

THE COMPANY LAW OF CHINA

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INTRODUCTION

The Standing Committee of the Eighth National People's Congress approved the Company Law of the People's Republic of China (Company Law) in its Fifth Session on December 29, 1993. On the same day, the President of the People's Republic of China promulgated it, and the Company Law of China came into force on July 1, 1994.

The Company Law is important because for the first time in mainland China the organization and activity of business entities are regulated. For this reason, the Company Law is the foundation of modern socialist enterprises and the market economic system. Many new companies are expected to be established pursuant to the Company Law, and many existing enterprises such as state-owned enterprises, enterprises with foreign investment, and privately owned enterprises will be reorganized under the Company Law. This will allow for the establishment of modern enterprises with clearly defined ownership rights, with articulated boundaries regarding rights and duties between government and enterprises, and with the use of scientific management techniques. The promulgation of the Company Law is also a significant step toward China's compliance with international practices, especially in the field of Company Law.

I. LEGISLATION GOVERNING COMPANIES BEFORE ENACTMENT OF THE COMPANY LAW

Before the birth of the Company Law, China did have some laws and regulations with respect to companies.¹ These laws govern only certain

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1. *See, e.g.* Enterprises Law; Enterprise Bankruptcy Law; Regulation for Registration Management Regarding Industrial and Commercial Enterprises; Provisional Regulation Regarding Company Registration Management; Provisional Regulation On Nationwide Specialized Company Management; Law of the People's Republic of China on Joint Venture using Chinese and Foreign Investment; Wholly Foreign Owned Enterprise Law of the People's Republic of China; Standard Opinion on the Limited Liability Company; Standard Opinion on the Joint Stock Company with Limited Liability. Citations omitted. Throughout this essay, citations to the original Chinese language sources used will be omitted. Various English language translations are available, which the reader can easily consult by referring

kinds of companies or govern only certain aspects of a company. For example, the Enterprise Bankruptcy Law only deals with the bankruptcy of state-owned enterprises. Moreover, all these laws were formulated for use in a planned economy rather than in a market economy.

When state-owned companies and collectively owned companies were established, the company's capital was usually subscribed by a certain government department, and approved documents were issued by the competent government department. The business scope, registered capital, manager, and staff were also verified by the competent authorities. With these approval documents, a company would then apply to its local industrial and commercial administration for issuance of a business certificate.

In the early stage of company regulation after 1949, the People's Republic of China adopted a planned economy. Companies were subject to the state planning system and company managers were appointed by the appropriate government departments. A company's staff, property, materials and supply, production, and sales were arranged in terms of state planning. As the legal representative, the company managers did not have the power to decide the company's business and development schedule. The companies, in fact, were the objects of state planning and were subordinate to governmental departments. Between 1957 and 1978, after the achievement of socialist reform, only two ownership entities existed: the state-owned company and the collectively owned company.

The Regulation of the State-Owned Industrial Enterprises Work in 1961 encouraged enterprises to cooperate in a planned way so that materials could be supplied by appointed units. Companies established were actually administrative companies implementing production and sales plans according to state specifications. In 1964, the Central Committee of the Chinese Communist Party set up a trust. This was a major reform in industrial enterprise management. The trust in fact followed the former Soviet Union's mode of industrial integrated process to conduct specialized production by combining small, medium, and large enterprises' productions. All the trusts, whether nationwide or regional, were established in accordance with administrative orders and were state owned monopolies in an integrated industrial complex. The participating enterprises were not involved out of their own willingness, joining the complex with their own shares and losing their independent legal personality.

In 1979, the 3rd Session of the 11th Congress of the Chinese Communist Party advanced a reform and an open door policy. This Session marked China's transformation from a planned economy to a market economy. In 1980, the State Council approved the Provisional Regulation on the Promotion of Crosswise Economic Co-Operation which advocated setting up all forms of cooperative bodies based on an enterprise's

willingness and without restrictions on operation or ownership. This regulation was the basis of recently developed jointly run companies. Companies emerged quickly and in great number thereafter. By the end of 1986, the registered companies numbered approximately 300,000—including the state-owned, collectively owned, private, jointly run, and foreign invested companies.

However, companies remained unregulated, without guidance as to the establishment, registration, operation, merger, and dissolution of companies. Many companies were attached to government departments and took advantage of the government's power. Some companies with large registered capital had investors who withdrew their capital after the verification of capital—often called “bag companies.” Some so-called companies illegally took over the capital and property of other companies or enterprises. Some companies profited by bribing government officials who held powerful positions in such areas as controlling the sale of export licenses. These problems resulted in the State having difficulties controlling all of the companies.

Due to the chaos in the economic order, the State Council issued the Notification on Further Clearance and Rectification of Companies and the Provisional Regulation Regarding Company Registration Management (Provisional Regulation) in 1985. These regulations cut the attachment of companies to government; suggested that companies actually have the level of capital, technology, personnel, and facilities corresponding to their manufacturing and business plans; and stipulated that the establishment of all companies should be under prior approval by the State Council or its authorized departments and under registration. These regulations also stated that company business items must be verified; that companies should be the economic entities engaging in manufacturing and providing service; that a company's opening, closing or alteration should be publicized; and that all companies should undergo examination at the end of each year.

The Provisional Regulation restricted the establishment of companies by individual businessmen. It emphasized the government's control over the companies. This restriction was due to the belief that flexible business practices espoused by individual businessmen caused chaos within a company and unfair competition. This regulation was of strong planned economy color because it did not regulate all the companies by legislation, but instead regulated by restriction on individual businessman and companies.

In 1988, with the progress of the market economy, the State Council promulgated Provisional Regulation for Private Enterprises which allowed three forms of private enterprises—the sole proprietorship, the partnership, and the limited liability company (LLC). Article 5 provided that “LLC means the enterprise that the investor's liability to the company is limited to its investment while the company shall take the responsibility with its whole assets.” This regulation is a big step toward creating a socialist market economy and complying with international practices. The regulation

also confirmed the legality of private enterprises and advanced the commonly acceptable concept of LLC. However, the fast growing economy, incomplete company laws and regulations, and weak implementation of the laws resulted in a chaotic economy and the second rectification of companies in 1988.

In 1992, the State Restructuring Commission promulgated the Standard Opinions on the Limited Liability Company and the Standard Opinion on the Joint Stock Company with Limited Liability which provide much more detailed descriptions of the establishment procedures for an LLC and for a Joint Stock Company (JSC) with limited liability. The two Standard Opinions are still transitional regulations. They laid the foundation for the current Company Law, which in turn absorbed the two Standard Opinions.

II. THE COMPANY LAW OF CHINA

A. *The Legislative History*

The legislative history of the Company Law, first enacted in 1988, may be divided into three stages. The first stage was from 1983 to 1986. During this stage the State Economic Committee and the State Restructuring Commission began drafting the Company Law. At the time, the economy was predominately a planned economy. Companies were divided in terms of ownership, with most being completely state-owned. These companies did not have shareholders or a share rights system. It was difficult for these companies to enter into a market economy. Although a few standard LLC's existed, JSC's were non-existent. Only two separate regulations on LLC's and JSC's were drafted.

The second legislative stage lasted from 1986 to 1992. During this period, the LLC and the JSC regulations were drafted. The pros and cons of the operation of companies were documented and considered. The problems found during the rectification were numerous. First, the establishment of companies was not standardized, with most companies not having "true capital" ("bag companies"). Second, the Communist Party and State authorities set up companies to take advantage of their commercial and financial powers. Third, the organizational forms were not regulated, and there was no distinction between a company and other forms of enterprises. Fourth, most companies focused on commercial, trade, and financial fields, leading to chaos in circulating fields and to abnormal, abrupt inflation. Fifth, the lack of necessary restraint resulted in chaos and corruption the internal management and in the allotment systems of many companies. These problems gave the impression that companies were specializing in illegal business activities. After Deng Xiao Ping's speech in his tour to southern China, JSC's emerged. To meet this situation and to regulate the LLC and JSC, the State Restructuring Commission formulated the Standard Opinions on LLC and JSC.

