# Foreign Investment and Minority Shareholder Protection in China



## Abstract


Despite the slowdown of the Chinese economy and the perceived backtracking of the reform and opening up policy, Western enterprises see the need of entering the Chinese market. This is easier said than done, Chinese corporate law holds a few unpleasant surprises, and in particular, the rules on corporate governance are somewhat underdeveloped. Any foreign company who plans to set up business in China first has to check the *Catalogue for the Guidance of Foreign Investment Industries (Amended in 2015)*. In many cases, the foreign company may set up a *Wholly Foreign Owned Enterprise (WFOE)*. However, depending on the business model and the legal framework, the only

option may be forming a Joint Venture with a Chinese company. In that event, protecting the interests of the (foreign) minority shareholder is of utmost importance.

## Introduction

The People's Republic of China[1] is largely seen as the workbench of the world, and was hailed as world champion of exports as early as 2009; more importantly, the PRC is the number one destination of foreign imports, making it the worlds largest trading nation[2]. The Middle Kingdom, with its total population of 1.376 billion[3] and the worlds largest GDP based on purchasing power parity[4], is a huge market that can no longer be ignored, especially in view of the growing consumerism of the upper and middle classes. For instance, China featured the staggering number of 1,590,000 millionaires in 2016[5], putting it on rank four behind the US, Japan, and Germany. In view of the huge market potential, it is imperative for most Western companies not only to maintain trade relations with Chinese business partners, but also to mark their presence locally with their own subsidiary.

Unfortunately, the business climate in China is not always favourable to Western companies. While China continues to play a central role in the investment strategy of multinational corporations, some small and medium-sized enterprises shrink back from entering the Chinese market. Many are afraid – for good reason – of product piracy, unfair business practices by their Chinese business partners, and of the obscure political and legal structures. Things certainly have changed since the initial phase of Chinese *Reform and Opening-up* policy in the 1980ies, but maybe not as much as expected. Recently, the policy of *Made in China 2025*[6] makes foreign companies wonder, whether they are still welcome, unless they give up valuable know-how and technologies. Looking back at the past, both success stories and tales of commercial failures are abundant:

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1 This paper only deals with the legal situation in "Mainland China", at the exclusion of Taiwan (Republic of China), Hong Kong, and Macau. The Taiwanese Company Law has evolved from the Company Law of the Republic of China, which was issued in 1928 and follows the Continental legal tradition. The corporate law of Hong Kong was shaped by the British who ruled the country until 1997 and enacted the Company Ordinance as early as 1865.

2 As a matter of fact, China only ranks first in absolute numbers. On a per-capita basis, the PRC only barely beats India (rank 20) and is surpassed by Asian neighbors such as Singapore (1), Taiwan (6), South Korea (8), Malaysia (9), Japan (14), and Thailand (16). Source: Datenquelle: http://atlas.media.mit.edu/en/ (exports); https://www.cia.gov/library/publications/the-world-factbook/rankorder/2119rank.html (population).

3 Source: Credit Suisse Global Wealth Databook 2016, http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=AD6F2B43-B17B-345E-E20A1A254A3E24A5.

4 See WEISBROT Mark, "The world has nothing to fear from the US losing power", The Guardian, 3 May 2014, www.theguardian.com/commentisfree/2014/ may/03/world-nothing-fear-us-power-china-economy-democracy.

5 Source: Credit Suisse Global Wealth Databook 2016, http://publications.credit-suisse.com/tasks/render/file/index.cfm?fileid=AD6F2B43-B17B-345E-E20A1A254A3E24A5.

6 «中国制造 2025» *Zhōngguó zhìzào 2025,* http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm.

- Schindler, a producer of elevators and escalators, was the first Western industrial group to dare to enter a joint venture with a Chinese state-owned company (CSE China Schindler Elevators). It managed things well and managed to gain the trust of Chinese business partners and the Chinese government. In the year 2000, Schindler was able to take over the Chinese company completely. With seven out of ten elevators being installed in the Asia-Pacific region, the risks Schindler ran must have paid off[7].

