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Economic reform in China and the function of company laws

I. Introduction: Economic reform in China and business organizations

China abandoned its self-sufficiency policy in 1978 and forcibly effected major domestic economic reforms. It has been more than twenty years since it first opened its doors to the world. The “reform” movement started from “agricultural reform” in rural areas and extended to the that is “industrial reform” in urban and city areas. The “open-door policies” began at the coastal regions in the southeast and extended to inland, northern and central regions. By 1990s, China had integrated such controversy between “planned economy” and “market economy and that between “socialism” and “capitalism” and established the basic developing direction of “socialist market economy”. During the “15th People’s Assembly held in September 1997, P. R. C. leadership further overcame the dispute between “public ownership” and “private ownership” in the ideology of ownership. Since then, China has been able to maintain a high annual economic growth of 10%. In 1998, its actual G. D. P. was 5.4 times higher than its 1980 G. D. P. (1980 was the first year changes were effected to China’s traditional systems). During the post-deregulation reform era, except for the interior parts of China, popular lifestyles improved immensely change for the better. Hence, during the early 21st century, China will have to overcome many challenges. However, its economic scale will undoubtedly make China into another great power.

What kind of great power can China become in the early 21st Century? Will it be able to maintain its social stability and economic development? The post-deregulation reform era witnessed the globalization of China’s economy and its inclusion into the world eco-

monic system. This transformation greatly affected other nations particularly in politics, and economics. In the process of China's economic reform, there are many business organizations that play a very important role in economic activities. Those include Sole Proprietorships, Partnership, State-owned enterprises, Collectively-owned Enterprises, and Companies. All kinds of business organizations are prohibited before the pre-deregulation reform era, so that those business organizations shall be supported by special legislation. Not only the Constitution of China, but also laws, regulations, and policies provides the legal basis for economic organizations or individuals to establish and operate the business by adopting the form of those business organizations.

The following parts, I will highlight the relationship between business organizations and the economic development of China as well as analyze related laws, regulations with regard to business organizations, specially laws, regulations what companies and enterprises shall comply with. In addition I shall discuss the role of foreign-invested companies and laws or regulations about those companies and characteristics of the 1993 P. R. C. Company Law, because foreign-invested companies play leading role in the "open-door" policies and the 1993 P. R. C. Company Law is a locomotive to help promoting the reform of State-owned enterprises and Collectively-owned Enterprises.

II. Business organizations in China: Arrangement in accordance with Ownership of the Means of Production or the Type of its Investor's Liability

Contemporary China is the legacy of the semi-colonial Ching Dynasty and the Republic era.¹⁾ It has undergone an evolution of Stalinist, Maoist and Ding Xiaoping style economic development strategies.²⁾ The Stalinist economy is a centralized power economic system. In contrast to this is the party-based Maoist system of self-sufficiency, however, there are several similarities between these two systems. The former advocates the confiscation of imperialist capitalist, private capitalist and huge landowner properties, then distributing a portion of said properties to proletarian farmers and other revolution supporters. A huge slice of these properties is then withheld for heavy industry development purposes. The latter advocates the popular commune system so the government may obtain privately-owned lands. Semi-privatized operations are expropriated from capitalist hands at very unreasonable prices and converted into socialist infrastructures. The core of these two economic systems is a compulsory savings program that controls consumer spending.³⁾

During the period from 1950 to 1978, all economic sector were controlled by the government. State-owned enterprises and Collectively-owned Enterprises were supported by the State or local government, and business did not have to bear their losses or profits inde-

1. Aron Shal, *The Fate of British and French Firms in China 1949-54*, pp. 5 ff. (Si Antony's, 1996).

2. Katsugi Nakagane, *Economic Development and Transition in China*, pp. 24 ff., pp. 41 ff. (Yuhikaku, 1999). A study of territories that experienced colonization, such as Hainan Island, Hong Kong, Xiamen, Shanghai, Chingtao, Talien, Harbin, Shenyang, etc., can further confirm the opinions herein presented.

pendently. All State-owned enterprises and Collectively-owned Enterprises followed rules of a planned economy and were required to gear their production to pre-drawn State economic plans rather market demands. Most State-owned enterprises and Collectively-owned Enterprises were not profitable entities on their own and the State was always required to support them financially.

Deng Xiaoping's development policy is the theory directing China's present-day economy. The policy advocates foreign investment, export propagation, policy development, a market economy, enrichment theory (permitting a gap between rich and poor), individual burdens, among other things. It was based on pragmatism, the economics first theory, gradualism, constitutional rights, stability consolidation and other ideas.

The economic reform program aimed at to standardize and modernize enterprise organization and practice. Market forces made the formation of economic enterprises a necessity for business people who had to deal with the continuing competition for survival and success.⁴⁾⁵⁾

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3. Shortly after 1949 China implemented the Stalinist and Maoist economic systems. The country enjoyed a period of stability during the first five years (1953 to 1957) of the program. However, during the years that followed, China was plunged into hardship by the political chaos and diplomatic friction created by the great dive, the Korean War, the Cultural Revolution, and the ideological war between China and the USSR. It even experienced six years of negative growth rate especially in 1961, 1967, 1968 and 1976, when such rate was over 20%. These economic depressions seemed to occur when politics were chaotic or when economic policies failed. China also had its growth periods, however, these were either due to falsified reports of figures or caused by momentary counteractions, or temporary adjustment periods (See Nakagima, op. cit. p. 32). There was another characteristic attributed to the Chinese economy during this period, that is, the economic growth momentum did not come from consumer spending or exports, but from domestic investment.

Since communism values equal distribution or allocation, China lacked an allure for productivity; hence it was natural course of development for its economy to break. However, during the years of China's economic depression, the Chinese government was able to learn one valuable lesson-social stability is essential for economic development.

4. During the years that followed the deregulation reform until 1998, China did not experience a negative growth rate; that means that from 1979 until then there were 20 years of positive growth. The economy continued to grow at a high annual growth rate of 9.8%, putting it at par with high growth rate developed nations. Beginning in 1984, when China reported a 15.2% growth rate, it enjoyed nine years of a two-digit (more than 10%) growth rate. The Chinese industrial structure also underwent significant changes during this period. Until the mid-80's, agriculture was the driving force of economic growth; henceforth, the third industry became the leading growth factor. In the 90's, industrial production became the principal growth factor. Agriculture's share in the GDP gradually decreased; it could no longer stand at par with the second and third industries.
5. The most notable characteristic of this era is the absence of the Stalinist and Maoist at least on the surface. China fully maximized foreign investment, technology and management techniques; hence, despite its socialist government structure, China has long abandoned its socialist obligations. The burdens of medical care, pensions, unemployment insurance, health insurance and other social welfare programs was passed onto the shoulders of the people. The economic reforms effected by the government used capitalist measures to bolster the economy while maintaining a kind of authoritarian government under the guise of socialism. As a result, they abandon the advantages of socialism and pass on the natural responsibilities of a socialist government to the shoulders of the people. This paper refers to this condition as "para-socialism".

The economic essentials for the post-deregulation reform period became diversified. In addition to the old social ownership system, i.e. a group ownership system, the government started to allow foreign capital and privately-owned investments. State-owned enterprises and Collectively-owned enterprises, Sole Proprietorships that contain individual industrial and commercial households (*Geti gongshang hu*) or of private enterprises (*Si ying qye*), Partnership that can be divided into two categories, individual partnership and enterprise partnerships, foreign-invested enterprises that include Solely Foreign-Invested Enterprises, Chinese-Foreign Equity Joint Ventures and Chinese-Foreign Contractual Joint Ventures, and companies are recognized as a business organization.