The third legislative era was from 1992 to 1993. As the representatives of the National People's Congress and other interested parties encouraged the formulation of the Company Law, the State Council formally proposed the LLC draft law to the Standing Committee of the National People's Congress. The Committee members felt that to meet the developing needs of the market economy, the Company Law should be more broad and complete. In accordance with the chairman of the Standing Committee of the National People's Congress decision, the Law Work Committee of the Standing Committee placed draft LLC and JSC regulations in the Company law by revising the Standard Opinions, consulting with legal and economic experts and the relevant central and local authorities, as well as analyzing developed nations' company legislation.

In December of 1992, the Law Work Committee handed a draft of the Company Law to the Thirtieth Session of the Seventh National People's Congress for examination. In June of 1993, after many revisions, the Company Law draft was handed to the Second Session of the Eighth National People's Congress for reexamination. The Company Law was approved by the Fifth Session of the Standing Committee of the Eighth National People's Congress.

B. The Contents of the Company Law of China

The Company Law of China absorbed the successful points of other nations' corporate law, yet retains its own Chinese characteristics. The Company Law is divided into eleven chapters with 230 articles. The first chapter deals with general principles, while the second chapter describes the establishment of LLC's and their organizational structures. The third chapter deals with the establishment of JSC's and their organizational structure. The fourth chapter is concerned with issuance and transfer of shares of JSC's. The fifth chapter relates to company debenture, while the sixth chapter deals with company finance and accounting. The seventh chapter covers mergers and divisions, while the eighth chapter governs a company's bankruptcy, dissolution and liquidation. The ninth chapter concerns branches and subsidiaries of foreign companies. The tenth chapter describes legal liability, and the eleventh chapter is the appendix.

For the fifteen years since China's opening to the outside world, the concept of the company has been quite ambiguous. It does not differ from the concept of general enterprise. The Provisional Regulation Regarding Company Registration Management (1985) provides that the "company" in this regulation means "the economic entity engaging in production, trade or service industry which is established pursuant to the formalities provided by this regulation and has its own assets and conducts business on its own decisions and undertakes its own losses and taking the economic liabilities

in accordance with the laws."² There is no substantial difference between this definition and the definition of a general enterprise.

The Company Law provides that LLC's and JSC's are legal enterprise entities.³ As of LLC, the shareholder's liability to the company shall take the liability to debts with its whole assets. As of JSC, its whole assets shall be divided into equal shares, with the shareholder's liability limited to the shares subscribed; the company shall take the liability to debts with its whole assets. The Company Law only governs LLC's and JSC's within Chinese territory. It does not govern other forms of companies within Chinese territory, so the Company Law does not give a common definition of all forms of companies.

Under the current socialist market economy in China, a company should, for the purpose of profit-making, be a legal enterprise entity established pursuant to laws and based on shareholder's investment. The General Principles of Civil Law requires that a legal entity should meet the following requirements: be established pursuant to laws; have its own assets or capital; have its own name, organizational structure and residence; and independently take civil liability.

C. Companies Established Before the Enforcement of the Company Law

Even before the enforcement of the Company Law of China, there were a great deal of companies. As the Company Law of China only governs LLC's and JSC's, how to deal with the existing non-LLC and non-JSC companies established before the enforcement of the Company Law became a problem. According to Article 229 of the Company Law, the companies established pursuant to laws, regulations, local laws, and the Standard Opinions on LLC's and JSC's before the enforcement of this law, as well as those not in compliance with this law, shall remain and shall meet the legal requirements within a stipulated time.⁴ The State Council is required to set the stipulated time. However, the State Council still has not promulgated the enforcement rule or set the deadline for the companies not in compliance. These companies will likely continue to exist for a considerable period of time.

Recently, the State Industrial and Commercial Administration, the highest authority on company registration in China, promulgated Certain Opinions on Implementation of Company Registration Regulation of the People's Republic of China. The Opinion in Article 1 provides that from the date of enforcement of the Company Law and the Company Registration Regulation, new companies shall be registered pursuant to the Company

2. Provisional Regulation Regarding Company Registration Management, art. 2 (1985).

3. *Id.* art. 3.

4. The Company Law, art. 229.

Law and the Company Registration Regulation. Those not in compliance with the above mentioned Law and Regulation shall not be regarded as legitimately registered LLC's or JSC's and shall not be named as companies.

From the above statement, it is clear that after a certain period of time forms of companies other than LLC's and JSC's will not exist because the Company Law only confirms the legality of LLC's and JSC's. Contrary to the Chinese Company Law, the company laws of many other countries confirm not only LLC's and JSC's but also other forms of companies. For instance, the British Companies Act governs LLC's including Companies Limited by shares, those limited by guarantee, and those unlimited. The Hong Kong Companies Ordinance also permits LLC's and JSC's limited by guarantee and those that are unlimited companies. In Japan, four different legal forms of companies exist under color of law: the partnership, the limited partnership, the limited company, and the stock corporation.

D. Company's Approvals And Registration

The Company Law of China stipulates that LLC's or JSC's must be registered if the terms and conditions provided in the law are met; otherwise nothing could be registered as an LLC or JSC.⁵ If other laws or regulations require prior approval for certain kinds of companies, the companies shall be subject to prior approval before the registration.

This stipulation is a major breakthrough from the original procedures. Before the Company Law, all the investors had to obtain prior approvals from the state planning departments and competent authorities. After obtaining these approval documents, application for registration of a company could be made. According to current Company Law, if the business items are not required by law or regulation for special approvals, the shareholders or promoter may, with the articles of association and capital verification report issued by a certified accountant or auditor and other documents, directly apply for issuance of a business certificate to establish an LLC. This is a major measure of China's company registration reform in compliance with international practices. However, this does not mean the state will not control the registration of companies, as Articles 8 and 11 require companies in certain industries or businesses to be subject to prior approval.

In connection with these provisions, the Company Law requires prior approvals in certain situations. First, the laws or regulations require prior approval for certain companies, the typical example of which is that all the foreign funded companies are now subject to such from the State Planning Commission and the Ministry of Foreign Trade and Economic Co-operation or their authorized authorities. Second, the laws or regulations require certain business items be subject to approval, such as manufactory and sales

5. The Company Law, art. 8.

of goods made of gold or silver. In these case, the promoters or shareholders may with these approval documents and other documents apply to local industrial and commercial administration for issuance of business certificates.

E. *A Company's Name*

In accordance with the Company's Law, the company's name shall indicate certain things, including the following: (1) whether the company is an LLC or a JSC; (2) the registration authority's jurisdiction; (3) the company's trade and business character; and (4) the company's trade name. Pursuant to article 14 of the Company Registration Regulation of the People's Republic of China, the company's name shall be verified. If laws or regulations require prior approval for certain companies or prior approval for certain business items, then the company's name shall be previously verified before the application for prior approval. The application for approval shall carry the company's name verified by the company's registration authority. When the company's name goes through previous verification, the following documents must be presented: (1) an application for previous verification of company's names signed by all shareholders of the LLC or all promoters of the JSC; (2) the shareholder's or promoter's legal person certificates or the natural person's identity certificate; (3) and such other documents as may be required for the company's registration. The company's registration authority shall, within 10 days from the date of receipt of the above-mentioned documents, decide to verify or not to verify. If the company's registration authority decides to verify the company's name, it shall issue Previous Verification Notification of Enterprise's Name. The previous verified name shall remain valid for six months within the period, and no business shall be conducted unless the company has been established. The verified company's name is non-transferable.

Protection of a company's name is not as strong as the protection of a trademark or patent. There are no special provisions in the criminal law for protection of a company's name. China has become a member state of the Paris Treaty on the Protection of Intellectual Property which has undertaken the obligations of the protection of intellectual property including the protection of a foreign company's name. In comparison, sections 20.21 and 22 of the Hong Kong Companies Ordinance provides detailed requirements on the use and the registration of a company's name. These sections prohibit the use of certain names and regulate the change of a company's name.

