shareholders can make decisions based on their different capabilities and interests. This is an important characteristic of stock companies generally in most industrialized countries.

C. Recent Laws and Regulations Support Organization of FICLBS

An essential prerequisite to the establishment of the FICLBS in China was a legal framework for both Chinese enterprises and foreign investors to incorporate into entities that are based on a stock ownership system. China enacted a series of laws and statutes relating to the FICLBS following the first local regulation promulgated in Shenzhen, April 26, 1993.¹⁶ Promulgation of the Provisional Regulations on Several Issues by MOFTEC on January 10, 1995,¹⁷ made the FICLBS a reality in law and available to foreign investors in China. Nevertheless, the regulations by various government bodies regarding the FICLBS are not systematic and are still largely works-in-progress. The authorities in China have not yet clarified the finer points of the new laws. Their underlying principles are scattered in the various government regulations and have not yet been consolidated. For example, the Company Law establishes the general rules governing the basic framework of all companies limited by shares, but it provides special exceptions for various administrative authorities to rely on as they act to build up a parallel foreign enterprises legislation system.¹⁸ MOFTEC is the

¹⁶ See Rules of Shenzhen Special Economic Zone on Companies Limited by Shares, 1 China L. For Foreign Bus. - Special Zones & Cities (CCH) ¶ 73-035, at 23,814 (1995) (issued on April 26, 1993 by the 5th Session of the 1st Shenzhen Municipal People's Congress and entered into effect on Oct. 1, 1993).

¹⁷ See Provisional Regulations on Several Issues, *supra* note 1.

¹⁸ See Company Law, *supra* note 11, art. 18. .

general administrative authority over foreign investment in China. MOFTEC promulgated general governing rules regarding the FICLBS, such as the Provisional Regulations on Several Issues. The China Securities Regulatory Commission ("CSRC") is the administrative authority for securities now. Earlier, both the State Council Security Commission and CSRC separately promulgated a series of security regulations regarding companies issuing their shares publicly inside of China and outside of China for Renminbi shares and foreign currency shares.¹⁹ Based on previous legislative history regarding other forms of FIEs, the Chinese government will apply these separate administrative regulations for several years, although sometimes ambiguous or conflicting, to gain practical experience. Then, systematic legislation or higher level regulations or laws would be issued by the State Council or by the People's Congress.

According to Chinese legal theory, the following principles are used to resolve any conflicts between domestic regulations: (1) a law by the People's Congress supersedes a law by the State Council; (2) a law by the State Council supersedes a regulation by a Ministry of the State Council; and (3) a law by the State (central government) supersedes a law by a local municipality. The laws and regulations include exceptions applicable to FIEs.

The current legal situation on the FICLBS is similar to the earlier development period for implementing Sino-Foreign joint venture laws in China. In fact, most successful foreign investment projects in China today were actually established during the earlier development period and buried their roots before the legislation became systematic and more restrictive. This lag time for legislation is a "Chinese characteristic."

II. REQUIREMENTS TO ESTABLISH A FICLBS

A. Approaches Available To Organizers of FICLBS

The main requirements to establish the FICLBS are qualified shareholders and a relatively large amount of capital. Two methods of establishing the FICLBS are allowed in China. Promoters of a FICLBS follow the same methods to establish domestic companies limited by shares, by using

¹⁹ See Detailed Rules for the Implementation of the Regulations of the State Council on Foreign Capital Shares Listed in China by Companies Limited by Shares, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-604, at 17, 631 (promulgated and took effect on May 3 1996 by SCSC); Special Provisions of the State Council Concerning Floating and Listing of Shares Overseas by Companies Limited by Shares, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-552, at 17,169 (1993) (promulgated Aug. 4, 1994 by the State Council); Provisional Regulations Concerning the Administration of the Issue and Trading of Shares, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-574, at 17,371 (1993) (promulgated and implemented on Apr. 22, 1993 by SCSC).

either the “promoting method” or the “share float method.”²⁰ The promoting method requires promoters to purchase all of the shares issued by a company for its establishment, and no shares are made available to any party other than the promoters.²¹ The share float method requires promoters to purchase a portion of the shares issued by a company and the balance is made available to the public for purchase.²²

Promoters are the principal investing group responsible for the preparatory work involved in establishing the stock company. Promoters’ two main functions are to organize the establishment of the company, and to act as “deep pockets” in the event problems are encountered.²³ Thus the promoters of a company limited by shares assume the following financial responsibilities: (a) promoters must subscribe to their subscribed shares in accordance with the provisions of the Company Law and shall undertake the preparatory work for establishment of the company;²⁴ (b) in the event the company cannot be established, the promoters bear joint liability for all of the debts and expenses incurred during the course of establishment;²⁵ (c) and the promoters bear joint liability for repayment of share subscription funds and bank deposit interest amounts for the period to subscribers who have already paid their share subscription moneys;²⁶ and (d) in the event of the company incurring losses during the course of its establishment due to mistake on the part of the promoters, the promoters must bear joint liability for compensation to the company.²⁷

There are several general requirements for promoters’ qualifications in establishing the FICLBS: (1) a foreign investment promoter can be either a legal enterprise person, or a natural (individual) person; but a Chinese investment promoter may not be a natural (individual) person, and may only be a legal enterprise person, for example, companies, enterprises or other economic entities.²⁸ This requirement means that a Chinese party has to meet a higher standard than a foreign party in establishing a FICLBS because an economic entity generally has more fiduciary and financial ability than an individual presently in China; (2) at least five or more promoters are required for the principal investing group.²⁹ This is to assure that the pro-

²⁰ See Provisional Regulations on Several Issues, *supra* note 1, art. 5; see also Company Law, *supra* note 11, art. 74.

²¹ See Company Law, *supra* note 11, art. 74.

²² See *id.*

²³ See Matthew D. Bersani, *Privatization and the Creation of Stock Companies in China*, 1993 COLUM. BUS. L. REV. 301 (1993).