The business organizations mentioned above can be classified by the standard of its economic essentials and its investor's liability into two categories. The business organizations in China are historically arranged in accordance with ownership of the means of production. State-owned enterprises and Collectively-owned Enterprises belong to a group ownership system. Sole Proprietorships and individual partnership are owned by individuals. Enterprise partnerships can be arranged by individuals or public enterprises like State-owned enterprises and Collectively-owned enterprises (the horizontal economic integration of enterprises).⁶⁾ Solely Foreign-Invested Enterprises are known as wholly foreign-owned enterprises. Chinese-Foreign Equity Joint Venture or Chinese-Foreign Contractual Joint Ventures is a limited liability company, established by foreign companies, enterprises, other economic organization or individuals with Chinese companies, enterprises or other economic organization.

If enterprises mentioned above, for example State-owned enterprises, Solely Foreign-Invested Enterprises, and Chinese-Foreign Equity Joint Ventures have the status of legal persons. And Chinese-Foreign Contractual Joint Ventures or Collectively-owned Enterprises may obtain the status of legal persons as specified in the law. The investors of enterprises with the status of legal person will not bear unlimited liability for the debts of this enterprise. The investors of enterprises without the status of legal person like Sole Proprietorships, Partnership, or Chinese-Foreign Contractual Joint Ventures or Collectively-owned Enterprises which did not obtain the status of legal persons shall bear unlimited liability for the debts of this enterprise.

All companies have the status of legal person, but an enterprise with the status of legal person is not always a company. Foreign-invested enterprises with the status of legal person are companies. A State-owned enterprise, or a Collectively-owned Enterprise which have obtained the status of legal person is not a company. A State-owned enterprise which fulfills the requirements for the establishment of a company under 1993 P. R. C. Company Law may be reorganized as a company. A Collectively-owned Enterprise which even fulfills the requirements for the establishment of a company under 1993 P. R. C. Company Law can be an promoter to establish a company, but not be reorganized as a company.

A fundamental defect clearly exists in the relationship between the status of legal person and his legal capacity in practice. As a matter of course, Business organizations with

6. Wang Chenguang & Zhang Xianchu, *Introduction to Chinese Law*, at pp. 346 ff (1997, Sweet & Maxwell).

the status of legal person have the legal capacity. But Business organizations without the status of legal person, partnerships or Collectively-owned enterprise which have not obtained the status of legal person, for instance run business under their owned name. The difference of a business organization with the status of legal person between those without the status of legal person is if the business organization is not a legal person, the owner may be personally liable for the debts of the organization. Because State-owned enterprise, Collectively-owned enterprise or other business organizations run business historically before laws conferred the status of legal person on those business organizations.⁷⁾ The only purpose of the Chinese government to confer the status of legal person on State-owned enterprises is to separate those enterprises from the government organizations and prevent the government from assuming the debts of State-owned enterprises to foreign creditors. Because the government used to bear full liabilities for loss including the debts to foreign creditors before deregulation reforms.

III. The Role of Foreign-invested Companies and Laws

It has been 22 years since China opened its doors to the world in 1978. As at March 1996, there were more than 250,000 foreign invested enterprises operating in China.⁸⁾ Foreign-invested enterprises, namely Chinese-Foreign Equity Joint Venture, Chinese-Foreign Contractual Joint Ventures, and Solely Foreign-Invested Enterprises are instruments to introduce capital and bring the technique of business management and technical skill from foreign countries into China. Foreign-invested enterprises began to play an indispensable role in the economic growth of China.⁹⁾ As of the end of 1994, the total foreign business investments reached U. S. D. 300 billion. The shares of foreign-invested enterprises in the national trade pie amounted to: export, 45% and imports, 28%.¹⁰⁾

For accomplishing the State's purpose to introduce foreign capital and bring the technique of business management and technical skill into China, a great of national law and local regulation, measures and policies have been made to try to control the establishment, government, operation, and termination of foreign-invested enterprises. The legal framework for foreign-invested enterprises consists of the national laws on foreign investment, the State Council Regulations and departmental rules on foreign investment, the local laws and regulation on foreign investment, and the foreign investment policies of both national and local governments. 1. Law on Chinese-Foreign Equity Joint Venture, 1979 (hereafter

7. Articles 9, 36, 50 and 51 of The Civil Law, 1986. Now, the Civil Law Principles do not recognize the civil ability of an organization which is not a legal person.

8. Wang Chenguang & Zhang Xianchu, op. cit. at p. 275.

9. In a speech made during his 1992 southern tour, Deng Xiaoping referred to them as important opportunities. After that, the investment of foreign capital, corporations, and governments, especially local governments, investments have expanded rapidly, boosting economic growth. During the period from 1991 to 1995, investments in property increased by an average of 36.9%, a sharp rise from the 16.5% posted during the 1986-1990 period.

10. Masataka Kiyokawa = Minehiro Nishimura, *Joint Venture Business in China after Enforcement of the Company Law 1995* -, p. 3 (Shoizhoumukenkyukai, 1995).

“Equity Joint Venture Law”; See Appendix “B”); 2. Regulations for the Implementation of the Law on Chinese-Foreign Equity Joint Venture, 1983 (hereafter “Equity Joint Venture Regulations”; See Appendix “C”); 3. Law on Chinese-Foreign Contractual Joint Ventures, 1988 (hereafter “Contractual Joint Ventures Law” See Appendix “D”); 4. Regulations for the Implementation of the Law on Chinese-Foreign Contractual Joint Ventures, 1995 (hereafter “Contractual Joint Ventures Regulations”; See Appendix “E”); and 5. Law on Solely Foreign-Invested Enterprises, 1986 (hereafter “Foreign-Invested Enterprises Law”; See Appendix “F”); 6. Regulations for the Implementation of the Law on Solely Foreign-Invested Enterprises 1990 (hereafter “Foreign-Invested Enterprises Regulations”; See Appendix “G”) are the most important part of laws and regulations on foreign investment.¹¹⁾ Generally speaking, the main purpose of those laws and regulations is to encourage foreign investors to establish Chinese-Foreign Equity Joint Venture, Solely Foreign-Invested Enterprises, and Chinese-Foreign Contractual Joint Ventures to run business in China. Foreign-invested enterprises enjoy lower tax rates and lower import duties. Depending on the nature of the investment, a foreign-invested enterprise may also be given better access to funding and markets, or benefits, privileges and concessions relating to the use of land, facilities and infrastructure. And there are a lots of provisions of those Laws and Regulations regarding the formation, management and organization structure of a company, so that Law on Chinese-Foreign Equity Joint Venture, 1979 was a first law concerning a limited liability companies in China before 1993 P. R. C. Company Law was promulgated. Consequently, China has gotten a lot of capital, the technique of business management and technical skill from foreign countries for this 20 years.¹²⁾ This chapter only discusses the provisions which are relevant to company under those Laws and Regulations.

At first, the government issued the Provisional Guidelines for Foreign Investment to indicate to foreign investors the areas and projects open or closed to them. The Guidelines divide investment project onto four categories. Foreign Investment projects are accordingly encouraged, permitted, restrictive and prohibited. The scope of business is limited in encouraged, permitted, restrictive project. Foreign invested enterprises can rely on the Guidelines to choose an area of operation, and can not run the business which are prohibited.¹³⁾

11. See Michael J. Moser, “Foreign Investment in China: The Legal Framework”, Moser, *Foreign Trade, Investment and the Law in the People's Republic of China*, pp. 106 ff (1984, Oxford University Press).