F. *A Company's Residence*

A company's residence will have various legal effects in China. First, in civil litigation, it is the basic standard used to determine a court's

jurisdiction and a legal document's delivery.⁶ Second, in contract relation, if the place of performance is not clear, the company's residence determines the place of performance of a contract.⁷ Third, a company's residence should comply with the jurisdiction of the industrial and commercial administration authority. Finally, in foreign civil relations, a company's residence decides the application of the proper law.

Designation of the place of the company's residence is one of the necessary requirements for establishing a company⁸ and should be decided before attempting to establish a company. The residence shall be the location of the principle office.⁹ The residence is one of the registered matters, and any alteration of a company's residence shall be reported to the company registration authority. When the applicant applies for company registration, evidence must be presented to prove the company is entitled to the use of the residence.¹⁰ In general, a company's residence must be in compliance with its registered office. In contrast, Singapore and Hong Kong Company Laws only require the registered offices of a company to be in the country or region. Usually, the registered offices are in solicitors' offices or certified accountants' offices, while the business locations or residences are in other places.

G. *A Company's Capital*

In the Company Law and the germane regulations, "capital" has multiple meanings. Registered capital: (1) must be carried in the articles of association;¹¹ (2) must be raised sufficiently before the establishment of the company; (3) shall not be less than the minimum limit;¹² and (4) must be registered. According to relevant laws and regulations, the registered capital must be in conformity with the paid up capital.

Great Britain and its former colonies, such as Australia, Singapore, Hong Kong, and New Zealand, adopt authorized capital, allowing the capital to be paid by installments. Consequently, there are concepts such as unpaid capital, issued capital, uncalled capital, reserve capital, and the like. In comparison, China imposes harsher requirement on capital. The Company Law requires that total capital must be carried in a company's articles of association, that it shall not be less than the minimum limit, and that it must be raised sufficiently when the company is established. The capital is fixed to maintain a company's capacity of repayment of debts and to protect the creditor's interests; the amount of the company's reinvestment to set up its

6. The Civil Litigation Law of the People's Republic of China, art 79.

7. The General Principle of Civil Law, art 88.

8. The Company Law of China, art. 79.

9. The Company Law, art. 10.

10. Company Registration Regulation.

11. The Company Law, arts. 22, 79.

12. *Id.* arts. 23, 78.

subsidiary or other enterprises shall not exceed 50% of its net assets.¹³ In addition, the JSC shall not issue stocks at a price below par value.¹⁴ Except for the special purposes by special procedure as stipulated in the Company Law, a company may not redeem its own stock,¹⁵ and a company may not, before making up for losses and drawing accumulated funds and public welfare funds, distribute profits to its shareholders.¹⁶ In addition, a company's registered capital shall not be altered unless legal procedures are followed. According to the Company Law, any increase or decrease of registered capital shall be approved at a shareholders' meeting. Meanwhile, a company's balance sheet and asset inventory shall be made for reduction of registered capital. Notification to the creditors should be issued and publication for reduction shall be made in a newspaper at least three times within thirty days.¹⁷ Any violation of these stipulations may result in fines.

H. *Limited Liability Company (LLC)*

According to Article 3 of the Company Law, shareholders of an LLC shall be liable to the company with their subscription, but the company shall take full responsibility for its debts with its whole assets. An LLC under the Company Law is similar to a private company limited under the laws of Britain, Hong Kong, and Singapore and a close corporation under U.S. law.

Certain requirements must be met before setting up an LLC. First, membership shall not be less than two members and not more than fifty. An exception is for state-owned companies which may have less than two members. This requirement is in conformity with other countries. The Hong Kong Companies Ordinance provides the same requirement in sections 4 and 29. Japan, France, and Belgium also limit membership to fifty members. However, the Company Law permits a state-owned LLC with a sole investor.¹⁸ This stipulation has taken into account the fact that most of the state-owned enterprises are created by single investor.

Second, an LLC must meet a minimal level of capital via shareholder's subscription. According to article 23 of the Company Law of China, an LLC's registered capital shall be the paid-up capital registered in the company's registration authority. The Company Law imposes varying requirements on different LLC's. Some of these varying requirements include: (1) not less than RMB 500,000¹⁹ for a manufactory LLC; (2) not less than RMB 500,000 for wholesale LLC; (3) not less than RMB 300,000

13. *Id.* art. 12.

14. *Id.* art. 131.

15. *Id.* art. 149.

16. *Id.* art. 177.

17. *Id.* art. 116.

18. *Id.* arts. 21, 64.

19. U.S. \$1 is equal to 85 RMB.

for retail LLC; and (4) not less than RMB 100,000 for technological development, consultation, and service LLC's. The Company Law also stipulates that other laws or regulations may impose requirements which demand the minimum registered capital for an LLC on special industries higher than the above-mentioned. The Company Law also permits the shareholders to subscribe with other property, intellectual property, non-patent technology, and any land use right other than capital. All of these must be fairly appraised. In practice it is difficult to know the real value of intellectual property and non-patent technology. For this reason, the Company Law provides that subscription with intellectual property shall not exceed 20% of the registered capital. The shareholders shall, if subscribing with capital, deposit the sufficient capital into the LLC's provisional account in a bank. If subscribing with other property, intellectual property, non-patent technology or land use right, the shareholder shall transfer the rights to them to the LLC.²⁰ After sufficient subscription, a legal verification institution shall be invited to verify the subscription, and a capital verification certificate shall be issued by the institution. However, the Company Law does not specify what institutions are legal verification institutions. Before the enforcement of the Company Law, a bank's certified accountant office, or auditor's office might issue valid capital verification certificates. Company registration authorities would accept these certificates. But only certified accountants may verify the subscription of foreign funded enterprises.

Third, shareholders must make articles of association. An LLC's articles of association comprise the written document stating the company's organizational rules and regulating the company's actions. It should be signed by all of the shareholders jointly. The articles of association are binding on all shareholders, a company's organizational structure and a company's staff. The following matters are required to be carried in articles of association: (a) the company's name and its residence; (b) the company's business scope; (c) the company's registered capital; (d) the names of the shareholders; (e) the rights and obligations of shareholders; (f) the subscription means and amounts for each shareholder; (g) the terms and conditions for transfer of a shareholder's subscription; (h) the company's structure and a summary of all powers and rules of procedure; (i) the name of the company's legal representative; (j) the company's dissolution and liquidation provisions; and (k) such other matters as shareholders think necessary.

Fourth, the LLC shall have a name and should establish an organizational structure. LLC's should not dispense with the wording "limited" in Chinese characters. Section 21 of the Hong Kong Companies Ordinance allows companies to dispense with "limited" if such company was established in order to promote commerce, art, religion, charity or any

20. The Company Law, art. 25.

other useful object and prohibits the payment of any dividend to its members.

Finally, LLC's shall have a fixed manufacturing and business location and maintain the necessary facilities, such as a factory building, machinery, transportation vehicles, technology, and professional personnel.

I. Procedures for Establishing LLC

The following are nine procedures required to establish an LLC. The first step involves the promoter's promotion. After a feasibility analysis, the promoters shall sign a promotion agreement or meeting resolution. Before the establishment of a company, promoters should take joint and unlimited liability. In this stage, their agreement or resolution is regarded as a partnership agreement.

Second, articles of association must be drafted. The articles of association regulate all of the involved parties' actions. Consequently, the articles of association must strictly comply with all applicable laws and regulations. Hong Kong and Singapore company laws require the articles of association to be attested by third parties (usually solicitors). The Company Law of China does not impose this requirement, but it requires all shareholders' signatures. The articles of association shall come into force after its approval by a company's registration authority.

Third, the necessary approval must be obtained. In most circumstances, promoters may directly apply for registration of a company without other authority's approval. However, in certain situations prior approval from some other authority is required.²¹ Currently, companies engaging in (without limitation to) tobacco, stock, finance, and medicine shall be previously approved.

Fourth, capital must be accumulated through subscription. When signing a promotion agreement or articles of association, the promoters shall subscribe their investment. If the subscription is in money, it shall be deposited in the company's provisional bank account. If the subscription is in property, intellectual property, non-patent technology, or a land-use right, all their rights shall be transferred to the company.