²⁴ See Company Law, *supra* note 11, art. 76.

²⁵ See *id.* art. 97; see also Provisional Regulations on Several Issues, *supra* note 1, art. 13.

²⁶ See Company Law, *supra* note 11, art. 97.

²⁷ See *id.*

²⁸ See *id.* art. 1.

²⁹ See *id.* art. 75.

motors of the FICLBS will not be too few and serves to spread the financial risk; (3) at least one of the promoters must have their domicile within the territory of China.³⁰ This is to assure the FICLBS has a foundation of Chinese legal person status; (4) if a FICLBS is established through the promotional method, at least one of the promoters should be a foreign shareholder, in addition to complying with the above conditions.³¹ This requirement conforms with the legal nature of a FICLBS as one kind of FIE subject to the specific regulations only for FIEs in China; (5) if a FICLBS is established through the share float method, at least one of the promoters shall have profit records for each of the three successive years prior to the share float, besides complying with the preceding conditions.³² If the promoter is a Chinese shareholder, the promoter shall provide its financial and accounting report for the recent three years, which has been audited by a Chinese certificate public accountant, if the promoter is a foreign shareholder, the promoter shall provide its financial report which has been audited by a certified public accountant at the location where the foreign shareholder is resident.³³

There is a special requirement that promoters should know early. A promoter cannot transfer its own shares until the FICLBS has existed for three years. After that, any promoter may transfer the shares, but the prerequisite is that their shares to be transferred must be approved by the original authorized organ of government.³⁴

B. Capital Requirements for a FICLBS

There are strict requirements for the registered capital amount to organize the FICLBS. The registered capital of a FICLBS is the total amount of paid-up share capital registered by the company with the company registration authority of the Chinese government.³⁵ The total amount of shares is owned by both the promoters and the public.

The minimum amount of total registered capital required for a FICLBS is Renminbi 30 million yuan (approximately USD 3.63 million).³⁶ A minimum of 25 percent of outstanding shares must be purchased and held by foreign shareholder(s).³⁷ The minimum amount of total registered capital requirement is intended to ensure that the scope of a FICLBS operation will not be so small that shareholders will take too much financial risk, and the

³⁰ See *id.*

³¹ See Provisional Regulations on Several Issues, *supra* note 1, art. 6.

³² See *id.*

³³ See *id.*

³⁴ See *id.* art. 8.

³⁵ See *id.* art. 7; see also Company Law, *supra* note 11, art. 78.

³⁶ The exchange rate for Renminbi on August 18, 2000 was \$100 = 827.97 Renminbi. See *Currency Trading Exchange Rate*, WALL ST., J., Aug. 21, 2000, at C16.

³⁷ See Provisional Regulations on Several Issues, *supra* note 1, art. 7.

minimum amount of foreign shares is to ensure that the company's foreign ownership exceeds 25 percent to enable the company to qualify as a FIE for receiving beneficial tax and other favorable treatments specifically granted to the FIEs under Chinese law.

There are also specific capitalization provisions for the establishment of a FICLBS. Promoters may contribute capital by using currency and also by using capitalized physical goods, industrial property rights, technology with non-patent rights, or land use rights.³⁸ Capitalized physical goods, industrial property rights, technology with non-patented rights, or land use rights contributed as capital must be evaluated, verified and converted into shares. Such capitalized contributions shall not be over or under valued. The value of capital contributed through capitalization of industrial property rights and technology with non-patented rights shall not be permitted to exceed 20 percent of the registered capital of a company limited by shares.³⁹

C. FICLBS Business Only In Authorized Subjects or Industries

The establishment of a FICLBS shall be in conformity with relevant State-stipulated provisions on national industrial policy for FIEs because a FICLBS is one form of FIE.⁴⁰ FICLBS also must have limited operation time periods for "restricted Sino-foreign joint operated projects"⁴¹ when jointly established by Sino-foreign shareholders.

The State Council published an amended Guideline Catalogue of Foreign Investment Industries ("Amended Guideline") on December 29, 1997, which became effective on January 1, 1998.⁴² It covers 329 industry sectors, and includes 440 different products, types of technologies, and services. The industries which are currently being encouraged include: technology related to agriculture; power engineering; transportation; technology related to environmental protection; telecommunications; petroleum exploration and petroleum products; electronics; pharmaceuticals; medical technology and equipment; aviation; and satellite launch services.⁴³

III. ADMINISTRATIVE PROCEDURES TO ORGANIZE A FICLBS

Incorporating a FICLBS involves not only general stock limited liability company's laws, but also separate and additional FIE laws. Thus, the process of incorporating a FICLBS is more complicated than incorporating

³⁸ See Company Law, *supra* note 11, art. 80.

³⁹ See *id.*

⁴⁰ See Provisional Regulations on Several Issues, *supra* note 1, art. 3.

⁴¹ Provisional Regulations on Guiding Foreign Investment, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-420, art. 9(1), at 16,482 (1993)(promulgated by State Planning Commission, on Jun. 27, 1995).

⁴² See 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶13-430, at 16,495 (1993).

⁴³ See *id.*

in any U.S. state. It is also different from incorporating Chinese domicile companies. The main procedures for establishing a FICLBS are as follows.

A. Preliminary Agreement of Promoters

Before submitting an application to the government, the promoters should first make a FICLBS establishment preliminary agreement by negotiation.⁴⁴ The agreement normally will include the following: the promoters' names, addresses, legal representatives, nationalities, and occupations; the company's principals and scope of operation; the company's method of establishing its management; the company's registered capital, amount of issuing shares and type of shares; amount, type and time limit of shares purchased by the promoters; the promoters' rights, obligations and responsibilities in the event of their breach; the provisions for dispute resolution; the statement of controlling law and jurisdiction; the agreement expiration and alternation; the signatures, date and place where the establishing agreement was entered; as well as other necessary written items.⁴⁵

After this preliminary agreement, the promoters should issue the establishment feasibility study reports and the asset valuation reports to be attached to the application. Under the share float method of establishment, the applicant should also submit the "Instruction of Raising Funds By Shares," which shall be approved preliminarily by the security and stock department of the State.⁴⁶

B. Application Procedures

After the promoters have reached agreement on the establishment of a FICLBS, one promoter may be entrusted to handle the application procedure for the establishment of the company.⁴⁷ The application to establish the company, a feasibility study report, asset valuation reports and the other documents are submitted to the enterprise administration department of the Chinese government. The proper department may be at the level of a province, autonomous region, municipality directly under the central government, or municipality subject to independent planning by the Chinese government where the company will be located.⁴⁸ The other documents, including the preliminary agreement of the promoters, shall be explained here.