12. Lack of confidence in China's treatment of unsuccessful non-banking enterprises caused foreign investments (making up 25% of the private sector investments) to reflect a more 0.5% growth in 1998, and in the first-half of 1999, investments decreased by 9.2%. The investment contract execution rate of the current index dropped further to 19.9%. For details of the legal settlement of the failed China Guangdong International Trust & Investment Co, please refer to Yukitaka Murakami, “The Guangdong International Trust & Investment Co. Ripple”, *J. C. A. Journal*, August 1998, pp. 10 ff. In January 1998, except for some exceptional cases, China has revived its equipment importation tax holiday incentives. In order to increase the export recovery rate of the “value appreciation tax” thereby, and revive the inclination to investment and increase exports. Ryunosuke Ikegami, “China's Investment Environment-Achievements of 1998 and Outlook for 1999”, *China Economy*, March 1999, p. 21.

13. See Article 4-5 of Foreign-Invested Enterprises Regulations.

The laws and regulations provided that a foreign-invested enterprise can make its own managerial decisions within the approved scope of business operations and shall not be subject to intervention. But there are a great many matters of permission, admission or approval under those laws and regulations. The managerial autonomy of companies regard to management is limited. Foreign private corporations whose aim is to maximize profits join together with the industrial enterprises of a socialist state geared toward Maximizing output, control, and social order. Foreign-invested enterprises shall flight not only with government officials but also with their Chinese partners who are the proxy of government or the official of the state-owned enterprises on the day-to-day management and operations for the company.¹⁴⁾

Chinese-Foreign Equity Joint Ventures

A equity joint venture is established by Chinese and foreign investors jointly as a Chinese company.¹⁵⁾ A joint venture is a limited liability company. Each party is liable to the joint venture within the limit of the capital subscribed by it. A joint venture shall able to promote the development of China's economy and the raising of scientific and technological levels for the benefit of socialist modernization.¹⁶⁾ Individual Chinese and government bodies can not be a promoter or a shareholder.¹⁷⁾

(1) At first, the Chinese partner of the venture submit a proposal and feasibility study. After the proposal has been approved, the parties to the venture are allowed to negotiate and form an agreement to establish a equity joint venture. The equity joint venture agreement, contract and articles of association shall be submitted to the state's competent department in charge of foreign economic relations and trade for examination and approval. The examination and approval authorities shall decide to approve or disapprove the venture within three months. When approved, the venture shall register with the state's competent department in charge of industry and commerce administration, acquire a business license and start operations.¹⁸⁾

The proportion of the foreign investment shall be not less than 25 percent of joint venturer's registered capital.¹⁹⁾ There is no limitation on the maximum shares held by a foreign investor. If all shares are held by a foreign investor, the company shall be a Solely For-

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14. "Chinese factory managers spent much of their time on welfare problems and had little independent decision-making authority. The real power, they learned, lay with cadres in the municipalities, in government ministries, or in the Party leadership. The Western executives placed the highest possible value on economic efficiency, even if it led to differentials in income or unemployment; by contrast, Chinese state enterprises were more willing to tolerate inefficiency for the sake of equality of income, full employment, and social order". Jim Mann, *Beijing Jeep: The Short, Unhappy Romance of American Business in China*, pp. 49ff (1989, Simon and Schuster).
 15. See Margaret M. Pearson, *Joint Ventures in the People's Republic of China. The Control of Foreign Direct Investment under Socialism*, pp. 84ff(1991, Princeton University Press).
 16. Article 4 of Joint Equity Venture Law; Article 3 and 4 of Joint Equity Venture Regulations.
 17. Article 1 of Joint Equity Venture Law.
 18. Article 3 of Joint Equity Venture Law; Article 11-18 of Joint Equity Venture Regulations.
 19. Article 4 of Joint Equity Venture Law.

eign-invested Enterprises and not a joint venture. An investment can be made in the form of cash, equipment, intellectual or industrial property, land or building.²⁰⁾ There are minimum requirements for the ratios between a venture's registered Capital and total investment. A joint venture is not allowed to reduce its registered capital during the term of operation. If one party intends to assign all or part of its investment subscribed to a third party, consent shall be obtained from the other party and approval from the examining and approving authorities is required. Law confers preemptive right to buy the investment subscribed by one party on other party, and the terms of assignment shall not be more favorable than those to a third party. If an assignor can not get said consent or approval, the problem shall become very serious and complicated.

The parties shall share the profits in proportion to their contributions to the registered capital.

(2) There is no shareholder's meeting, even a joint venture is a limited liability company. The board of directors exercise the highest power to decide all major issues concerning the joint venture. The board of directors shall consist of no less than three members. The parties appoint the directors to the joint venture. The appointment of the board chairman and vice chairmen should be made through consultation between the parties. If the chairman is appointed by one party, the other party can appoint vice chairman. The term of office for the directors is four years and may be renewed. The board is required to meet at least once a year to decide the important matters.²¹⁾ The board chairman is the legal representative of the joint venture. The other issues of the venture are usually dealt with by chairman, vice chairman or managers. A management office contains the general manager and several deputy general managers shall be responsible for the day-to-day management and operations.

Trade unions are allowed under the present legal framework for foreign investment. A joint venture is required by law to look after the interests of unions and its employees.²²⁾

(3) A joint venture should have a definite term of operation. The duration of a joint venture shall be determined by all the parties in the agreement, contract and articles of association but it can not over 30 years. The duration begins from the date when the joint venture is issued a business license and may be extended by all parties.

A joint venture may be dissolved or terminated before the end of the expected term in the some situations, such as inability to continue operations due to heavy losses, the failure of one of the contracting parties to fulfil its obligations prescribed in the agreement, contract and articles of association, heavy losses cause by *force majeure*; or failure to obtain the desired objectives of operation and no prospects for future development.²³⁾ Upon announcement of the dissolution or termination, the board of directors shall work out procedures and principles governing the liquidation and nominate candidates for the liquidation committee. It shall report to the department in charge of joint venture for examination, ver-

20. Article 25-32 of Joint Equity Venture Regulations.

21. Article 36 of Joint Equity Venture Regulations.

22. Article 95-99 of Joint Equity Venture Regulations.

23. Article 102 of Joint Equity Venture Regulations.

ification and supervision of its liquidation. The detailed process of liquidation is governed by Equity Joint Venture Regulations.

Chinese-Foreign Contractual Joint Ventures

A contractual joint venture is entirely based on a contractual arrangement. In establishing a contractual joint venture, the Chinese and foreign parties shall prescribe in their contractual joint venture contract such matters as the investment or conditions for cooperation, the distribution of earning or products, the sharing of risks and losses, the manners of operation and management and the ownership of the property at the time of termination of contractual joint venture.²⁴⁾ It must be emphasized that contract is a keystone of this venture. Everything can be settled in the contract as long as the parties so agree. This is one of the advantage that this venture has over the equity joint venture.²⁵⁾ A contractual joint venture can be a form of partnership or can be a limited liability company.²⁶⁾ The establishment of productive contractual joint ventures that are export-oriented or technologically advanced are encouraged.

(1) Like a equity joint venture, for the purpose of applying for the establishment of a contractual joint venture, such documents as the agreement, the contract and the articles of association shall be submitted for examination and approval to the department in charge of foreign economic relations and trade under the State Council or to the department or local government authorized by the State Council. The examination and approval authority shall, within 45 days of receiving the application, decide whether or not to grant approval. The venture is obliged to register with the local administration of industry and commerce, which should issue a license to the venture. The venture commences its operation from the date on which the license is issued. The Administration for Industry and Commerce can set out deadlines for the parties to fulfil their contractual obligation under contract.²⁷⁾

The investment for cooperation contributed by the Chinese and foreign parties may be provided in cash or in kind (that includes movable or immovable property), or may include the right to the use of land, industrial property rights, non-patent technology or other property rights. Foreign investment in a venture which is a company should normally be more than 25 per cent of the venture's registered capital. The parties shall share earnings or products, undertake risks and losses in accordance with the agreements prescribed in the contract. If one party wishes to make an assignment of all or part of its rights and obligations prescribed in the contract, it must obtain the consent of the other party and report to the examination and approval authority for approval. If said consent or approval can not be obtained, same problems in equity joint ventures shall occur.