Fifth, certification of subscription is necessary. After the full subscription of their investment, the promoters shall invite an eligible verification institution to verify the subscription and request the institution to issue a capital verification certificate.

Sixth, the company must apply for registration. After satisfaction of the formalities, the promoters or their agents may directly apply to the company's registration authority for registration of the company. This is done with a written registration application and requires attachment of the articles of association, capital verification certificate, and approval

21. The Company Law, art. 8.

documents if so required by law or regulation. An application for setting up a branch shall be submitted if the branch is intended to be set up at the same time.

Seventh, registration and issuance of business certificate follows. A company registration authority shall examine the application and issue a business certificate for those qualified. The issuing date of the business certificate is the date of the LLC's establishment. The company may conduct business thereafter. An LLC's branch may conduct business after obtaining a business certificate, but all liability shall be borne by the LLC itself.²²

After establishment, the LLC shall issue subscription certificates to the shareholders who have fully subscribed their investment. The subscription certificate shall carry the following matters: (a) the company's name; (b) the registration date of the company; (c) the company's registered capital; (d) the shareholder's name and their subscription date; and (e) the subscription's number and issuing date. The subscription certificate shall be affixed with the common seal of the company, and the subscription is neither freely transferable nor negotiable. Chinese laws and regulations prohibit the Communist Party and State organizations from being shareholders. Those who hold stock in another company may be shareholders in this company; however, other companies may not hold stock of other companies.

The company shall prepare a shareholders' book to register the shareholders' names and places of residence, the shareholder's subscription amount, and the number of subscription certificates. The rights of the shareholders include the following: to attend the shareholder's meeting and at such to participate in the making of policy and to choose the managers; to be eligible to be elected as the director of the board and a member of the supervision council; to obtain the distribution of dividend in proportion to each shareholder's investment; to transfer his subscription and to enjoy the right of first refusal for purchase of other shareholder's in any transfer of subscription; to examine the minutes of the shareholder's meetings, any recordings, financial reports and statements; to supervise the company's business activities; to obtain the distribution of the company's spare assets when the company is dissolved; to enjoy other legal rights.

The shareholder's obligations, on the other hand, include the following: to pay in full his investment; to refrain from withdrawing his investment after the registration of the company; to abide by the company's articles of association; to be loyal to the company and to other shareholders; to execute his rights pursuant to legal procedures; to perform other legal obligations required of him.

22. The Company Law, arts. 13 and 2.

J. LLC's Organizational Structure

An LLC shall make policy, implement the policy, and supervise the establishment of the power structure, the administration, and any supervisory organs. The shareholder's meeting is the power organ for the LLC. The meeting is a non-standing organ comprised of all shareholders expressing the company's ideas. Except for solely state-owned or foreign funded LLC's, each LLC has shareholder meetings. The meeting shall not represent the company externally and shall not conduct the actual concrete business of the LLC. This does not mean that the shareholders are not permitted to engage in the company's business when they become members of the administrative organ. With the latter, identity is no longer that of a shareholder.

According to article 38 of the Company Law of China, the shareholder's meeting is to perform the following function: to decide the company's business principles and investment plan; to elect and change directors and decide the remuneration of directors; to elect and change the supervisory councilors and to decide the remuneration of the supervisory councilors; to examine and approve the board's report; to examine and approve the supervisory council or supervisory councilor's report; to examine and approve the company's annual financial budget and final accounts; to examine and approve the company's profit distribution plan and the losses remedy plan; to make resolution on any increase or decrease of the company's registered capital; to make resolution on issuance of the company's debentures; to make resolution on transfer of shares to non-shareholders; to make resolution on the company's merging, division, dissolution, liquidation or alteration of its form; and to amend the company's articles of association.

Many countries grant different powers to shareholders for actions during their meetings. Under the Company Law, the first shareholder's meeting shall be convened and presided over by the shareholder owning the most shares. The shareholder's regular meeting shall be held according to articles of association. Shareholders representing 1/4 or more voting power of 1/3 or more directors or supervision council may suggest holding a provisional meeting. The shareholder's meeting shall be presided over by the chairman of the board or his appointed vice chairman or director. Notice of the shareholder's meeting should be issued fifteen days prior to the meeting to each shareholder. The meeting record shall be signed by all attending shareholders.

The company's administrative organ is the board of directors or executive director. The directors should be elected by the shareholders at their meeting. The board of directors or executive director is to perform the shareholder resolutions, authorized matters, or any other matter set in the articles of association and to engage in day-to-day management and representation of the company externally.

According to the Company Law, an LLC's board shall have the following powers: to convene shareholder meetings and report its work to such meeting; to implement all the resolutions passed by shareholders at their meetings; to make the company's business plan and investment schemes; to make the company's annual budget and prepare its final accounts; to make the company's profit distribution proposals and losses remedy plan; to make proposals for any increase or decrease of the company's registered capital; to make proposals for the company regarding possible merger, division, alteration, or dissolution; to decide the company's internal administration structures; to employ or dismiss the company's manager, and according to the manager's recommendation, to employ the company's vice manager and person in charge of the company's finances, and to decide their remuneration; and to make the company's administrative rules.

For an LLC without a board, the executive director's powers may be made similar to those of the board as set out in the articles of association. In accordance with the Company Law, the board shall be composed of three to fifteen directors. The Company Law requires that for an LLC invested in by two or more state-owned enterprises, the board should have a staff representative who shall be democratically elected by the staff. The board shall have one chairman and one or two vice chairmen. The election rules for chairman or vice chairmen may be set in the articles of association. The chairman of the board is the legal representative. For an LLC without a board, the executive director should be the legal representative.

The tenure for each director's position may be set in the articles of association, but each position period shall not exceed three years. The director shall continue his position if elected continually. Before the expiration of the director's position, the shareholders shall not dismiss the director from his post without legal cause. The Company Law, however, does not specify the causes under which the director's position could be terminated; so the causes shall be set in the articles of association and other relevant regulations or stipulated to in compulsory legal documents.

The board meeting shall be convened by the chairmen of the board or his authorized director. The directors with one-third or more members of the board may propose to open the board meeting. The notice for the board meeting shall be issued to all of the board members 10 days prior to the board meeting.

All the members attending the board meeting shall sign their names on the meeting record book. The company's manager, who is appointed by the board, shall preside over the day-to-day management of the company, and he shall be responsible to the board. If he is incapable of his duties or is in violation of any laws, regulations, or the company's own articles of association, the board may dismiss him. The executive director of an LLC operating without a board is permitted to be the company's manager.

The Company Law does not specify the situation which will result in the compensation of the director in default to the company or if the company or shareholders may file litigation against the director in default. In Japan, the commercial code was revised in part as of June 4, 1993, and came into force as of October 1 of the same year. One feature of this revised code proposed to make derivative action by shareholders more available than they have been. A derivative action refers to a legal action filed by a shareholder on behalf of the company because of the failure by directors of the company to take the necessary legal action for some failing by the company or its board of directors. This is a means of strengthening the duties of the company's directors and any individual shareholder's rights. Where a legal action is used, the auditor of the company is, in principle, entitled to institute a suit against the board of directors and represent the company.²³

K. *The Supervisory Organ*

The Company Law provides that LLC's shall have a supervisory organ in the form of either a council or a councilor. The duty of this supervisory organ is to supervise the business activities of the company's administrative organ. The supervisory councilor may, when he performs his duty, represent the company externally.

The supervisory council or supervisory councilors shall exercise the following functions or powers: to examine the company's finances; to supervise the directors' or managers' acts for violations of laws, regulations, or the articles of association when they exercise their duties; to require the director or manager to rectify their acts prejudicing the company's interests; to propose to hold provisional shareholder meetings; to exercise other powers as provided by the articles of association of the company.²⁴

The supervisory councilors may attend shareholder's meetings. According to the article 52, the directors and managers are not permitted to act as the supervisory councilors. In addition, the Company Law provides that the supervisory council is to be, in part, made up representatives from the staff and also shareholders. The Company Law prohibits certain kinds of persons acting as directors or supervisory councilors, such as incapable persons, persons who are personally liable for the enterprise's bankruptcy, and these committing economic offenses.