- The German / Swiss machine manufacturer Liebherr likely was less pleased with the outcome of the cooperation with a Chinese partner. Starting in 1984, Liebherr shared its know-how with a run-down state enterprise in Qingdao. The cooperation ended in 1991, without much ado. Only the Chinese version of the trademark "Liebherr" remained: Haier – the world market leader for white goods.

- Between 2007 and 2009, the quarrels between the French dairy company Danone and the Chinese beverage producer Wahaha, were brought to public. Danone specifically complained that the founder and ruler of Wahaha, ZONG QINGHOU, was running competing businesses outside the joint venture. ZONG, on the other hand, felt the deal with Danone (who had 51% of the shares of the Joint Venture) was unfair to him[8]. The various cases brought to courts and arbitrators in various jurisdictions brought valuable lessons for law students[9]. The 10-year-old joint venture between Danone and Wahaha, however, did not survive the brawl. In 2009, the dispute was resolved by Danone selling its shares.

For Western companies there are many hidden stumbling blocks in China, as the last two examples show. But not being active in China can also be a risk. Known risks are easier to handle, so a basic knowledge of Chinese corporate law, which contains quite a few unwelcome surprises, may be helpful.

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7 Source: http://www.schindler.com/com/internet/en/about-schindler/schindler-history.html#/2009.

8 How Danone's China venture turned sour, Financial Times, April 11, 2007, https://www.ft.com/content/89a31958-e855-11db-b2c3-000b5df10621.

9 SCHWALB Micah, Wahaha as Pedagogy, Working Paper, December 15, 2007, available at http://ssrn.com/abstract=1073622, 3; TAO Jingzhou/HILLIER Edward, A Tale of Two Companies, available at http://www.jonesday.com/files/publication/6027415e-bc9d-44b2-9e90-f8ef4870150d/presentation/publicationattachment/a602d7dc-b34c-4f3a-8041-fdde482927ac/a_tale_of_two_companies.pdf; BU Qingxiu (2011) Danone v. Wahaha: who laughs last? European Journal of Law Reform, 13 (3-4), available at http://sro.sussex.ac.uk/45622/1/BuEJLR.pdf, 614 et seq.

# Chinese Corporate Law

## History of Chinese Corporate Law

The characteristics of Chinese corporate law can not be understood without some basic knowledge of the history and the political system of China. Chinese corporate law, like many other legislative acts in the People's Republic of China, is largely a Western transplant. However, this should not lead to the erroneous assumption that things are exactly the same as in Western countries. The local environment and the historical implications must not be ignored, if one wants to avoid unpleasant surprises.

Until the end of the Qing Dynasty in 1911, there were no significant legal provisions on corporate law. In ancient China, trade and civil law were considered of lesser importance, and provisions relating to those fields were interspersed in the vast codes of criminal and administrative law. In view of the Confucian tradition, it was the highest goal of the educated classes was to be employed in the government service. Traders and merchants belonged to the lowermost social class. Hence, little attention was paid to their needs. Economic activity was a matter for the families or clans, as is the case for the *Chaebols*[10] (eg Samsung, Hyundai, LG), which still dominate the Korean economy, or for the *Zaibatsu*[11] in imperial Japan until the First World War (eg Mitsubishi, Nissan and Kawasaki until the last century). Ancestral rites ensured continuity in the clan company and the Confucian family hierarchy guaranteed the stability of the family enterprise. Blood relations were not strictly necessary, on the other hand, if no suitable successor was available, external talent was adopted[12].