(2) A venture can enter legal relationships in its own right as a limited liability company, and shall establish a board of directors which shall, according to the contract or the articles of association, decide on the major issues concerning the venture. If the Chinese or for-

24. Article 2 of Contractual Joint Ventures Law.

25. Wang Chenguang & Zhang Xianchu, op. cit. at p. 294.

26. Article 4 of Contractual Joint Ventures Regulations.

27. Article 9 of Contractual Joint Ventures Law.

eign party assumes the chairmanship of the board of directors, the other party shall assume the vice-chairmanship of the board. The board of directors may decide on the appointment or employment of a general manager, who shall take charge of the daily operation and management of the venture. The general manager shall be accountable to the board of directors.

If a contractual joint venture chooses to entrust a third party with its operation and management, it must obtain the unanimous consent of the board of directors, report to the examination and approval authority for approval, and register the change with the administrative authorities for industry and commerce.

(3) The period of operation of a venture shall be determined through consultation by the parties and shall be clearly specified in the contract. If the parties agree to extend the period of operation, they shall apply to the examination and approval authority 180 days prior to the expiration of the venture's term. The examination and approval authority shall decide whether or not to grant approval within 30 days of receiving the application.

If, upon the expiration of the period of a venture's operation, all the fixed assets of the contractual joint venture, as agreed upon by the contract, are to belong to the Chinese party, the Chinese and foreign parties may prescribe in the contract the ways for the foreign party to recover its investment ahead of time during the period of the venture's operation. If the foreign party, as agreed upon in the contract, is to recover its investment prior to the payment of income tax, it must apply to the financial and tax authorities, which shall examine and approve the application in accordance with state provisions concerning taxes. The foreign party is to recover its investment ahead of time during the period of the venture's operation, the Chinese and foreign parties shall, as stipulated by the relevant laws and agreed in the contract, be liable for the debts of the venture.²⁸⁾

A venture may be dissolved before the end of the expected term in the same situations of a equity joint venture.²⁹⁾

Solely Foreign-Invested Enterprises

Solely Foreign-Invested Enterprises refers to those enterprises established in China by foreign investors, exclusively with their own capital. This term does not include branches set up in China by foreign companies. The enterprise shall be a limited liability company. With approval, the enterprise may also take any other liability form. The liability of the foreign investor to the enterprise which is a limited liability company, shall be limited to the amount of investment subscribed by the investor.

The foreign investor of the Solely Foreign-Invested Enterprise can enjoy autonomy in administering the affair of the enterprise. Such managerial autonomy distinguishes this enterprise from a Chinese-foreign joint venture. A Solely Foreign-Invested Enterprise is a convenient means for foreign investors who prefer to run business at their own pace and under their own managerial system.³⁰⁾

28. Article 22 of Contractual Joint Ventures Law.

29. Article 48 of Contractual Joint Ventures Regulations.

30. Wang Chenguang & Zhang Xianchu, op. cit. at p. 281.

(1) The application to establish an enterprise with foreign capital shall be submitted for examination and approval to the department under the State Council which is in charge of foreign economic relations and trade, or to another agency authorized by the State Council. The authorities in charge of examination and approval shall, within 90 days from the date they receive the application, decide whether or not to grant approval.

An enterprise must be conducive to the development of China's national economy, be capable of gaining remarkable economic results. The enterprise is to adopt advanced technology and equipment, engage in the development of new products, conserve energy and raw materials, and realize the upgrading of products and the replacement of old products with new ones which can be used for placing similar imported goods; or its annual output value of export products accounts for more than 50% of the annual output value of all products, thereby realizing the balance between revenues and expenditures in foreign exchange or with a surplus.³¹⁾

The foreign investor shall, within 30 days from the date of receiving a certificate of approval, apply to the industry and commerce administration authorities for registration and obtain a business license. The date of issue of the business license shall be the date of the establishment of the enterprise. An enterprise shall, within 30 days after its establishment, go through the procedures for taxation registration with the tax authorities.

Foreign investors may use convertible foreign currencies for the contribution of investment, or use as their investment machinery and equipment, industrial property rights, and proprietary technology that are assigned a fixed price.³²⁾ The said machinery and equipment must meet the certain requirements mapped out under Foreign-Invested Enterprises Law and Foreign-Invested Enterprises Regulations. Foreign investors may use, as their investment, their profits in RMB earned from other enterprises with foreign investment in China. The time limit for a foreign investor to make the investment contributions shall be clearly stipulated in the written application for the establishment of the enterprise and also in the articles of association of the enterprise. A foreign investor may make the investment contribution by installments, but the last installment of the contribution shall be made within the period of three years beginning from the day when the business license is issued. The industry and commerce administration authorities shall inspect and supervise the investment situation.

The registered capital of the enterprise shall fit in with the enterprise's scope of business operations; and the proportion between the registered capital and the total amount of investment shall conform with the provisions of the relevant laws and regulations. The registered capital shall not be reduced during the term of business operations.

(2) The legal representative of an enterprise shall be the person-in-charge who, in accordance with the stipulations in the enterprise's articles of association, executes his functions and powers on behalf of the enterprise. The production and operating plans of enterprises shall be reported to the competent authorities for the record. Enterprises shall con-

31. Article 3 of Foreign-Invested Enterprises Regulations.

32. Article 26 of Foreign-Invested Enterprises Regulations.

duct their operations and management in accordance with the approved articles of association, and shall be free from any interference.

The enterprise falls under the scope of a company, the managerial enterprise are left with the hands of the board. The management and organization structure of the enterprise are similar to those of the joint venture which is a limited liability company.

(3) The term of operations of the enterprise shall be proposed by the foreign investor in the written application for the establishment of the enterprise in the light of the specific conditions of different enterprises, and shall be subjected to the approval by the examining and approving organ. The foreign investor shall report the period of operations to and secure approval from the authorities in charge of examination and approval. The term of operations of a foreign-capital enterprise shall be calculated from the day when the business license is issued.

For an extension of the period of operations, an application shall be submitted to the said authorities 180 days before the expiration of the period. The authorities in charge of examination and approval shall, within 30 days from the date such application is received, decide whether or not to grant the extension.

An enterprise that falls under one of the circumstances provided under Foreign-Invested Enterprises Regulations such as the term of operations expires, bankruptcy etc. shall terminate its business operations.³³⁾ When terminating its operations, an enterprise shall promptly issue a public notice and proceed with liquidation in accordance with legal procedure. Upon the conclusion of the liquidation of a foreign-capital enterprise, it shall go through the procedures for the cancellation of registration with the administrative department for industry and commerce, and to hand in the business license for cancellation.

There is no any doubt the Western company law has had an influence on the provisions of those laws and regulations concerning a limited liability company particularly given the fact that the company has been used as a substantial means of raising badly needed foreign investment. In order to make it easier for foreigners to invest, the Western model was to some extent adopted. There are, nevertheless many similarities between Western and Chinese company law, substantial differences between the two. Many aspects of the Chinese approach to legislation are reflected in its company law.³⁴⁾ In the same token, there has same phenomena in 1993 P. R. C. Company Law. Socialist market economy, the reform of state-owned enterprise and the "open-door policies" are precisely reflected in this Company Law.