⁴⁴ See Provisional Regulations on Several Issues, *supra* note 1, art. 9, at 16,333, the sub-sentence of "[a]fter promoters have reached agreement on the establishment of a company," indirectly demands a preliminary agreement for establishing a FICLBS.

⁴⁵ See *id.* art. 12.

⁴⁶ See Company Law, *supra* note 11, art. 84.

⁴⁷ See Provisional Regulations on Several Issues, *supra* note 1, art. 9.

⁴⁸ See *id.* art. 9(1).

The above mentioned documents shall, after examination and approval by the enterprise administration department, be directly transferred to the department of foreign trade and economic cooperation administration of the Chinese government at the level of a province, autonomous region, municipality directly under the central government, or municipality subject to independent planning where the company will be located.⁴⁹ After the above documents have been examined and approved by the department of foreign trade and economic cooperation administration, the promoters shall officially conclude and sign the agreement and the articles of association for the establishment of the company.⁵⁰ The application and required documents should be submitted to MOFTEC for final examination and approval. MOFTEC shall make a decision within 45 days.⁵¹

C. Capital Funding

After the agreement and the articles of association for establishment of the company have been approved by MOFTEC, the promoters shall open a special account with a bank within 30 days by presenting the certificate of approval issued by MOFTEC. The promoters shall subscribe for their respective shares in full in one lump sum within 90 days of the date of issue of the certificate of approval.⁵²

D. Setting Up the Organization

If a company is established through the “promoting method” of establishment, after the promoters have subscribed for their respective shares in full, a board of directors and a supervisory committee shall be elected.⁵³ If a company is established through the “share float method,” after payment of the share funds has been settled in full, verification must be made by an official capital verification authority and a capital verification certificate shall be issued. The promoters shall convene a founding meeting within 30 days and a board of directors and a supervisory committee shall be elected.⁵⁴

E. License Registration

Under the promoting method of establishment, the board of directors shall submit the documents of approval for the establishment of the company, the company articles of association and capital verification certificates and other documents to the company registration authority to apply

⁴⁹ *See id.* art. 9(2).

⁵⁰ *See id.*

⁵¹ *See id.* art 9(3).

⁵² *See id.* art. 13.

⁵³ *See id.* art. 14.

⁵⁴ *See id.*

for registration of its establishment.⁵⁵ Under the share float method of establishment, the board of directors shall submit additional minutes of the founding meeting to the authorized registered state organ to apply for registration of its establishment within 30 days of the end of the founding meeting.⁵⁶

The administrations for industry and commerce are the FIE companies' (including FICLBS) registration authorities.⁵⁷ They must complete the procedures for entry onto the register and shall issue a Business License to the company within 30 days of receipt of all registration documents.⁵⁸ After receiving its Business License, the FICLBS is officially established and qualified as an enterprise legal entity of the People's Republic of China.⁵⁹ The date on which the Business License of the company is issued shall be the date of the establishment of the FICLBS. After the company has been established, a public announcement shall be made.⁶⁰

F. Securities.

A FICLBS which is established through the share float method of establishment shall additionally file a report on the share float to the securities management department of the State Council for its record.⁶¹ The public issue of shares must comply with the conditions contained in the provisions of Company Law, and must be reported to the securities supervision and administration body of the State Council for ratification.⁶² The issuer must submit to the securities supervision and administration body all application forms required by Company Law, and all relevant documentation required by the securities supervision and administration body.⁶³

⁵⁵ *See id.*

⁵⁶ *See id.*

⁵⁷ *See* Administrative Rules of PRC governing the Registration of Companies, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-568(6), art. 4, at 17,313 (1994) [hereinafter Rules of Registration] (promulgated by the State Council on Jun. 24, 1994).

⁵⁸ *See* Company Law, *supra* note 11, art. 95.

⁵⁹ *See* Rules of Registration, *supra* note 57, art. 3.

⁶⁰ *See* Company Law, *supra* note 11, art. 95.

⁶¹ *See id.*

⁶² *See* Securities Laws of the People's Republic of China, 1 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 8-699, art 11, at 10,765 [hereinafter Securities Law] (adopted on Dec. 29, 1998 by the 6th Session of the Standing Committee of the 9th National People's Congress and has come into force on 1 July 1999).

⁶³ *See id.*

IV. RESTRUCTURING EXISTING FOREIGN INVESTED ENTERPRISES INTO NEW FICLBS

New FICLBS can be organized by converting some existing companies in China.⁶⁴ According to the promulgated regulations, generally, the new FICLBS must assume all of the liabilities of the original enterprise and the original enterprise automatically terminates after the new FICLBS is established.⁶⁵ The new FICLBS may be able to retain previous privileges and identifications, for example, business name, trademark, principal office, etc. There are certain specific requirements in the regulations for existing enterprises that are to be transformed into a FICLBS.