After the fall of the Qing dynasty in 1911, up until 1949, the raging civil war was an impediment to the formation of a corporate law in China. From 1949 onwards, the Marxist theory was incompatible with any form of (bourgeouis) civil law and especially corporate law: Periodical economic crises with high unemployment and economic depression were considered a necessary by-product of the competition between the companies and therefore entirely inacceptable[13]. According to the ideological ideal, an economic undertaking should not only ensure the production of goods, but also offer a stable workplace during a lifetime, it was also to dispense food, shelter, health care and provide for the aged; profits, on the other hand, were not deemed strictly necessary[14]. To attain those goals, the means

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10 재벌/財閥.
11 財閥.
12 RUSKOLA Teemu, Conceptualizing Corporations and Kinship: Comparative Law and Development Theory from a Chinese Perspective, Stanford Law Review, No. 52, July 2000, 613 et seq.
13 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 277 et seq.
14 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 278.

chosen was the nationalization of all private companies and the establishement of a planned economy shortly after the Communist Party of China (CPC) took the rule over Mainland China[15].

Between 1949 and 1984, approximately, all enterprises were solely owned by the state and managed by government officials who were appointed by government agencies; their performance was measured with reference to plans set forth by government agencies[16]. The communist economic experiment resulted in a perniscious mismanagement, and at the time of the death of Chairman Mao in 1976, China was on the brink of ruin[17].

In 1978, a *Reform and Opening-up* policy started, aiming at attracting foreign capital to aid the ailing state enterprises, and allowing for private micro-enterprises of individuals or households with a maximum of eight employees[18]. There was no intention whatsoever to change the system of State Owned Enterprises (SOEs)[19]. An actual privatization, such as it took place in Eastern Europe around 1990, was never an option at that time. Instead, the state enterprises were to be modernized and the (considerable) savings of the population were to be steered into the system[20].

In October 1984, the 3rd plenum of the 12th Central Committee of the Communist Party proclaimed that the socialist system was based on planning and collective ownership. But then, on 23 October 1985, the Chinese leader DENG XIAOPING declared that socialism and market economy would not fundamentally contradict each other[21]. A first, hesitant step towards market economy was made in 1988 with the adoption of the *Law on Industrial Enterprises Owned by the Whole People*[22], which initiated a separation of management and administration; however, the last decision-making power remained with the administration and the CPC, respectively, and incentives for efficient management were inexistent[23]. At the same time, the privatization of small state-owned enterprises was made

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15 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 280 f.; TAN Lay Hong, Corporate Law Reform in the People's Republic of China, 1 et seq.

16 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 95.

17 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 277.

18 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995,281 und 286.

19 Likely, the Chinese government took Singapore as an example at that time, after a visit of then Vice-Premier Deng Xiaoping to the Southeastern city-state in November 1978: Ties will improve with mutual visits: Teng, The Straits Times, 13 November 1978, 1, http://eresources.nlb.gov.sg/newspapers/Digitised/Article/straitstimes19781113-1.2.3.

20 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 282 et seq.

21 羊城晚报 October 28, 2004, Editorial.

22 中华人民共和国全民所有制工业企业法 *Zhōnghuá Rénmín Gònghéguó quánmín suǒyǒuzhì gōngyè qǐyèfǎ.*

23 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 279.

possible, but only in cases where they either were bankrupt[24], hardly generating any profits or otherwise did not fit into the concept[25].

On the occasion of an inspection trip to southern China in early 1992, DENG XIAOPING stressed once again in a speech that planning and market economy would not be mutually exclusive; one would only have to find ways to counter undesirable side effects of the market economy, such as strikes, in order to remain faithful to the socialist ideal[26]. This speech is likely to have paved the way for the Chinese Company Law of 1994. Even before that, in 1990, the Shenzhen and Shanghai stock exchanges were opened, and in 1992 the 1992 the China Securities Regulatory Commission (CSRC) was established in order to monitor the stock market[27].

Partial or complete privatization of SOEs on a larger scale only were permitted starting in the 1990ies and took one of four forms: (1) share issues to the purchaser; (2) joint ventures with foreign firms; (3) management buyouts; or (4) sale to outsiders[28].