IV.Characteristics of the 1993 P. R. C. Company Law

The Company Law was formally adopted by the National People's Congress on December 29, 1993. At that session it was decided that the Company Law would become effective on July 1, 1994, 6 months after its promulgation. It contains 11 chapters and 230 ar-

33. Article 75 of Foreign-Invested Enterprises Regulations.

34. I. A. Tokley & Tina Ravn, *Company and Securities Law in China*, p. 4 (1998, Sweet & Maxwell).

ticles. The Company Law is a nationwide company law. It applies to limited liability companies and companies limited by shares (the joint stock company). The contents of the Company Law are mainly Establishment and organizational structure of a limited liability company and a companies limited by shares (Article 19-72, 73-128), issue and transfer of shares by company limited by shares (Article 129-158), corporate bonds (Article 159-173), financial affairs and accounting of a company (Article 174-181), merger and division of a company, insolvency, dissolution and liquidation of a company (Article 189-198), and branches of foreign companies (Article 199-205), legal liabilities (Article 206-228). The contents of the Law are very similar to those in Western company law. But it is formulated in order to not only adapt to the needs to establish a modern enterprise system, standardize the organization and activities of companies, protect the rights of companies, shareholders and creditors, but also safeguard social and economic order and promote the development of the socialist market economy.³⁵⁾ The purpose to safeguard social and economic order and promote the development of the socialist market economy are precisely reflected in the Company Law makes many provisions of this Company Law quite different from those in Western company law.³⁶⁾

The Chinese government tried to blend the business organizations of capitalistic country into a socialist market economic regime that maintains socialist principles and goals. The company concept is in conflict with the dominant Marxist ideology, China retains its socialist character through the state. The Company Law contains provisions concerning socialistic elements and capitalistic elements. This chapter highlights some of the most pronounced technical aspects of Chinese Company law such as the formation and the internal governance of companies, and the various safeguards against malfeasance and points out the functions and Characteristics of the Company Law.

The Need for a Nationwide Company Law for State-owned Enterprises

(1) Since the post-deregulation reforms were effected, industrial reforms, specially the reform of enterprises have been China's most important political agenda.³⁷⁾ Industrial structure adjustment efforts have been centered on how to consolidate or liquidate ailing state-owned enterprises. The past reform measures taken include enhancement of factory managers' authority, the subcontracting system, business conversion, close operations, semi-merger and full mergers, as well as the stock corporation system. They were aimed at

35. Kingsley T. W. Ong & Colin R. Baxter, "A Comparative Study of the Fundamental Elements of Chinese and English Company Law", *International and Comparative Law Quarterly* Vol. 48 at pp. 88 ff(1999).

36. Article 3 of the Company Law provides that "A shareholder of a limited liability company, is liable to the company to the extent of the amount of the shareholder's capital contribution. The entire capital of a company limited by shares is divided into shares of equal value and shareholders shall be liable to the company to the extent of the shares held by them. A company limited by shares or a limited liability company is liable for the debts of the company with all its assets". The definition of limited liability company and a company limited by shares is perfectly same to that under western company law.

37. Murray Scot Tanner, *The Politics of Lawmaking in China*, pp. 167ff (1999, Oxford University Press).

segregating managerial authority from ownership rights.³⁸⁾ These reforms were effected under the basic premise of enterprise preservation, but the effects of the long period of “bureaucrat-entrepreneur” collaboration and partnership, as well as the worker’s “lifetime employment” mentality, remained deep-rooted diseases that could not be eliminated. Since businesses were unable to reduce or eliminate their social or employee welfare burdens, the industrial reforms so far have resulted in a series of failures.

Therefore for the reform of state-owned enterprises, company law is needed.³⁹⁾ The management and ownership of the state-owned enterprises are separated completely. The Chinese government gives those enterprise managerial autonomy and push them to face the market to fight with the other enterprises. Even though, the public industries of China, especially state-owned enterprises, still experienced very serious economic problems; hence the ratio of state-owned enterprises in the industrial sector took a rapid dive, leaving the number at 30%. Investments that poured into revive these state-owned enterprises took up a huge share of government finances, creating the possibility of rapid financial and monetary instability. On the other hand, the number of non-state-owned enterprises, including foreign-invested enterprises, continued to rise. During the period from 1981 to 1996, the annual average growth rate of non-state-owned enterprises was higher than that of state-owned enterprises; the best growth rates reported came from direct foreign investments.⁴⁰⁾

(2) It was apparent that for a period after of time reforms were instituted, despite the implementation of market theories and a certain degree of a market economy orientation, reinforced market competition, and corporate bankruptcy and unemployment resulted in urban unemployment of 5.7 million persons. Temporarily retrenched employees of state-owned enterprises amounted to 11.51 million persons. The state-owned enterprises continue to employ a considerable number of supernumeraries. The most serious problem of all was state-owned enterprises. Competition from urban and private enterprises, as well as foreign-invested enterprises had put more and more state-owned enterprises in the red. In their attempts to cover their financial deficits, state-owned banks were unable to recover numerous huge loans; they ended up holding astronomical bad debts.⁴¹⁾

38. For details of the decision-making mechanisms of state-owned enterprises and companies, as well as their semi or full-merger problems, please refer to Masanobu HARADA, “Merger as Reform of State-Owned Enterprises in China”, *Sandai Law Review* Vol. 29, No. 3, pp. 106 ff.

39. I. A. Tokley & Tina Ravn, *op. cit.* p. 5.

40. China’s GDP soared to 14.2% in 1992, but since then its G. D. P. has declined. The subsequent GDPs were: 1993, 13.5%; 1994, 12.6%; 1995, 10.5%; 1996, 9.6%; 1997, 8.8%; 1998, 7.8%; and the first-half of 1999, 7.6%. This downward trend seems to be continuing. Since 1997, the internal and external environments that bolstered the previous annual growth underwent major transformations.

41. According to the reports released by the Chinese government, bad loans held by banks in 1997 were less than 25% (approx. 18.729 trillion RMB) of the total loans. In the worst cases, funds were already disseminated into localities and enterprises. Despite of the weakening foundation of the national government, the state still had to absorb financial and monetary risks; as a result, the state lost its control over the general economy.

Recently, after the implementation of the stock ownership system - e.g., limited liability companies, companies limited by shares (the joint stock company) -, despite the fact that private and foreign capital were mobilized to a certain degree, such policy did not do much good in breathing life into business activities. It was realized that unless drastic measures were implemented, it would be impossible to remedy the conditions of the ailing state-owned enterprises. In 1997, the Chinese government applied some very strong medicine; it implemented a policy to save large enterprises and abandon helping small ones. In effect, there was a massive tidying up and closing of state-owned enterprises. The government also attempted to consolidate competitive and massive enterprises into conglomerations.⁴²⁾ It identified 3,000 huge enterprises as beneficiaries of state-bank financial guarantees and stock market capital appropriation, and then promoted their merger and acquisition in an attempt to group them into conglomerates. To achieve this purpose, China encouraged reorganization, mergers, long-term lease of production equipment, business subcontracting, special employee share systems, as well as the privatization of state enterprises. It hoped to liberalize and privatize the 53,000 small state enterprises under its umbrella. At the same time, the Chinese government makes good use of company system in promoting its reform policies.