23. Commercial Code 275(4)

24. The Company Law, art. 54.

L. Transfer of Subscription and Increases or Decrease Of Registered Capital

The Company Law of China restricts the LLC shareholder from free transfer of his subscription. Any shareholder may transfer his shares to another shareholder of the same company. But if the shares are to be transferred to a person other than a shareholder of the same company, consent of more than 5% of shareholders is required. The shareholders not consenting to the transfer should purchase the transferred shares or the nonpurchase shall be regarded as consent to the share transfer. Any other shareholder has the right of first refusal for purchase of transferred shares.

Any increase in an LLC's registered capital must be based on special resolution at a shareholder meeting. The articles regarding the registered capital and subscription should be altered accordingly. After a shareholder's subscription, he shall apply for alteration of registration. For decrease of capital, the shareholders shall deal with the same formalities as increase of capital. Furthermore, the shareholders shall, within ten days after the resolution notify the creditors and shall disclose it in the newspaper by publication at least three times. The creditors may within thirty days after the acceptance of notification or ninety days after the first disclosure in the newspaper, demand the company to settle the debts or to provide guarantee.

M. Wholly State-Owned LLC

The permission of wholly state-owned LLC's reflects the characteristic of China's state-dominated economy, and it is also the character of the Company Law of China. Currently, many companies in China are state-owned enterprises and companies. These companies will gradually be transformed into wholly state-owned LLC's. Wholly state-owned LLC's shall not have shareholder meetings; rather, the board of directors shall perform part of shareholders' duties and decide important matters. But the problems regarding the company's merger, division, dissolution, increase or decrease of the registered capital, and issuance of the company's debentures must be decided by the state authorized investment institutions or departments which will exercise the powers of supervision and management of state owned assets.

The main distinction between wholly state-owned LLC's and other LLC's include the following. First, boards of wholly state-owned LLC's possess more powers than boards of ordinary LLC's. Second, only one investor is allowed in a wholly-state owned LLC while ordinary LLC's are allowed to have two or more investors. Third, wholly state-owned companies may, under prior approval, issue the company's debentures while ordinary LLC's are not so permitted. Fourth, designated fields, professions, and special product companies are required to take the form of a wholly state-owned LLC.

N. *JSC's Establishment Procedures*

The number of promoters for a JSC must meet the minimum legal requirement of five or more, among which at least half must be a resident within Chinese territory. For wholly state-owned enterprises, which are to be transformed into JSC's, there may be less than five promoters, but it shall be established by raising capital. Likewise, the share capital subscribed by the promoters or the public must reach the minimum legal requirement. According to the Company Law of China, JSC's lowest registered capital amount shall not be lower than RMB 10 million.

The issuance of shares and preparation of other official company matters must comply with all applicable laws and regulations. The articles of association made by the promoter must be approved at the establishing meeting. The company's name must be chosen and the company's structure must comply with the legal requirements for a JSC. The fixed production or business location must be available, and other necessary production and business conditions must be ready.

O. *Documents Required by the Company Registration Authority for the Establishment of a JSC*

According the Company Registration Regulation of the People's Republic of China, the applicants should present the following documents to the company registration authority. A written application signed by the chairman of the board is required for the establishment of a JSC. Appropriate approval documents must be issued by the State Council, authorized departments, or the provincial, autonomous region or municipal governments, with approval documents issued by the State Council Securities Administration if the JSC is established by means of raising capital. A copy of the meeting record of the establishing meeting is also required, along with the company's articles of association, an audited financial report for the prepared JSC, a capital verification report issued by a legal verification institution. In addition, legal personality proof or natural person identity cards of the promoters are necessary, as is a certified document indicating the JSC's directors, supervisory councilors, and the manager's names, residences, and their dates of employment election or appointment. An appointment document for the company's legal representative and his identity certificate is also necessary. Finally, the previously verified name of the JSC and the company's residence proof completes the list of necessary documentation.

One of the distinct characteristics in establishing JSC's is that the JSC must be approved by the State Council authorized department or provincial level government, in addition to the State Council Securities Administration. This is not required in the establishment of LLC's. The requirement for JSC's implies that the government is more cautious and prudent in

establishing JSC's. This requirement also reflects the fact that since JSC's have more capital, the public has a direct interest. This public interest is in avoiding social instability on the one hand, and because Chinese securities markets are still not mature, in preventing securities fraud on the other hand. Consequently, it is necessary to strengthen the state's participation and control. After obtaining the above-mentioned approvals and formalities, the promoters or their agents may apply for registration of the JSC.

The Company Law provides that JSC's may be established by means of promotion by raising capital. Establishment by means of promotion means that all the shares of the JSC are subscribed by all of the promoters. Establishment by means of raising capital means that the promoters subscribe part of the issued shares, and the other shares are sold to the public. In this situation, the promoters should subscribe at least 35% of all issued shares. The promoters must submit written applications for capital raising to the State Council Securities Administration, together with the following documents: (1) prospectus; (2) articles of association; (3) business estimation; (4) each promoter's name, subscribing share numbers, and subscription means along with a capital verification certificate; (5) approval documents for the establishment of the JSC; (6) the name and address of the agency bank for accepting the share capital; and (7) the name of the institutional underwriter and a copy of the underwriting agreement.

Without prior approval from the State Council Securities Administration, the promoter should not issue shares to the public. In accordance with the State Council's Special Stipulation on Issuing and Listing of JSC Shares Outside Chinese Territory (Special Stipulations), a JSC may issue shares outside Chinese territory after prior approval of the State Council Securities Administration. The stocks may be traded in the Stock Exchanges outside China, but the applicant should submit written application and such other materials as required by the State Council Securities Administration for approval. The shares issued and listed abroad (foreign capital shares) should take the form of registered stocks or other stock forms indicating RMB par value and subscribed with foreign currency. If the state-owned or state asset-dominated enterprises are restructured to be JSC's, issuing and listing their shares abroad as such, the JSC's promoters may be less than five, but only if established by means of promotion. If they are so established, they may issue shares. A JSC which has issued shares and been listed abroad may issue its shares ("domestic shares") to domestic investors, but its domestic shares should be registered. After the board's issuance of foreign shares and approval of the domestic shares scheme by the State Council Securities Administration, the JSC may make arrangements and implement them within fifteen months of the above approvals. The JSC's foreign and domestic share's issuance schemes should be disclosed in its prospectus. Any adjustment of the scheme must be disclosed again. All the planned foreign and domestic shares must be raised unless otherwise approved by the State Council Securities Administration.

The State Council Securities Administration and the company registration authority may provide compulsory articles to be set by all JSC's in their articles of association. JSC's articles of association are binding on the JSC, its directors, shareholders, supervisory councilors, managers and other senior management staff (including the person in charge of the JSC's finances). These persons have rights and can claim their rights by tendering a request for arbitration or submitting to litigation pursuant to the articles of association. Meanwhile these persons have the obligation to be loyal and diligent to the company. They should at all times abide by the company's articles of association and safeguard the company's interests, and at no time shall they take advantage of their powers for their own interests. The owners of foreign shares may, pursuant to the laws where the shareholders' book is maintained or where the stocks are listed, request to register their stocks under their nominal beneficial owners. The foreign shareholders' book is strong evidence to prove that the shares are owned by the shareholders.

Any allegation of alteration of the foreign shareholders' book may be ruled on by the foreign court having jurisdiction if so required by its local laws. The foreign shareholders may apply for reissuance of the stocks according to stipulations of the place where the original shareholders' book is kept or the foreign Stock Exchange rules if they lose the stocks. The notice for holding shareholder meetings should be issued forty-five days prior to the meeting in which the matters are expected to be discussed, with the date and place for the meeting specified. Shareholders expecting to attend the meeting shall answer in writing to the company twenty days before the meeting. The shareholders who have more than 5% voting right may put forward new proposals in writing at the annual shareholder meeting. The company shall list the proposals on the meeting's agenda if they fall within the scope of the called shareholder meeting.