Starting from 1998, the CPC embraced a "going abroad" strategy in order to gain a footing in international markets, take advantage of resources abroad, and strenghten the Chinese economy[29]. At first, companies in Asia and Africa seem to have been the main target of acquisitions. However, in 2016 even Western countries including Switzerland began to realize that Chinese companies are on an acquisition spree, with a total $249 billion of foreign purchases being announced in that year[30]. For instance, the tourism company Hainan Airlines (HNA) alone spent over $30 billion, taking heavy risks and taking on a lot of debt[31]. As a consequence, many foreign companies will find themselves in Chinese hands and thus be affected by the corporate structure of their Chinese owners and indirectly subject to the influence of the Chinese company law.

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24 Despite corporate bankruptcy laws have been in place since 1988 and 2007, respectively, the number of official bankruptcies is insignificant (Corporate insolvency in mainland, Hong Kong seen rising this year, South China Morning Post, May 31 2015, http://www.scmp.com/business/china-business/article/1814062/corporate-insolvency-mainland-hong-kong-seen-rising-year).

25 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 287.

26 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 287.

27 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 95.

28 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 96.

29 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 95 et seq.

30 See https://www.bloomberg.com/graphics/2016-china-deals/.

31 See https://fajus.wordpress.com/2016/10/30/hainan-airlines-im-einkaufsfieber/.

## Chinese Company Law

### Legislative History of the Company Law

*The Company Law of the People's Republic of China (Company Law)*[32] was adopted by the Chinese National Congress in 1993 and entered into force in 1994. It represents a milestone in the transformation of the Chinese economy from a planned economy to a market-oriented economic regulation.

The primary objective of the 1993 Company Law was to remove the inefficiencies of state enterprises, which should improve management structures, strengthen competition, and influence the state's influence on the day-to-day business[33]. As already mentioned, privatization, which took place in Eastern Europe in the nineties, was not an issue. The promotion (small) private enterprise was a mere secondary goal of the Company Law of 1994[34].

The Company Law of 1994 suffered from numerous shortcomings. In particular, the hurdles for founding a company were to high, there were major gaps in corporate governance, the protection of shareholders was inadequate, the responsibilities of the governing bodies were not clearly defined, and in general the law seemed vague or even contradictory. After some minor corrections had been made in 1999, the accession to the World Trade Organization in 2001 necessitated further adjustments of the legal framework, especially in view of Western investors. Therefore, the Company Law was radically revised only eleven years after its entry into force. Out of 229 provisions of the 1994 Company Law, 46 were deleted, 137 were changed and 41 newly added[35]. The revised law was adopted in 2005 and entered into force on January 1, 2006.

But after the reform is before the reform: The next amendment was passed on December 28, 2013, the corresponding changes came into force on March 1, 2014. In particular, the requirement of a fixed capital was abolished do some degree in this third round of amendments[36].

### Content of the Company Law

The Chinese company law follows largely its Western models with regard to vocabulary and structure, whereby two company forms are available: a CLS, the Company Limited by Shares, comparable to

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32 中华人民共和国公司法 *Zhōnghuá Rénmín Gònghéguó gōngsīfǎ.*

33 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 274 et seq.

34 ART Robert C./GU Minkang, China Incorporated: The First Corporation Law of the People's Republic of China, Yale Journal of International Law, Vol. 20, 1995, 275.

35 MOLCHYNSKY Andrei, "Seize and Hold With Both Hands": The Political Implications of Corporate and Securities Law Reforms Under Hu Jintao, November 2012, http://ssrn.com/abstract=2257263, 3.

36 In detail see KÖPPEL Christoph, The Chinese Company Law Revision and its Implications for Foreign Invested Enterprises, in: Jusletter June 16, 2014.

large stock corporation or *Aktiengesellschaft (AG)* in Western countries, or a Limited Liability Company (LLC) intended for a smaller and more closely-knit group of investors, modeled on the *Gesellschaft mit beschränkter Haftung (GmbH)*.

Variations of those two types of companies are the Wholly State-Owned Limited Liability Company (WSOLLC), a special type of LLC that may be wholly owned by a state agency, and the Wholly Foreign-Owned Enterprise (WFOE) which will be discussed below.