Furthermore, the Chinese government, in an attempt to prevent drastic inflation and the creation of a bubble economy, started a decompression policy in the second half of 1993. Although the move solved the inflation problem, the government was unable to totally eradicate the effects of the emerging bubble economy for instance, the massive debts shouldered by state enterprises and the bad loans in the hands of state banks. Soon after the Asian financial crisis, the state had to address the risks resulting from this bubble economy. In an attempt to disperse these risks, the Chinese government encouraged huge corporations to join the stock market. New stock certificates were issued to invigorate enterprises with direct capital infusions.⁴³⁾ State enterprise stock certificates (state stocks and institutional shares) were also issued to absorb and use individual or investment company capital as state enterprise capital, in the hope of reducing state's liability rates and stopping the drain of state capital.⁴⁴⁾

(3) The Chinese government wants company law to help them to do what are mentioned above, therefore Article 7 of the Company law stipulates that in accordance with the laws, a State-owned enterprise which replace its system of operation, gradually and systematically take inventory of its assets and verify its capital, determine property rights, clear creditors' rights and indebtedness, value assets and set up a standardized internal management structure which can be reorganized as a limited liability company or a company limited by shares.⁴⁵⁾ All kinds of companies enjoys all legal person property rights con-

42. "Political Report of the 15th General Convention of the Chinese Communist Party", Beijing Weekly News 1997, No. 40 Annex.

43. Masataka Kiyokawa, "Characteristics of the 1993 P. R. C. Company Law (3): Company Fund Raising Techniques in Non - market Economy Countries", Sandai Law Review, Vol. 32, No. 1, pp. 42 ff (1998).

44. Japan Economic and Financial News, October 13, 1999 and October 18, 1999 Annexes.

stituted by the shareholders' investment, enjoys civil rights and assumes civil liabilities. A company conducts its business autonomously and is responsible for its own profits and losses. Under the state's macro regulation and control adjustment, a company can organize its production and operations autonomously according to market demand with the objectives of raising economic efficiency and labor productivity.

This is far from saying that State-owned enterprises are reorganized as a limited liability company or a company limited by shares mean privatization of State-owned assets. Article 4 of this Company Law provided that ownership of the State-owned assets in a company belongs to the state.⁴⁶⁾ "This provision appears to indicate that assets may included in the company which belong to State. Its is curious therefore that Article 4 appears to provide for continuation of State ownership".⁴⁷⁾ Large-scale wholly state-owned companies with a sound system of operation and management and whose operational situation is relatively good may be authorized by the State Council to exercise rights as the owner of the assets.⁴⁸⁾ It means no any companies included wholly state-owned companies can exercise right as the owner of the assets belong to the State, except Large-scale wholly state-owned companies mentioned above.

The Company Law also has special provisions to provide "Wholly State-Owned Company" under Chapter 2 and Section 3, that you can scarcely find under the Western company law. "A wholly state-owned company" refers to a limited liability company in which a state-authorized investment institution or a state-authorized department is the sole investor and which is established solely by a state-authorized investment institution or by a state-authorized department (hereafter "the state-authorized investor"). Wholly State-Owned Company shall be established for the production of special products of belonging to a specified trade designated by the State Council.⁴⁹⁾ The Management and organization structure of the company are quite different form those of the other limited liability company. There are no shareholders' meetings in a wholly state-owned company. The company's board of directors who are appointed or replaced by the state-authorized investor is authorized by the state-authorized investor to exercise part of the powers of the shareholders' meetings, decide on the major issues of the company, provided that decisions on merger, division, dissolution of the company, increase or decrease in capital and issue of corporate bonds shall be decided by the state-authorized investor and carries out its duties in accordance with Article 66 of the Company Law.⁵⁰⁾ Members of the board of directors shall include representatives of the staff and workers of the company. The chairman and vice-chairman of the board of directors are designated from among the directors by the state-authorized investor. The board chairman is the legal representative of the company. A wholly state-owned company used to have no supervisory board. The state-authorized investor ex-

45. Article 21, 81 of the Company Law.

46. Article 4 of the Company Law.

47. I. A. Tokley & Tina Ravn op. cit. p. 5, cf. Kingsley T. W. Ong & Colin R. Baxter, op. cit. p. 96.

48. Article 72 of the Company Law.

49. Article 64 of the Company Law.

50. Article 66, 68 of the Company Law.

exercised supervision and management over the state-owned assets of a wholly state-owned company. But Article 67 of the Law was revised and supervisory board in lieu of the state-authorized investor to exercised the power of supervision.

Foreign Invested Companies and the 1993 P. R. C. Company Law

(1) The Company Law applies to limited liability companies with foreign investment. Where the laws on Chinese-Foreign Equity Joint Venture Enterprises, Chinese-Foreign Contractual Joint Venture Enterprises and Solely Foreign-Invested Enterprises otherwise provide, the provisions of such laws apply.⁵¹⁾ The foreign investors are not prohibited to set up the foreign-invested limited liability company in accordance with the Company Law. But the company is established under the law on foreign-invested enterprises will enjoy benefits, privileges and concessions under the law and regulations on foreign-invested enterprises. The Company Law also applies to foreign-invested company. Article 18 of the Company Law states that foreign-invested company is established under this Law is subject to the provisions of the laws on foreign-invested enterprises if there is any inconsistency between the Company Law and the laws on foreign-invested enterprises. This Article may resolve a number of inconsistencies between the Company Law and the law on foreign-invested enterprises.⁵²⁾

The Company Law also has been used as a substantial vehicle of raising badly needed foreign investment.

(2) The Company Law and the laws on foreign-invested enterprises did not mention foreign-invested company limited by shares and a foreign investment holding company.⁵³⁾ In order to fill the gap, "Provisional Regulations on Certain Issues Concerning Establishment of Foreign-invested Company Limited by Shares" (hereafter "Provisional Regulations") and "Provisional Provisions concerning Establishment of Investment-type Company by Foreign Business Investment" (hereafter "Provisional Provisions") are issued by the Ministry of Foreign Trade and Economic Cooperation, the State organ in administration of investment in 1995.⁵⁴⁾

A foreign-invested company limited by shares is a company whose shares are jointly held by Chinese-foreign shareholders with the foreign shares being more than 25 per cent of the registered capital. Said company may be set up through new establishment; conversion of the existing foreign-invested enterprises which are limited liability company; acquisition of State-owned enterprises or collectively owned enterprises.

51. Article 18 of the Company Law.

52. For a further discussion of Article 18 of the Company Law, see Masataka KIYOKAWA "Characteristics of the 1993 P. R. C. Company Law (2): Which is the Applicable Law in Given Situations involving State Enterprise, Enterprise under Collective Ownership, Private Enterprise and Enterprise with Foreign Investment Company Law or the Specific Laws on those Enterprise?-", *Sandai Law Review*, Vol. 29, No. 3, pp. 48 ff. (1995).

53. Article 12 of the Company Law refers to investment companies and holding companies specified by the State Council.

54. Wang Chenguang & Zhang Xianchu, op. cit. at p. 357-358.

A foreign-investment-type company is holding company with limited liability for the purpose of foreign-Invested in China. The business areas that a foreign investment holding company may engage include direct investment in the sectors of industry, agriculture, infrastructure and energy and supply of services to its invested enterprises, such as the procurement of equipment and materials, after-sales service, assistance for foreign exchange balance, recruitment, market development and consultation. The Provisional Provisions also allow foreign investor to establish a holding company by their wholly-owned subsidiaries.

Foreign-invested company limited by shares and foreign-investment-type company mentioned above, are not only the instrument to introduce the foreign capital, also activate State-owned enterprises or collectively owned enterprises.

Formation of Companies

China rules companies as shares-holders and the state. On the formation of companies, a concessionary approach towards the company is adopted.⁵⁵⁾ The strict regulation is imposed on promoters in the process of incorporation. The Company Law sets different conditions that must be satisfied by limited liability companies and companies limited by shares prior to their establishment.

The establishment of a company shall comply with the requirements set out in this Law. A company shall be registered as a limited liability company or a company limited by shares. Where the Law requires that the establishment of a company be submitted for examination and approval, the procedures for such examination and approval are carried out before the company is registered.