The company shall retain an independent certified accountant's office to audit the company's annual report and verify other financial statements. The company's payment of dividend and other money shall be declared in RMB and paid in foreign currency. Any dispute in connection with the articles of association or matters between foreign shareholders and domestic shareholders, between the shareholders and directors, manager, and the supervisory councilor, and between foreign shareholders and the company shall be settled by the method set in the articles of association and shall be governed by the laws and regulations of the People's Republic of China.

In terms of the Company Law of China, if the company capital is raised from the public, a prospectus with articles of association must be made and the following matters should be set therein: (1) total share subscribed by the promoters; (2) par value and the issuing price; (3) total amount of unregistered shares; (4) subscriber's rights and obligations; and (5) starting and expiration dates of any attempt to raise capital and an explanation for withdrawal of subscription in case the unsuccessful attempt

goes past the deadline. In addition, the shares should be underwritten by legal securities institutions. After sufficient capital has been raised, the verification institution shall be asked to issue a certificate. The promoters shall then hold an establishing meeting within thirty days, which all the subscribers shall attend.

The establishing meeting shall implement the following powers and say who holds these powers: (1) the power to examine the promoter's report for the preparation of the company; (2) to approve the company's articles of association; (3) to elect the directors of the board; (4) to elect the company's supervisory councilors; (5) to examine the preparation cost estimate for establishing the company; (6) to examine the value of the promoter's assets used for the promoter's subscription; and (7) to decline to establish the company in the case of force majeure or a substantial change of business conditions. The Powers shall be approved by more than half of the attending subscribers. The JSC's promoters shall be jointly liable for the debts in the event the company is unsuccessful. In the establishing process, the promoters should compensate the company if the company's interests are damaged through any action of any of the promoters. The LLC may, after approval, be reorganized as a JSC.

P. Organizational Structures of JSC's

As a JSC usually concerns a wider range of interests, it must establish perfect structures in compliance with the Company Law. The structures of a JSC shall include: shareholder's meeting, board of directors, and a management and supervisory council. All of the organs have similar powers, rights, and obligations as an LLC, but an executive director and supervisory council may not replace the board and supervisory council respectively.

Q. Issuance and Transfer of JSC Shares

The capital of a JSC is divided into shares of equal value. The issuing price of shares may exceed the par value, but the issuing price cannot lower the par value. Prior approval from the State Council Securities Administration is required. Stocks that are issued to the promoters, to the state authorized institutions, or to legal persons must be registered before shares can be issued with a higher price than the par value. Stocks issued to the public may be registered or unregistered.

The Company Law of China does not provide specific stipulations regarding the classes of shares. Preference shares or deferred shares do not exist. However, the Company Law authorizes the State Council to determine whether or not to create other classes of shares. The State Council and its agencies are reportedly considering whether or not to draft rules or regulations regarding issuance of preference shares, company employee shares, or special RMB shares.

The company shall, if issuing registered stocks, prepare the shareholders' book to reflect the following information: each shareholder's name and residence, the amount and number of each holder's stocks, and the date of acquisition. For unregistered stocks, the company shall retain a record of the number, amount, and issuing date. The company may issue new stocks if all the terms and conditions are met and approval is obtained. After sufficient capital has been raised, the company must apply for registration and publish its intent to issue stock.

The issued shares are transferable in legal stock exchanges. The promoter's stocks are prohibited from transfer within three years from the date of establishment of the company. The company's directors, supervisory councilors, or manager should not transfer all of their personal shares during their position period. The state authorized investment institutions may transfer the stocks they hold and may also purchase the stocks other shareholders hold. But the transfer and purchase are subject to approval. Companies should not purchase their own stocks, unless for the purposes of reducing their capital or merging with other companies having their shares. In the latter case, alteration of registration and publication are required within ten days from the date of partial deduction of the registered capital. If the registered stocks are stolen or lost, the shareholder may apply to the court for declaration of their invalidity and apply to the company for reissuance of the stocks.

R. *The Listed Company*

A listed company is a JSC whose stock is traded in the stock exchange after approval by the State Council Securities Administration. A company applying for listing must meet the following requirements: (1) the stock has been issued to the public after being approved by the State Council Securities Administration; (2) the total amount of registered capital is not less than 50 million RMB; (3) the company has been operating for more than three years, with the previous three years showing a profit; (4) at least 1,000 shareholders have over 1000 yuan of the par value stock, with at least 25% of the total shares offered to the public, and the company's total registered capital has been over 400 million RMB, with its total shares offered to the public exceeding 15%; (5) the company does not have any serious violation of laws and does not have any false recording in its financial statements; and (6) such other terms and conditions as may be provided by the State Council. The JSC may apply to the State Council Securities Administration for listing in both domestic or foreign Stock Exchanges. The State Council Securities Administration may order the suspension of a listing for any violation of the above requirements.

S. *Debenture*

A JSC, wholly state-owned LLC, and other LLC's invested in by two or more state-owned investors may, for the purposes of raising capital to support its business or production, issue debentures according to the law. The company shall apply to the State Council Securities Administration for issuance of debentures. Certain requirements must be met for the issuance of debentures, such as the company's net assets, investment direction, interest rates, and other terms and conditions as provided by the State Council. The raised capital must be used for the approved course only.

When applying for approval of issuance of debenture, the company is required to present the following documents: (1) an incorporation certificate; (2) articles of association; (3) a description of the intended means for raising debenture capital; and (4) an appraisal report of assets and an investment verification report. After approval, the company must publish a description of the intended method for raising debenture capital. The following must be included in such a publication: the company's name, the total debentures and their par value, the interest rate, the date and method of repayment of principal and interests, the starting and expiration date of issuance of debenture, the net value of the company assets, the total debentures which have been issued and are due, and the underwriter of the company's debenture.

The company's debentures may be registered or unregistered. As for the registered debentures, the company must prepare a debenture holder book, which registers the name and residence of every holder, the acquired date and number of the holders' total debentures and their par value, the interest rate, the date and method of the repayment of principal and interests, and the issuing date of the debentures. Regarding the unregistered debentures, the following should be recorded: the total debentures, the interest rate, the date and method of repayment, and the issuing date and their number. Debentures are transferable, and their price shall be based on the agreement of the transferor and transferee.

Listed companies may issue debentures which may be converted into stocks after the resolution of the shareholder's meeting. In this case, certain conditions must be met, including prior approval from the State Council Securities Administration.

T. *Company's Finance and Accounting*

All companies are required to establish financial and accounting systems which comport with the relevant laws, regulations and stipulations. Companies are also required to make certain reports and statements, *e.g.*, balance sheets and profit allotment statements. These reports should be made available to the shareholders for their inspection. Companies are also

required to draw public accumulation funds and public welfare funds. Any violation may result in the compulsory return of profit from shareholders to the companies.

U. *Company's Merging and Division*

A merger or division is subject to shareholder resolution. For JSC's, a merger or division is also subject to the approval of the State Council, authorized departments, or provincial level governments. In a merger, all of the debts and credits from the merging JSC's are passed through to the surviving company. In a division, the company's property and debts shall also be decided correspondingly. Under both situations, the companies shall publish news about the merger or division in the newspaper three times within thirty days or notify the creditor directly if possible. The creditors may demand acceptance or notification ninety days from the first publication.

Companies may also reduce their registered capital. The procedures are the same as merging and division, including notification of the creditors or publication in the newspaper, but the reduction of the registered capital shall not cause the registered capital below the minimum requirement of registered capital as set by the Company Law. Companies may also increase their capital, but must meet legal requirements and deal with relevant formalities. Companies are required to apply for an amendment to their business certificate in case of any alteration.