A. Transforming Existing FIEs Into FICLBS

A new FICLBS may be organized by transforming other kinds of existing FIEs including Sino-foreign equity joint ventures, Sino-foreign contractual joint ventures, and wholly foreign-owned enterprises. If any of these established FIEs makes an application to transform into a FICLBS, it must additionally have kept records showing profits for the last three successive years.⁶⁶

Procedurally, the agreement and articles of association for the establishment of a FICLBS shall be signed by investors of the original FIE, acting as the FICLBS promoters (or in conjunction with other promoters), and submitted to the examining and approving authority at the location of the original FIE for preliminary examination. After the above documents have been examined and approved by the local foreign trade and economic cooperation administrative authority, the documents shall then be transferred to MOFTEC for final examination and approval.⁶⁷

The following documents shall be submitted when applying for transformation into a FICLBS: (1) contracts and articles of association of the original FIE; (2) a resolution of the board of directors of the original FIE concerning the reorganization of the enterprise; (3) a resolution of the investors of the original FIE on the termination of the original contracts and articles of association; (4) a capital verification report on the original FIE; (5) the promoters' agreement ("promoters" to include but not to be limited to investors of the original FIE); (6) the company's articles of association; (7) the business license and certificate of approval of the original FIE and a financial report for the last three successive years; (8) an application of the establishment of a FICLBS by transformation; (9) the proofs of creditworthiness for the various promoters; (10) a feasibility study report.⁶⁸

⁶⁴ See Provisional Regulations on Several Issues, *supra* note 1, art. 15.

⁶⁵ See *id.* arts. 17, 18 & 20; see also Company Law, *supra* note 11, art. 100.

⁶⁶ See Provisional Regulations on Several Issues, *supra* note 1, art. 15.

⁶⁷ See *id.*

⁶⁸ See *id.*

B. Transforming Existing Domestic Enterprises Into FICLBS

New FICLBS may be organized from existing domestic state or collectively owned enterprises. Most Chinese domestic enterprises are state or collectively owned enterprises at the present time. There are several additional requirements for a domestic state or collective enterprise, which wants to be transformed into a FICLBS: (1) The existing enterprise must have been operating its business for a minimum of 5 years and kept profitable records for the last 3 successive years; (2) the foreign shareholder(s) must have bought and held 25 percent or more shares of the existing enterprise's registered capital with freely convertible foreign currency; (3) the scope of business operation of the existing enterprise must be in conformity with the industrial policies for FIEs.⁶⁹

There are two exceptions for an existing state-owned enterprise to be a promoter of the newly organized FICLBS. (1) When a state-owned enterprise is restructured as a FICLBS, fewer than 3 promoters are allowed, and the promoter(s) shall only use the share float method of establishment.⁷⁰ (2) The existing state-owned enterprise, which is applying to be converted into a FICLBS as a promoter must obtain priority approval from the Bureau of National Administration of State Property because the application involves the change of the registration of state-owned assets.⁷¹

New FICLBS may be organized from existing domestic companies limited by shares. A domestic stock company which wants to be transformed into a new FICLBS must conform to the following requirements: (1) the existing FICLBS has been established with the official approval of the State; (2) the foreign shareholder(s) must have bought and held 25 percent or more shares of the transformed enterprise's registered capital with freely convertible foreign currency; (3) the scope of business operation of the new FICLBS must be in conformity with the industrial policies for FIEs.⁷²

There are three methods for existing Chinese domestic companies limited by shares to be transformed into new FICLBS: (1) a new FICLBS may result from issuing special Renminbi-denominated shares (B shares) to the public by the existing company limited by shares;⁷³ (2) a new FICLBS may result from increasing or expanding the proportion of shares of its foreign capital, or assigning Chinese shares to foreign shareholders by the existing company limited by shares;⁷⁴ (3) a new FICLBS may result from issuing overseas listed foreign capital shares in stock markets outside of China (in-

⁶⁹ See *id.* art. 18.

⁷⁰ See Company Law, *supra* note 11, art. 75.

⁷¹ See *id.* art. 84.

⁷² See Provisional Regulations on Several Issues, *supra* note 1, art. 20.

⁷³ See *id.* art. 21.

⁷⁴ See *id.* art. 22.

cluding but not limited to H type and N type), by the existing company limited by shares. An additional requirement for these kinds of transformations is that the reorganized domestic companies limited by shares must provide the related documents to the securities administration department for examination and must obtain a preliminary approval.⁷⁵

C. Summary of Omitting Certain Procedures For Transformation

The initial organization of a FICLBS must follow certain procedures, whereas the reorganization and transformation of an existing enterprise into a new FICLBS may omit these procedures: (1) for approval, the existing enterprise does not need the initial approval by the authorized enterprises' administration to apply for its transformation into a new FICLBS; (2) for registered capital, the original enterprise's assets may be directly used as part or full payment to purchase certain amount of the shares in the new FICLBS; (3) for management, the original management team can be used but the team must be approved by the board of directors of the new FICLBS and must be registered again; (4) for documents, the promoters can directly change the documents of the original enterprise into the documents for the new FICLBS but the valid date of these documents is the date of issuing of the new business license for the new FICLBS.

V. COMPARISON OF FICLBS WITH U.S. BUSINESS ORGANIZATIONS

A. Comparison of Definitions for Chinese and U.S. Organizations

1. A practical understanding of the definition of the FICLBS in the context of U.S. law and Chinese legislation is difficult due to confusing terminology. The form of the FICLBS has been described by different names in English: "company limited by shares,"⁷⁶ "stock enterprises with foreign investment,"⁷⁷ "joint stock company,"⁷⁸ "stock company with foreign investment."⁷⁹ Companies limited by shares in China are designed specifically for large investment or raising capital from public investors including international investors, whereas American corporations may issue shares of stock with limited liability for any amount of capital to anybody. The basic structure of the FICLBS is similar to American "public (stock)

⁷⁵ See *id.* art. 23.

⁷⁶ See *id.*

⁷⁷ See *Utilization of Foreign Capital*, *supra* note 2.

⁷⁸ See Daniel J. Brink & Xiao Lin Li, *A Legal and Practical Overview of Direct Investment and Joint Ventures in the "New" China*, 28 J. MARSHALL L. REV. 567, 587 (1995).