A representative or agent of all the shareholders applies to the company registration authority to register the establishment of the company, submitting the company registration application, the company's article of association, investment verification certificate and other documents. If examination and approval from relevant departments is required in accordance with any law, the approval documents shall be submitted when applying to register the establishment of the company. Where the conditions required by this Law are met, the company registration authority registers the company and issues a company business license. The date of issue of the business license is the date of establishment of a limited liability company. The system of registration serves to stop any entrepreneur's abuse by ensuring that company meet minimum requirement.

In establishing a company, the company's articles of association shall prepared in accordance with this Law.⁵⁶⁾ A company's business scope is specified in its articles of association and registered. For items in a company's business scope which are restricted by law, approval shall be obtained. A company shall conduct business activities within its registered business scope. A company may change its business scope by amendments to its articles of association in accordance with procedures provided by law and after changing its

55. Kingsley T. W. Ong. & Colin R. Baxter, op. cit. p. 94.

56. Article 11 of the Company Law.

registration with the company registration authority. Therefore, the incorporation and operation of a company are matters of government control and permission.

The minimum share capital for establishing a company is high depends on the type of business.⁵⁷⁾ The promoters of a company limited by shares have to retain their shares for 3 years. The Chinese government exercise much greater regulation over the establishment of companies anyway. Chinese companies must fulfil higher capital and shareholder requirement. A company limited by shares also impose restrictions on their promoters.

Governance and Organization Structure of a Company

On internal governance, China adopts the managerial approach. The objective of the Company Law is to guaranteed that directors and managers run the company in the interests of shareholders, bestowed the desirability of centralized management. It allows the State as a shareholder to maintain ultimate control of companies and regulate them. This approach combines socialistic approach with capitalistic approach.

The Company Law has followed a socialistic ideology, to require a company shall abide by the law and by business ethics, strengthen the construction of socialist spiritual civilization and accept the supervision of the government and the public in conducting its business activities. On the other hand, directors are entrusted with the management of a company.

(1) A company has a board of directors. The members of directors are three to thirteen or five to nineteen depend on the company structures. The board of directors is responsible to the shareholders' general meeting and exercises the powers are provided under the Law.⁵⁸⁾ The directors shall be responsible for the resolutions of the board of directors.

The board of directors has one chairman and may have one or two vice-chairmen. The board chairman is the only one legal representative of the company. A director included vice-chairmen is a member of the board of directors and can exercise his power in the board meeting. He or she has no any chance to exercise his or her powers out of the board meeting. The term of office of the directors shall not be longer than three years. The director may serve another term if re-elected. The shareholders' meeting shall not without reason remove a director from office before the expire of that director's term.

If a resolution violates the law, or the articles of association and this results in the company sustaining serious losses, the directors participating in the resolution are liable to compensate the company. However, if it can be proven that a director expressly objected to the resolution, and that such objections were recorded in the minutes of the meeting, such director may be free of liability.

A company has a manager who is appointed or dismissed by the board of directors. The manager is responsible to the board of directors and exercises the powers to run everyday operation for company. His or her powers are to be in charge of the company's produc-

57. Article 23, 78 of the Company Law. The minimum amount of a company limited by shares shall be RMB. 10 million (about 1.3 million US dollars). The total amount of a listed company's registered capital must amount to at least 50 million (about 6.81 million US dollars).

58. Article 46, 112 of the Company Law.

tion, operations and management and organize the implementation of the resolutions of the board of directors; to organize the implementation of the company's annual business plan and investment plan; to propose plans for the putting in place of the company's internal management structure; to propose the company's basic management system; to formulate specific rules and regulations for the company; to propose the appointment or dismissal of the company's deputy manager and financial officers; to appoint or dismiss management officers other than those required to be appointed or dismissed by the board of directors; and exercise other powers conferred by the articles of association and the board of directors. The manager is present at the board meetings without the vote.⁵⁹⁾

However, The Law is more cautious in granting powers to directors. Protection against the abuse of extensive directorial power is seem to weigh more than the need to encourage enterprise.

(2) A large limited liability company and a company limited by shares shall have a board of supervisors. A small limited liability company may have one to two supervisors. The term of office of the supervisors is three years. The supervisor may serve another term, if reelected. The directors, manager and financial officers of the company shall not act concurrently as supervisors.

The board of supervisors as supervisor has the powers to inspect the company's financial situation; to exercise supervision over the acts of the directors and manager carried out while performing their corporate functions which violate laws, regulations or the company's articles of association; to demand remedies from a director or manager when the acts of such director or manager are harmful to the company's interests; to propose the convening of an interim shareholders' meeting; and to exercise other powers specified in the company's articles of association. The supervisors shall faithfully execute their supervisory duties and the power of directors is further limited by the implementation of a supervisory board. The supervisors are present at the board meetings and inspect the company's affairs.⁶⁰⁾ The supervisory board serves to ensure *ex ante* director's accountability, before any damage occurs.

State civil servants shall not act concurrently as a company's director, supervisor or manager. The directors, supervisors or managers shall abide by the articles of association, faithfully execute their official duties and protect the company's interests. They shall not exploit their position and power in the company to advance their own private interests or to accept bribes or other illegal income or wrongfully take over company property. The directors or managers shall not misappropriate company funds or loan such funds to others and open accounts in their own names or in the names of other individuals for the deposit of the company's assets. They shall not provide a guarantee for debts of a shareholder of the company or other individual with the company's assets, and engage on their own behalf or on behalf of others in any business similar to the business of the company in which they hold office or in activities harmful to the company's interests. They also shall not disclose the secrets of the company except in accordance with the provisions of the law or with the con-

59. Article 50, 119 of the Company Law.

60. Article 52, 126 of the Company Law.

sent of a shareholders' meeting. Unless otherwise provided in the articles of association or with the consent of a shareholders' meeting, a director or manager shall not enter into any contracts or transactions with the company.

The director, supervisor or manager who violates the law or the articles of association while performing his official corporate duties resulting in harm to the company, shall be liable for damages. The Company Law attaches greater importance to ensure accountability, than to encourage entrepreneurs. This approach is more consistent with "socialist market economy".

(3) The State has preserved their socialist character through an extension of shareholder' powers and controlled the companies through the extensive shareholder' powers. The Law adopted the concept of general meeting sovereignty. The shareholders in general meeting controlled all the company powers. The general meeting exercises its powers as the company's authoritative organization. It has the power to decide on the company's operational policies and investment plans; to elect and replace directors and decide on matters relating to the remuneration of directors; to elect and replace the supervisors who are representatives of the shareholders and decide on matters relating to the remuneration of supervisors; to examine and approve reports of the board of directors, to examine and approve reports of the board of supervisors; to examine and approve the company's proposed annual financial budget and final accounts; to examine and approve the company's profit distribution plan and plan for recovery of losses; to decide on increases in or reductions of the company's registered capital; to decide on the issue of bonds by the company; to decide on issue such as merger, division, dissolution and liquidation of the company and other matters; and to amend the company's articles of association.⁶¹⁾

Shareholders' general meetings shall be held once every year. An interim meeting is held under some certain circumstances within two months.

Shareholders present at a general meeting have one vote for each share. Resolutions of the shareholders' general meeting shall be adopted with half of more of the voting rights held by shareholders present at the meeting. Resolutions on merge, division or dissolution of a company, and amendments to the articles of association shall be adopted by shareholders with two-thirds or more of the voting rights present at the meeting. Shareholders may appoint proxies to attend general meetings. A proxy shall present to the company a power of attorney from the shareholder and shall exercise his voting rights within the scope of his authorization.

Shareholders have the right to examine the company's articles of association, minutes of shareholders' general meetings and financial and accounting reports, and to make proposals or inquiries in respect of the company's operations. If any resolution adopted by a general meeting or the board of directors violates any law or infringes the rights of shareholders, shareholders have the right to initiate proceedings in the people's court to require that such acts of violation or infringement be stopped.