V. *Bankruptcy, Dissolution, and Liquidation*

Currently, China has a bankruptcy law which applies to the state-owned enterprises, including state-owned companies, but it does not apply to all companies. The National Peoples Congress is reportedly considering new bankruptcy laws which will govern all companies. With bankruptcies, the Company Law has only one general article which says that "[i]f a company is unable to settle its debts due and is declared bankrupt, the people's court should, according to relevant laws, organize shareholders, relevant authorities and professional people to establish liquidation group to conduct liquidation."²⁵

A company's dissolution may be voluntary or compulsory. The former situation may include the occurrence of dissolution for reasons stipulated in the articles of association, expiration of the business period, the resolution of the shareholders meeting, or a merging or division dissolution. Except in cases of a merger or division, the dissolving company shall form a liquidation group composed of shareholders. The compulsory dissolution occurs in circumstances where the company violates laws and regulations

25. The Company Law, art. 189.

and is ordered to close. In this situation, relevant authorities shall organize shareholders, other relevant authorities, and professional people to establish the liquidation group, which group shall conduct the liquidation. A liquidation group performs the following duties during the liquidation period: (1) inventorying and liquidating the company's assets and making balance sheets; (2) publishing notice of the liquidation or otherwise notifying creditors; (3) dealing with any unsettled business in relation to the liquidation; (4) paying off all owed taxes; (5) setting credits and debts; (6) disposing of all remaining property of the company after clearance of debts; and (7) participating in any civil litigation activities on behalf of the company.

The liquidation group has ten days to form, notify creditors, and to set up publication of notice in the newspaper at least three times within sixty days. The creditors may, within thirty days from the acceptance of notification or ninety days from the first publication, report their credits and provide evidence. The liquidation group shall register credits and report its liquidation proposals to competent authorities for approval. The company's assets will be disposed of in the following order: (1) payment of liquidation charges; (2) worker's salary and labor insurance premium; (3) payment of owed taxes; and (4) settlement of the company's other debts. After these procedures, the remaining assets may be allotted to the shareholders according to their investment proportion or shares. The company is prohibited from engaging in any business activity in the liquidation period. If the liquidation group find that the company's assets are not sufficient to settle all debts, it shall apply to the court for bankruptcy. If the company is declared bankrupt by the court, the liquidation group shall handle the liquidation matters before such court.

After liquidation, the liquidation group must compose a liquidation report for the confirmation of shareholders or competent authorities, and report to the company's registration authority for permission to terminate the company. The liquidation group should be loyal to its duties and should implement its liquidation obligations lawfully. It should not take advantage of its powers to accept any bribe or any other illegal income, and should not take the company's property. Any default of its members in the performance of their duties resulting in losses to the creditors may result in personal liability to the injured creditors.

W. Foreign Invested Companies

Before the birth of the Company Law of China, China did draft three laws governing Sino-foreign joint ventures, Sino-foreign cooperative joint ventures, and wholly foreign owned enterprises. These laws are still valid, and suggest that all foreign invested companies utilize the LLC format.

In the Company Law, there is no special chapter regulating foreign invested companies. The Company Law "applies to foreign invested LLC's.

If laws have special stipulations in relation to Sino-foreign joint ventures, Sino-foreign cooperative joint ventures, wholly foreign owned enterprises ["3 laws" collectively], these stipulations shall prevail."²⁶ Indeed, by comparing the Company Law and these 3 laws, we may find many differences in their stipulations.

Four main differences include the following. First, a single foreign investor is permitted to establish a wholly foreign owned company with limited liability according to the Wholly Foreign Owned Enterprise law. However, the Company Law only allows two or more investors (except for a wholly state-owned company) to set up either a limited company or a joint stock company with limited liability.

Second, the three laws do not require foreign invested companies to set up the organs of shareholder (investors) meetings or a supervisory council. The board of directors is the most powerful organ and to a great extent it executes shareholder powers. The Company Law requires all companies to establish shareholder meetings, a board of directors, and a supervisory council. Each organ has its own clear duties and responsibilities and work in a system of checks and balances to restrain each other.

Third, the 3 laws require more complicated establishment procedures. For instance, each foreign invested company is required to be approved by the State Planning Commission, Ministry of Foreign Trade and Economic Cooperation, and other authorities of the People's Republic of China or by local authorities. After these approvals, the investors may apply for a business certificate recording the establishment of the company.

X. Company Laws Beyond Chinese Sovereignty

Company Law provides that all of the investors may, without any approval, directly apply for registration of the company. This may be done if all of the legal requirements have been met, other than those for which the law has special provisions or if the business items require previous approval. Joint stock companies are still required to have previous approvals by the Company Law.

Fourth, business certificate may be issued to the investors of foreign invested companies before subscription has been verified by a duly authorized institution. This certificate marks the formal establishment of the foreign invested company. The investors may not make one full payment of the all registered capital they intend to subscribe unless their contract and Articles of Association have been so approved by relevant authorities. The 3 laws provide that the first payment shall not be less than 15% of the registered capital, and it must be made within thirty days if the payment is made in installments. The rest of the payments are subject to the terms of the contract and the Articles of Association. If the payment of registered

26. The Company Law, art. 18.

capital is not made in installments, all of the registered capital shall be made available within six months from the date of issuance of the business certificate. This condition is similar to authorized capital of uncalled shares under the British Company Act and the Hong Kong Company Ordinance. The Company Law adopts the principle that shareholders must pay their investment in full, whether it is toward the establishment of an LLC or a JSC.

Y. A Foreign Company Subsidiary

A foreign company is a company established pursuant to foreign company law and headquartered in a foreign country. Foreign companies are permitted to set up their branches and subsidiaries in China pursuant to this company law, engaging in the production and business activities but remaining subject to the approval of competent authority in Chinese government. In this connection, the foreign company's Articles of Association, incorporation certificate, and other required documents, shall be presented. After approval, the foreign company may apply for registration of its branches or subsidiaries and acquire a business certificate. The competent authority refers to the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China or its authorized local authority. In general, the foreign company's branches and subsidiaries require a foreign company's representative offices to refrain from the import or export goods directly by themselves. Their business items are limited. Except the foreign representative office, there are no other forms of branches or subsidiaries. Because wholly foreign-owned companies are registered in China, they are Chinese legal persons and are not recognized as the foreign company's branch or subsidiary. As article 203 provides, the foreign company's branch or subsidiary's activities are activities within Chinese territory. The foreign company should offer capital to its branch or subsidiary in correspondence with their business activities. Although the Company Law requires a minimum level of capital, the State Council has not yet made corresponding stipulation on a foreign company's branches or subsidiaries that their assets are not permitted to move abroad unless its branches or subsidiaries have settled their debts in China.

Z. Legal Liabilities

Any violation of the Company Law may result in civil and/or criminal liabilities. Chapter ten of the Company Law focuses mostly on civil liabilities for violation of the company law, such as the imposition of a fine on the violators. In an effort to enforce the Company Law more strongly, the Standing Committee of the National People's Congress passed a Decision on Cracking Down on Crimes in Violation of Company Law on February 2, 1995. This decision covers a number of crimes, including false

registration of a company; the promoter's or shareholder's false subscription or withdrawal of registered capital; making an untrue prospectus; the use of a false method of issuing the company debentures for raising capital; misleading use of or non-disclosure of facts relevant in accounting report that result in injury to shareholders or to the public's interest. Furthermore, when in liquidation, it is a crime to conceal the company's assets, making an untrue balance sheet, distributing the company's assets before settling debts, and hurting creditor's interest. It is also a crime to offer untrue evidence in relation to assets appraisal, capital verification, or audits. It is illegal to, without prior approval, issue stocks or the company debentures. The government official's illegal granting of approval or registration certificate in relation to the company's establishment, registration application, application for stocks or debentures constitutes a crime, as does the company's director, supervisory councilor or staff demanding or accepting a bribe. To occupy the company's property, divert the company's capital for personal use or offering a loan from the company's funds to other people is also illegal.

It is a difficult task to enforce the Company Law and its corresponding regulations and decisions because of wide existence of non-compliance with the law, especially regarding the status of the withdrawal of the company's registered capital and false proof of the subscription of the registered capital. Untrue statements and reports are not rare for companies. It is a long procedure to formalize the activities of the company, including its shareholders, directors, managers, and supervisory council, but individuals found guilty of violating the Company Law may face five years imprisonment and/or a fine of up to 200,000 yuan.