⁷⁹ See Bersani, *supra* note 23, at 321.

corporations” but with some extra limitations in certain circumstances.⁸⁰ Although Chinese and foreign investors jointly own shares of the same capital stock in the FICLBS, it provides limited liability for its shareholders, compared to the American “Joint Stock Companies,” which are an unincorporated association (under the U.S. law) being unincorporated, the owners of the joint stock company do not enjoy the limited liabilities that shareholders of a corporation do, since they are very often treated in a manner similar to partners.⁸¹ Therefore, the FICLBS should be defined as a limited liability company rather than a “joint stock company.”

B. FICLBS Ownership Subject To Restrictions

American corporations may be used for private, public or complete foreign ownership. The FICLBS phrase “Foreign Investment Companies Limited By Shares” was literally translated into English from its original meaning in Chinese. Therefore, logically, FICLBS should include not only Sino-foreign joint companies limited by shares but also wholly-foreign-owned companies limited by shares in China because by definition they have more than the minimum required 25% of foreign investment capital. In addition, Article 19 of the Detailed Rules for the Implementation of Wholly Foreign-owned Enterprises expressly states that a wholly foreign-owned enterprise can be established either in the form of a limited liability company or the form of other limited liability structures.⁸² Nevertheless, the FICLBS was intentionally structured to require at least one foreign shareholder to establish the stock company with at least one domestic shareholder.⁸³ Because of this required structure, wholly foreign-owned FICLBS have not yet been allowed to be established in China.

C. Chinese Capital Stocks Differ From U.S. Capital Stocks

Shares of capital stock for the FICLBS in China have different categories compared to capital stock in American corporations. U.S. companies normally issue common or preferred shares and their classes are voting and sometimes non-voting. The equity securities of Chinese stock companies including the FICLBS are by regulation available in three categories that define stockholder status according to Company Law: (a) “Name” shares are issued by companies to a certain promoter, an organization authorized by the state to make investments, or a legal person, and the shares are regis-

⁸⁰ See Alfred F. Conard, *Business Enterprises in* INTRODUCTION TO THE LAW OF THE UNITED STATES 310 (David S. Clark et al. eds., 1992).

⁸¹ See Joseph Jude Norton, REGULATION OF BUSINESS ENTERPRISES IN THE U.S.A. 1-13 (1985).

⁸² Detailed Rules for the Implementation of Wholly Foreign-owned Enterprises, 2 China L. For Foreign Bus. - Bus. Reg. (CCH) ¶ 13-507, at 16,669 (Dec. 12, 1990).

⁸³ See Provisional Regulations on Several Issues, *supra* note 1, art. 1.

tered and bear the name of the party,⁸⁴ (b) "Nameless" shares are normally issued to the public and may be without the holder's name (shares issued to the public may be also registered shares),⁸⁵ and (c) Other types of shares.⁸⁶

Sales and exchanges of capital stocks, including those of the FICLBS, by Chinese stock exchanges requires them to assign different classifications to such equity securities. These classifications are not used by American stock exchanges. China has officially set up its own over the counter stock trading system and two stock exchanges, the Shenzhen⁸⁷ and the Shanghai,⁸⁸ meanwhile, some Chinese companies have been also listed on foreign stock exchanges.⁸⁹ Both Chinese security law and stock exchanges, designate all shares of equity securities as being one of three authorized kinds: (a) "A" shares, which are registered shares issued by enterprises established in China.⁹⁰ These shares can only be owned or traded by Chinese citizens on domestic stock markets and denominated, sold and purchased in Renminbi; (b) "B" shares, which are registered shares offered inside China but exclusively to foreign investors.⁹¹ They are denominated in Renminbi but are subscribed for and traded in foreign currency; (c) "H" shares (Hong Kong), "N" shares (New York), or other special stocks, which are issued and traded exclusively on overseas stock markets by companies incorporated in China.⁹² The Provisional Regulations on Several Issues applies the above classifications to the FICLBS transformed from existing domestic stock companies.⁹³

In summary, the Chinese capital stock system has (1) three categories that define stockholder status as "Name," "Nameless" and "Other," and (2) classifications for sale and exchange of "A" shares to the state, legal person, and individual; "B" shares for hard currencies; "H" shares distributed in

⁸⁴ Company Law, *supra* note 11, art. 133.

⁸⁵ *Id.* art. 134.

⁸⁶ *Id.* art. 135.

⁸⁷ See Provisional Measures of Shenzhen Municipality on Share Issuing and Trading, 1 China L. For Foreign Bus. – Special Zone and Cities (CCH) ¶ 71-160, at 31,663 (1991).

⁸⁸ See Administrative Measures of Shanghai Municipality Governing Securities Trading, Chapter V – Stock Exchange, 2 China L. For Foreign Bus. – Special Zone and Cities (CCH) ¶ 92-120, at 197,271 (1990).

⁸⁹ Brilliance China Automotive Holdings was the first PRC's company to list on the New York Stock Exchange. See *Bumpy Road For Car Groups*, FIN. TIMES, Nov. 18, 1993, Section III, at IX. Merrill Lynch & Co. has been named lead underwriter for a Chinese company for listing in Hong Kong and China. See *Merrill Lynch Named As Lead Underwriter For Chinese Offering*, WALL ST. J., Jan. 11, 1993, at A7C.

⁹⁰ See Securities and Future Regulations, Issuing of Securities, China Bus. Law Guide (CCH) ¶ 38-345 at 38,221 (1999).

⁹¹ See *id.*

⁹² See *id.*

⁹³ See Provisional Regulations on Several Issues, *supra* note 1, arts. 21,23.

Hong Kong; "N" shares distributed in New York; and special symbols for shares distributed in other overseas stock markets.