61. Article 104 of the Company Law.

(4) Chinese working class is the ruling class in society. Workers are regarded as masters of the State. Worker's rights is very important owing to its traditional socialist ideology. The Company Law reflects this ideology faithfully to keep Chinese workers high status in a company.

A company shall protect the rights of workers, strengthen labor protection and bring about production safety and use various means to enhance vocational education and on-the-job training for staff and workers to increase their work quality. When considering and deciding on the wages, welfare and production safety of the workers and labor protection, labor insurance and other issues involving the personal interests of the workers, and major issues relating to the company's production and operations the company shall first solicit and consider the opinions of the company's trade union and workers, and shall invite representatives from the trade union and the workers to attend the relevant meetings. It should be mentioned that traditionally the trade unions did not have the right to demand wage increases as those matters were dealt with through managerial plans. Their roles were limited to handling other welfare benefits of the employees and recreational activities. When considering and deciding on and formulating important rules and regulations, the company shall solicit and consider the opinions and proposals of the company's trade union and staff and workers too.⁶²⁾

Limited liability companies established with investment by a wholly state-owned company and those established with investment by state-owned investors practice democratic management through the representative conferences of the workers.⁶³⁾ Members of the board of directors in wholly state-owned company shall include representatives of the staff and workers of the company.⁶⁴⁾ For a limited liability company established with investment by state-owned investors, members of its board of directors shall include representatives of the workers of the company.⁶⁵⁾ The board of supervisors is made up of representatives of shareholders and a reasonable proportion of representatives from the company's workers.⁶⁶⁾

The workers of a company organize a trade union to carry out union activities and protect the lawful rights and interests of the staff and workers. A company shall provide the necessary conditions for activities of the trade union of the company.

Article 17 of the Company Law provides that the activities of the base-level organizations of the Communist Party of China in the company are dealt with in accordance with the Charter of the Communist Party of China. In practice, Chinese workers exercise great influence because of the strong power of the Communist Party. Recently the Chinese government admits and encourages the secretary general of the Communist Party in a company to hold a post of the board chairman or vice-chairmen in public. The presence of Communist Party members on the governing board will result in significant influence.⁶⁷⁾

62. Article 56, 56 and 121, 122 of the Company Law.

63. Article 16 of the Company Law.

64. Article 68 of the Company Law.

65. Article 45 of the Company Law.

66. Article 52, 124 of the Company Law.

Company Officer's Misconducts and Sanctions

On one hand, Chinese company has conferred the certain powers in accordance with managerial conception on the company officers included directors, chairman and vice-chairman, and managers. On the other hand, the company officers are imposed severe duties for their company and shareholders. It is subject to socialist ideologies. One of the significant characteristic of the Company Law is the duties of company officers are enforced on administrative and criminal processes, rather than through civil actions.

It is relatively clear, however, that the *ultra vires* doctrine is not in the Company Law. A company as a legal person shall bear liability for the directors' or managers' decisions which result in activities going beyond the registered scope of business of the company. The legal representative is subject to sanctions for the company's misconduct. He is personally at risk if the company engages in business beyond its authorized scope, conceals facts from registrations and tax authorities, or hides property to evade repayment of debts. The legal representative may be fined or subjected to administrative. If the offense constitutes a crime, he may also be prosecuted.⁶⁷⁾

The Company Law enforces the duties of company officers to their company and shareholders is same to force citizens' duties to the state. Owing to their collectivist ideologies, Misconducts to company are those that are same to society because the most of shareholders are the State. The Chinese believe administrative and criminal sanctions are more efficient to protect the interests of company and shareholders.

There are generally three steps to treat the misconducts of a company and its officers. First one is collection. For instance, a company which violates the Company Law by falsely reporting its registered capital when registering, presenting false documentation or employing other deceptions to conceal important facts in order to obtain registration of the company shall be first ordered to correct the situation.⁶⁹⁾ A company which prepares a false prospectus, share subscription application or corporate bond offer procedure in connection with the issue of shares or corporate bonds shall be ordered to halt such issue and return all funds raised together with interest. A promoter or shareholder who does not pay cash or property in kind or does not transfer property rights, so making a false capital contribution and committing fraud against creditors and the general public, shall be ordered to remedy his wrongs.

Second step is administrative sanction. A company that falsely reports its registered capital shall be fined at least five per cent and no more than ten per cent of the amount of the registered capital falsely reported. A company that presents false documentation or employs other deceptions to conceal important facts shall be fined at least RMB 10,000 and no more than RMB 100,000. In serious cases, the company's registration shall be canceled.

67. Masataka Kiyokawa "Characteristics of the 1993 P. R. C. Company Law (1): How the Law Can be Used by the Communist Party Reassert its Power as Part of the "Iron Triangle" Along side Company Management and Labor Unions", *Sandai Law Review*, Vol. 29, No. 2, pp. 1 ff (1998).

68. Article 49 of General Principal of Civil Law the P. R. C.

69. Article 206 of the Company Law.

The last one is criminal processes. If the violation mentioned above constitutes a criminal offence, criminal liability shall be investigated in accordance with the law.⁷⁰⁾ And the criminal punishment is serious. It contains from a definite term to prison and the death sentence.

V. Conclusion

China abandoned its self-sufficiency policy and jubilantly announced its deregulation reforms. In its effort to modernize the nation as rapidly as possible, the Communist Party leadership headed by Deng Xiaoping not only permitted but invited, indeed encouraged, Western corporation to join hands with Chinese state-owned enterprises. Motivated largely by the centuries-old Western desire to penetrate and capture the vast China market, Western companies heeded Deng's call. By the beginning of 1989 more than five thousand foreign-owned companies had invested in China. The numbers of these foreign businesses in China and scope of their business operation far exceeded anything seen in the other reforming socialist economies. It was a grand experiment, not just for China but for the rest of the world; and it suggested at least the possibility of dramatic change in the relationship between private capital and Communist states.

In reality' it was but an attempt to make use of foreign capital and allow foreign investors to established the foreign-invested company included a limited liability company and a company limited by shares. During the bubble economy of the 80-90's era, capital from different parts of the world was channeled into China's markets. When Japan's bubble economy collapsed, massive capital still continued to flow from it into the Chinese financial market despite its tremendous bad bank loan problems. Hundreds of thousands of foreign-invested companies have produced high quality and reasonable price of goods to export into the world market. Making use of foreign capital and allowing the establishment of foreign invested company are successful concreted measures of the "open door policies".

The Company Law was enacted in 1993. It accepted a more restrictive concession theory approach towards the incorporation and granted a company a status of legal person to enjoy all company property rights constituted by the shareholders' investment, civil rights and assume civil liabilities. A company conducts its business autonomously and is responsible for its own profits and losses. China uses the managerial approach towards the internal governance structure of companies under which shareholders receive primacy. The Chinese government pays more attention to ensuring directorial accountability than to encouraging entrepreneurs. Socialist China is reluctant to give up dominating enterprises. The managerial approach finally preserves the Chinese traditional socialist character under Chinese company system. Though maintaining ultimate control as a majority shareholder in a company, the Chinese government guarantee the companies are truly business organizations serving social interests. It is consistent with the "socialist market economic". It must be pointed out that it is has comparatively easier to enact a company law than to make

70. Article 207-224 of the Company Law.

this law operate in reality. Whereas various private companies have been established in accordance with the Company Law, State-owned enterprises still have too many traditional burdens to be reorganized into a company. Even if those enterprises can be reorganized into companies, companies shall endure an ensuing competition with private companies and foreign-invested companies.