In this article, the company laws beyond Chinese sovereignty refer to the company laws of Hong Kong, Macao, and Taiwan. The Company Law of China does not have a stipulation regarding the company laws in those areas. According to former Chinese leader Deng-Xiao-Ping, China is one state with two systems of governance, and it is likely that the Company Laws in these areas will basically remain unchanged despite the drawing near of Hong Kong's return to China. People are very concerned about Hong Kong's future, including the impact of this political change on its laws. This fear merits a special look at Hong Kong's company law.

Pursuant to section 3.3 of the Joint Declaration between Chinese Government and British Government on December 19, 1984, Hong Kong Special Administrative Region will enjoy administration power, legislative power, independent judicial power, and the power of final trial. The current status shall remain basically unchanged. The Basic Law of Hong Kong Special Administrative Region also provides the similar stipulation in its article 8.

AA. *Hong Kong's Current Company Law: the Companies Ordinance*

Chapter 32 of Hong Kong's Ordinances were very influenced by the British Company Act. Compared with the Company Law of China, Hong Kong's Companies Ordinance is much more sophisticated. The current Companies Ordinance has 365 sections and 13 schedules, applying to unlimited companies and companies with limited liability (which may also be divided into companies limited by shares and companies limited by guarantee). It governs the company establishment, winding up of operations, companies incorporated outside Hong Kong, and other aspects. To some extent, the Company Law of China borrows from Hong Kong's company law such provisions as the restriction of members from two to five for an LLC.

But the Company Law of China differs in other areas from the Hong Kong Companies Ordinance. For instance, the Company Law of China does not require a Memorandum of Association, as does the Hong Kong Company Ordinance. The Company Law of China applies to LLC's and JSC's without other forms of companies available, but the Hong Kong Companies Ordinance covers an unlimited variety of companies, such as companies with limited liability (including companies limited by shares and limited by guarantee). Because the Companies Ordinance has operated smoothly in Hong Kong, one may assume that mainland China and Hong Kong will each continue to have their own independent company law and operate in different areas.

IV. PERFECTION AND IMPROVEMENT OF THE COMPANY LAW

In general, the Company Law is good law compared with some other laws in China, but there is room for further perfection and improvement. Currently, the Company Law only provides for basic legal principles and frameworks for companies in China, many detailed regulations, with many corresponding stipulations still needed to supplement the law. It is estimated that over thirty articles require supplement and perfection. Over eight implementing regulations or stipulations have been drafted, including: the Company Registration Regulation of the People's Republic of China, the Special Rules for Rallies and Listings Abroad by Joint Stock Companies Limited, and the Decision on Cracking Down on Crimes in Violation of the Company Law. Others will involve such issues as reorganization of state-owned enterprises into companies, the issuance of preference shares, transfer of ownership of assets of state-owned enterprises, branches of wholly foreign owned companies, standardization of existing companies pursuant to the Company Law, and the like.

Currently, the Company Law imposes different requirements on different companies. For example, state-owned LLC's only require a single

investor, as do wholly owned foreign LLC's, while other LLC's are required to have least two investors. In addition, Article 159 provides that JSC's, state-owned LLC's, and two or more investors in state-owned and subscribed LLC's may, for purposes of raising production and business capital, issue company debentures pursuant to this law. This article excludes the possibility for other LLC's to issue debentures to raise capital. These discrepancies cause unfair competition and treatment. We may expect that all LLC's will be face unified requirements and enjoy the same treatment in the future.

A. *Controversial Problems and Proposals*

With regard to the drafting process of the company law, the following points are quite controversial. First, there is the relationship between Company Law and Enterprises Law, the two laws currently operating parallel to each other with each under enforcement. The Company Law is based on the market economy, while the Enterprises Law was drafted on the basis of a planned economy. Many enterprises were established under the company's name pursuant to Enterprises law and still exist. That causes disorder in the application of laws because the theory behind these two laws differ greatly.

Second, types of companies that can be formed remain limited. Some suggest that the Company Law should govern all companies, including the unlimited company. Considering the practices regarding the unlimited company and that other forms of companies are still not sophisticated in China, legislators finally opted to limit the application of the law to LLC's and to JSC's. The spirit of the law does not prohibit other forms of companies, but the State Industrial and Commercial Administration (the top authority for company registration) in its Certain Enforcement Opinion of Company Registration Regulation of the People's Republic of China provides that nothing should be registered as names if the company fails to meet the conditions and procedures of the Company Law and the Company Registration Regulation. This clause obviously excludes the possibility of other forms of companies other than LLC's and JSC's.

Third, single shareholder companies, while the trend world-wide, remains problematic. Some suggest permitting this form of LLC because it has exists elsewhere so widely. Most people were opposed to this suggestion and agreed to restrict this form to state-owned the company because it is difficult to ascertain the true owner of assets, and it is risky for outsiders. The Company Law adopts this point of view.

Fourth, some suggested that all aspects of the company's establishment should be subject to prior approval and permission. Others suggested that one of the most important characteristics of the market economy is that companies should be set up freely without prior approval and permission, and except in special industries, the Company law now takes opposing

attitudes on this point for LLC's and for JSC's. The former may be set up without prior approval and while the latter should be subject to prior approval and permission.

Fifth, the principle of true capital focuses on whether or not to recognize authorized capital. Considering that the most serious contribution to the economic chaos of 1985-89 was untrue claims of capital and false subscription, the legislators deny the principle of authorized capital and require availability of capital before registration of companies.

Sixth, the debate over equal rights of shares centers on whether or not JSC's shall keep the method of directional raising of capital and keep the division of the state shares, legal person shares, individual shares and foreign shares. In view of insufficient publicity of directional raising of capital and activities not in compliance with the nature of JSC's, the legislators absorbed the viewpoint that no division of shares would be made, with all shares of equal rights.

Seventh, the question became which authority or institution shall, on behalf of the state, controls the state's shares. The Company Law only provides a general stipulation. It shall be specified by other law. The Company Law remains controversial on this issue.

Eighth, some people think that since the LLC's scale is comparatively smaller than that of a JSC, the internal institutions of the LLC shall be flexible and at the investor's option. Some other people insist that the internal mechanisms are for the protection of the shareholder, the company, and creditors.

V. CONCLUDING THOUGHTS AND SUGGESTIONS

In view of the imperfections with the current Company Law, we are expecting modification of the Company Law in its next amendment on the following points. First, the quick publication of corresponding regulations and decision of the Company Law will occur, so that the Company Law and its regulations and decisions will constitute the entire code to be used in governing all matters of companies. Second, to permit the other forms of companies, so that the Company Law will meet the desires of different shareholders and investors and have wider application to all kinds of businesses. Third, the Company Law will come to allow a single shareholder company of any type, not just state-owned. Each shareholder, no matter whether the state, a legal person, or an individual, shall be treated equally. In fact, an LLC established by a shareholder with 1% of the shares should be treated no differently from a shareholder with 99% of the shares.

Fourth, companies shall have equal opportunities to promote their company with fair competition in a healthy market economy. One of the typical examples is that only state owned or invested LLC's and JSC's may issue debentures to raise capital, while others are still prohibited. The other example is with the subscription of capital, in that the foreign funded

companies are permitted capital by installment while other LLC's are prohibited from such. That causes unfair competition and treatment.

Fifth, the Company Law should absorb all other related laws and apply to all companies. This would require abolishing the Sino-Foreign Joint Venture Law, the Sino-Foreign Cooperative Joint Ventures Law, and the Wholly Foreign Owned Enterprises Law, among others. For to a great extent, these laws exclude the application of the Company Law due to their special provisions. Foreign investors and shareholders would not change the nature of LLC's or JSC's in this regard, but the Company Law should be unified to apply to all companies.

Sixth, currently, the Company Law only provides a general word regarding subsidiaries, with no definition or specific requirement imposed. The Company Law should have a detailed stipulation on what a subsidiary is, how to form it, and its relation with the parent company.

Seventh, the Company Law should be amended so as to permit the existence of all classes of shares, especially preference shares, so that the shareholders may enjoy different rights and bear different obligations. Deferred shares, although rarely used even in foreign countries, should also be permitted.