VI. FICLBS PRESENTLY UNRESOLVED ISSUES NEED CAREFUL CONSIDERATION BY U.S. AND OTHER INTERNATIONAL INVESTORS

A. Potential Conflicts In Chinese Laws and Regulations On FICLBS

All FICLBS are subject to the foregoing complicated requirements for capital stock. The requirements could be changed in the future possibly resulting in even more confusing regulations. For example, the Company Law has been adopted by the highest legislature authority, People's Congress, and it applies to companies limited by shares.⁹⁴ However, the Company Law also provides that the State Council may formulate separate regulations governing the issue of types of shares, which are not covered by this law.⁹⁵ The Provisional Regulations on Several Issues is the present executive regulation regarding establishment of the FICLBS adopted by the authorized department of State council. Moreover, the Provisional Regulations on Several Issues requires other company matters not specifically stipulated in these Provisional Regulations shall be handled in accordance with "the Company Law . . . and relevant regulations."⁹⁶

Significantly, the Securities Laws of the People's Republic of China ("Securities Law") was adopted on December 29, 1998 by the 6th Session of the Standing Committee of the 9th National People's Congress and has come into force on July 1, 1999 after more than five years of debate and consultation.⁹⁷ The fledgling securities industry of China has operated in the absence of a complete and standardized legislative framework over the past eight years.⁹⁸ The Securities Law is China's first national legislation to address all securities-related issues and preparations for compliance with the law. This development provides a better protection for both Chinese domestic and overseas investors. However, the Securities Law does not address the classifications of various Chinese securities. It does not address overseas listings by Chinese companies including the FICLBS that has the status of a Chinese legal person. It also does not address "B" share activity, which involves shares, denominated in foreign currency for foreign investors. Securities that are not covered by the Security Law are to be governed by the "provisions of the Company Law and other laws and administrative

⁹⁴ See Company Law, *supra* note 11, chs. III & IV.

⁹⁵ See *id.* art. 135.

⁹⁶ See Provisional Regulations on Several Issues, *supra* note 1, art. 25.

⁹⁷ See Security Laws of the People's Republic of China, *supra* note 62.

⁹⁸ See Sally A Harpole, *First National Securities Law Adopted*, CHINA LAW NEWS, Nov. 1997, at 3.

regulations” instead.⁹⁹ The CSRC is to be responsible for the “centralized and unified” national supervision and administration of all securities markets and activities throughout China.¹⁰⁰ “With respect to the supply of shares in Chinese companies to foreign persons and foreign organizations for subscription and trading in foreign currency, specific measures should be separately implemented by the State Council.”¹⁰¹ Therefore, the securities issues with respect to the FICLBS are still developing.

B. High Capital Requirement for FICLBS May Discourage Foreign Investment

By U.S. standards, the requirements for the promoters and capitalization of the FICLBS are quite high. Foreigners might wonder why these minimum standards have been established at such high levels in China. One way to understand this legislation is that they are apparently designed to protect investors in these kinds of public fund raising companies. They apply not only to public investors, but also non-public investors. Under Chinese legislative context, the stability and safety of national economic order is China’s highest priority in the reforming period. When they could not be sure whether something would work, they make higher safety requirements under the present circumstance to avoid social or economic disorder. This is a so-called “Chinese characteristic.” Meanwhile, these considerations also take into account China’s situation whereby “complete privatization of stock ownership in China is not likely for the foreseeable future, foreign and domestic Chinese investors in new companies will need enhanced guarantees of fiduciary accountability so that enterprises in which they choose to invest will continue toward profitability.”¹⁰² That is why “many of whom (Chinese public investors) believe that the stocks present a risk free investment because ‘the authorities would never let a company fail.’”¹⁰³

C. Foreign Investors Should Analyze Advantages in Using FICLBS Compared To Other Foreign Invested Enterprise Organizations

If we assume that a U.S. investor could hold the same percentage interest in each entity, which investment vehicle would be better—a Sino-foreign joint venture or a FICLBS? The answer depends largely on the personal needs of the investor and balancing of advantages and disadvantages.

⁹⁹ See Securities Law, *supra* note 62, art 2.

¹⁰⁰ See *id.* art. 7.

¹⁰¹ *Id.* art. 213.

¹⁰² Michael Irl Nikkel, “Chinese Characteristics” in *Corporate Clothing: Questions of Fiduciary Duty in China’s Company Law*, 80 MINN. L. REV. 503, 54 (1995).

¹⁰³ *Reforming the State-Enterprise Property Relationship in PRC: The Corporatization of State-Owned Enterprises*, 16 MICH. J. INT’L L. 911, 935 (1995).

There are a few principal advantages for overseas investors to purchase shares of a FICLBS. First, a FICLBS may quickly raise large amounts of capital for establishing a new project or increasing the scope of an existing operation. Promoters are required to invest a large amount of initial investment, which is the basic fund of the company. The minimum amount of registered capital required for a FICLBS is Renmibi 30 million yuan. The most important part of capitalization is authorization to issue shares of stocks publicly inside and outside of China and raise unlimited investment funds. However, this is impossible for a Sino-foreign joint venture where all available capital only comes from the owner's initial investing. This distinction creates a significant advantage to invest in a FICLBS because raising public funds can be a powerful tool for increasing the company's capital power.

Second, investors of a FICLBS have freedom to purchase or sell their shares of stock for their benefit. There are few restrictions on the transferring the stock of a FICLBS. Investors can purchase the shares when they want to invest for benefit, or they can sell the shares when they predict they will lose their interest.¹⁰⁴ However, an investor of the Sino-foreign joint venture can't transfer the investment in that joint venture without all parties approving the transferring of an interest.¹⁰⁵ The added liquidity of shares of a stock company thus creates another advantage to investing in a FICLBS.

Third, employees may become employee-owners if they want to invest in their employer's FICLBS. The investing management and workers can participate in equity ownership of a FICLBS. In fact, motivating employees to improve their company was the initial purpose for which the Chinese government began to adopt this form of stock companies in China. That is why a large majority of state enterprises that have been reorganized as stock companies in China are "internal" stock companies—companies whose shares are held entirely by the state and by the management and workers of the enterprise.¹⁰⁶ Even in the listed stock companies, the employees have been given priority right to purchase certain amounts of the issuing shares of the companies. However, this is very difficult in a Sino-foreign joint venture because assigning all or part of ones own investment to a third party must be agreed to by all present owners, and approval from the administrative governmental authority is required.¹⁰⁷

Fourth, public shareholders in all FICLBS have greater protection against inadequate financing and management. The high fiduciary standards are set forth by numerous statutory legislation provisions. These pro-

¹⁰⁴ See Company Law, *supra* note 11, art. 143.

¹⁰⁵ See *Sino-Foreign Equity Joint Venture Law of the PRC*, *supra* note 4, art. 4.

¹⁰⁶ There are about 3,700 stock companies in China, only 69 of which are listed companies. The remainders are "internal" stock companies. See *More State Firms Liable for Profits and Losses*, CHINA DAILY, Aug. 12, 1993, at 1.

¹⁰⁷ See *Sino-Foreign Equity Joint Venture Law of the PRC*, *supra* note 4, art. 4.

visions require the FICLBS to satisfy certain standards in promoters' responsibilities and capitalization requirements. For example, "at least five or more promoters are required for the principal investing group;"¹⁰⁸ "at least one of the promoters shall have profit records for each of the three successive years prior to the share float if establishing through the share float method;"¹⁰⁹ "the minimum amount of total registered capital required is Renmibi 30 million Yuan."¹¹⁰ On the other hand, the standards of capitalization for investors of Sino-foreign joint ventures are extremely simple and lower. Anyone who has money to invest can establish a joint venture with others and the joint venture may also be dissolved easily.

Fifth, management of a FICLBS is chosen and controlled by majority shareholders. Investors of a FICLBS can control their investments through participation in management or policy decisions by purchasing and holding the majority shares. From a control perspective, the board of directors of a stock company is selected by a majority vote of the shareholders, so a shareholder who owns more than 50 percent of the common stock would in theory have total control over the board's composition. This majority shareholder has the right to elect more than 50 percent of the directors, to appoint all managers, and to dismiss all of the directors and managers.¹¹¹ In a joint venture, however, the parties generally negotiate an allocation of the board seats, and the board chairman and vice chairman positions are normally split between the foreign and Chinese parties.¹¹²

Moreover, the process by which major issues are decided in a FICLBS is preferable from a majority-shareholder's viewpoint. Two-thirds of a company's shareholders' votes are required to approve major activities including merger, separation, termination, and modification of the articles of association; and more than half of a company's shareholders' votes are required to approve the choice for chairman of the board and decisions of the board of directors.¹¹³ A group of shareholders representing a small percentage interest in the company cannot hold up the larger group. However, in a Sino-foreign joint venture, major issues must be decided by unanimous vote of the board of directors.¹¹⁴ The members of the board of directors are very often divided into one side as foreign investors and the other side as Chinese investors. If even one director in the joint venture opposes a particular action, a deadlock can arise.

Also, investors of a FICLBS can choose whether they take part in deciding company policy and management depending on their interest or time,

¹⁰⁸ Company Law, *supra* note 11, art. 75.

¹⁰⁹ Provisional Regulations on Several Issues, *supra* note 1, art. 6.

¹¹⁰ *Id.* art 7.

¹¹¹ See Company Law, *supra* note 11, chs. II & III.

¹¹² See *Sino-Foreign Equity Joint Venture Law of the PRC*, *supra* note 4, art. 6.

¹¹³ See Company Law, *supra* note 11, arts. 105, 106, 113, 117.

¹¹⁴ See *Sino-Foreign Equity Joint Venture Law of the PRC*, *supra* note 4, art. 6.

but investors in Sino-foreign joint ventures are obligated to participate in decision making and management. Furthermore, the shareholders of a FICLBS may enter into an agreement specifying the rights of each party to nominate a certain number of directors, but not in a joint venture.

D. Foreign Investors May See Some Disadvantages in FICLBS

There are several major disadvantages for a foreign investor purchasing shares in a FICLBS. First, the framework of the emerging Chinese security system may present an obstacle to an investor's interest in the FICLBS. As discussed above, the various strange classifications of stock systems conflict with each other and conflict with overseas stock markets. Therefore, overseas investors have to consider the Chinese practical meaning of "stock shares" of FICLBS and guard against potential legal conflicts. In the Sino-foreign joint ventures context, however, simple contractual structures of joint ventures are not difficult for investors to understand and play with. When there are conflicts of law, the Sino-foreign equity joint ventures laws supersede others.¹¹⁵ In this respect, Sino-foreign joint ventures are more attractive than the FICLBS to U.S. investors.

Second, establishing the FICLBS is a new development in China, and the relevant regulations will very likely undergo some substantial refinements in the near future. The procedures for establishing FICLBS are therefore not as familiar to foreign investors and are also more complicated than those required for establishment of a Sino-foreign joint venture. Also, the more complicated examinations and approvals by authorized departments of government for FICLBS may also be disliked.¹¹⁶

Third, there will be conflicts in the laws created to control and regulate the FICLBS. The Company law adopted by the highest level legislative authority, the People's Congress, allows the State Council to formulate separate regulations governing the issue of shares which are not covered by that law.¹¹⁷ The authorized relevant departments of the State Council have adopted several executive provisional regulations regarding establishment of FICLBS, including the Provisional Regulations on Several Issues. Hence, we may understand that FICLBS will be subject to these laws and regulations. Because of this, there will be problems for the investors when the laws conflict, for example, like conflicts of various stock classifications. Practically, in the case of conflicts, investors can follow the executive regulations according to precedents. In legal theory, however, a provisional regulation of the State cannot supersede a law of the People's Congress.

¹¹⁵ See Company Law, *supra* note 11, art. 18.

¹¹⁶ There are extra approval requirements from the securities management department of the State council. See *id.* arts. 84, 85, 86, 95, 131, 135, 139.

¹¹⁷ See *id.* art. 135.

By comparison, the legislation of Sino-foreign joint ventures are “ripe” parallel law systems because almost all of them are controlling absent specific provisions in other major company laws and related regulations. “If the provisions of relevant laws concerning Sino-foreign joint equity enterprises, Sino-foreign cooperative enterprises and Sino-foreign investment enterprises stipulate otherwise, such provisions shall apply.”¹¹⁸

E. Promoters of FICLBS Face Special Issues

Who is the promoter when an existing FIE is transformed to a FICLBS? Normally, the one initially providing the capital for the FICLBS will become the promoter. This is a general rule in both the U.S. and China. So an existing enterprise that elects to be transformed into a FICLBS ought to be the sole promoter for the transaction. However, this is not the case when a Chinese FIE is transformed into a FICLBS. The reason is that the original FIE will be dissolved and replaced by the FICLBS on a certain date according to their contractual agreement for the transformation. Since an existing FIE ceases to exist on an agreed date of transformation it could not be the promoter required to organize a new FICLBS when established. Therefore, only the investors of the original enterprises can be the promoters of the FICLBS rather than the original enterprises.¹¹⁹

Who will take over the rights and obligations of original FIEs? The rights and obligations of original FIEs are different from the rights and obligations of the FICLBS since each of them is created under different laws. These rights include creditors’ and debtors’ rights that continue to exist when the original FIEs are transformed into FICLBS. Chinese law requires that all of the old rights and obligations must still be taken over by the new FICLBS.¹²⁰ The method is that all of the rights and obligations of previous contract and articles of association are required to be written into establishing agreement and articles of association by the FICLBS, which it will assume when the new FICLBS takes over the original enterprise’s assets, rights and obligations.¹²¹

How does one calculate the capital of the original FIEs to the stock shares of the new FICLBS? When a FIE is approved for transformation to the new FICLBS, the amount of shares of the new FICLBS should be converted based on the real current or market value of the total assets of the old FIEs, rather than the old amount of registered capital.¹²² Meanwhile, the amounts of the shares owned by both Chinese and foreign parties must be

¹¹⁸ *Id.* art. 18.

¹¹⁹ See Provisional Regulations on Several Issues, *supra* note 1, art. 15.

¹²⁰ See Company Law, *supra* note 11, art. 100.

¹²¹ See Provisional Regulations on Several Issues, *supra* note 1, art. 17.

¹²² See Company Law, *supra* note 11, art. 99.

separately and clearly calculated.¹²³ The purposes of these provisions are: (1) to avoid overvaluation of the assets of the original FIEs because that would expose investors to unreasonable risk from lack of capitalization and indirectly reduce the required amount of investment that both Chinese and foreign investors should provide, and (2) to prevent the proportion of the capital owned by the foreign investing party from being artificially raised, which would reduce the investment amount that foreign investors should pay in.¹²⁴

Will the favorable government policy for the new FICLBS be rescinded if it arises out of an original FIE? No, it will not.¹²⁵ The reason is that FICLBS are basically one kind of FIEs in China. The favorable policy is on account of foreign investment, not on account of what kind of companies they are.

VII. THE MOST RECENT DEVELOPMENTS OF FICLBS

A. Use of FICLBS from 1996 to 1999

Based on statistics of the Chinese government, we can see the development of FICLBS in recent years. In 1997, six FICLBS were established, the amount of contractual foreign investment was USD 144 million, and the amount of actual foreign investment was USD 288 million.¹²⁶ In comparison, 9,046 Sino-foreign equity joint ventures, 2,371 Sino-foreign cooperative joint ventures and 9,604 wholly foreign-owned enterprises were established; their total amount of contractual foreign investment was about USD 51 billion and actual foreign investment was about USD 45 billion.¹²⁷

In 1998, nine FICLBS were established, the amount of contractual foreign investment was about USD 1 billion, the amount of actual foreign investment was USD 603 million.¹²⁸ In comparison, 8,146 Sino-foreign equity joint ventures, 2,010 Sino-foreign cooperative joint ventures and 9,674 wholly foreign-owned enterprises were established; their total amount of contractual foreign investment was about USD 31 billion and actual foreign investment was about USD 45 billion.¹²⁹

In 1999, when three FICLBS were established, the amount of contractual foreign investment was USD 103 million, the amount of actual foreign

¹²³ See *id.* art. 100.

¹²⁴ See Peifeng Li & Lixin Xun, *The Questions Regarding the Transforming Foreign Investment Enterprises*, 2 INT'L ECON. COOPERATION 55 (1996).

¹²⁵ See Provisional Regulations on Several Issues, *supra* note 1, art. 26.

¹²⁶ See *Utilization of Foreign Capital*, *supra* note 2.

¹²⁷ See *id.*

¹²⁸ See *id.*

¹²⁹ See *id.*

investment was USD 292 million.¹³⁰ In comparison, 7,065 Sino-foreign equity joint ventures, 1,654 Sino-foreign cooperative joint ventures and 8,370 wholly foreign-owned enterprises were established; their total amount of contractual foreign investment was about USD 41 billion and actual foreign investment was about USD 40 billion.¹³¹

B. FICLBS Trend To The Future

The above statistics show three aspects of the current status of the FICLBS. First, they are new projects to both Chinese and foreign investors because of their obvious limited quantity to date. Second, they are national security projects that satisfy China's important needs. They needed to be approved by the national administrative authority rather than regional or local authorities, and they needed extra examination and approval from the national security authority than other types of FIEs. Third, they are larger investment projects. The average amount of contractual foreign investment for the FICLBS is USD 87.6 million per project (in the past three years), which is approximate 41.27 times larger than the average amount of contractual foreign investment for the other three types of FIEs during the same period (USD 2.1 million per project). Therefore, the FICLBS are going in the direction of western type of public stock companies with major international investment.

The legislation of the FICLBS represents a giant step forward in China's effort to establish a foreign investment legal framework approaching the western model. Nevertheless, due to the legislation's weaknesses and national characteristics there is significant need for improvement. Chinese FICLBS may in time present very attractive opportunities for foreign investors as a new legal form of enterprise.

¹³⁰ *See id.*

¹³¹ *See id.*