The general rules are laid down in the first chapter of the Company Law. The second and third chapters contain provisions on the Limited Liability Company (LLC), in particular the provisions on their establishment and organs, as well as the transfer of the company shares. The fourth chapter deals with the establishment and the organs of the Company Limted by Shares (CLS), the fifth chapter with the issue and transfer of its shares. Chapter 6 deals with the qualifications and duties of the members of the Board of Directors and Supervisory Board as well as with the management. In the 7th to 9th chapter financial aspects of the company's activity are discussed, in the 10th chapter the dissolution of the enterprise. The 11th chapter covers some aspects of the establishment of branch offices of foreign companies. The 12th chapter contains the rules of liability, the 13th chapter lists some supplementary rules.

### Special Features of the Company Law

As shown above, the Company Law does not contain any major surprises with regard to structure and content, at a first glance. One might think that the Company Law is a mere legal transplant from Continental Europe. However, a closer look reveals that the specific socio-economic situation of Communist China has left its traces:

- First of all, Article 1 Company Law reveals the intended purpose, which may be translated as follows: *This law has been enacted in order to standardize the organization and activities of companies, protect the lawful rights and interests of companies, shareholders and creditors,* ***safeguard the social and economic order and promote the development of the socialist market economy****.*

- A similar intention is expressed by Article 5 (1) Company Law: *When engaging in business activities, a company shall abide by laws and administrative regulations,* ***observe social morality*** *and business ethics, act in good faith, accept supervision by the government and the public, and bear* ***social responsibilities****.*

- Article 18 of the Company Law defines the role of trade unions: *The employees of a company shall organize a labor union and conduct labor union activities in accordance with the Labor Union Law of the People's Republic of China to protect the lawful rights and interests of the employees.* ***The company shall provide its labor union with conditions necessary for conducting its activities.*** *The labor union of the company shall enter into collective contracts on behalf of the employees with the company with respect to such matters as labor remuneration, working hours, welfare, insurance and labor safety and health of the employees according to the law. [...]*

- The Communist Party is also firmly implanted in Chinese corporate law, more precisely in Article 19 of the Company Law: *In a company, an organization of the Communist Party of China shall be established to carry out the activities of the party in accordance with the charter of the Communist Party of China.* ***The company shall provide the necessary conditions for the activities of the party organization.***

The four provisions above may look harmless at first sight, but they have tremendous influence on the operation of a company in China. In particular, Article 18 and 19 of the Company Law ensure that the Communist Party of China (CPC) is equally anchored in virtually every enterprise, regardless whether it is small or large, one-hundred percent Chinese, or wholly foreign-owned.

The presence of the CPC in a Chinese company usually is marked by a party member who bears the harmless title of "secretary"[37], and who might not be particularly noticeable – many of the "secretaries" are well-mannered, of modest appearance and dress unobtrusively. But often, the "secretary" is a gray eminence who exercises a lot of influence behind the scenes. Therefore, one should not underestimate the party representative in a company or even dare to insult him. On the positive side, the members of the communist party are usually highly educated people who have a genuine interest in contributing to the success of the enterprise[38].

As the trade unions are subject to the strict control of the Party, the CPC is actually doubly represented in a company through Article 18 Company Law[39]. The influence of the trade unions again should not be underestimated, as the interests of the labourers they represent basically also are the interests of the CPC who wants to promote a "harmonious society", full employment and social security.

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37 书记 *shūji*.

38 HAWES Colin, Interpreting the PRC Company Law Through the Lens of Chinese Political and Corporate Culture, UNSW Law Journal, Vol. 30 (3) 2007, 817 et seq.

39 HAWES Colin, Interpreting the PRC Company Law Through the Lens of Chinese Political and Corporate Culture, UNSW Law Journal, Vol. 30 (3) 2007, 815.

In the neoclassic theory of the firm the operation of an enterprise in a market economy has only one objective: the (long-term) profit optimization. The Chinese legislator obviously sees this differently. Thus, the (more or less compulsory) negotiations with the trade union are not limited to questions of remunerations or arrangements for working hours. On the contrary, Article 18 of the Company Law cements the function of the enterprise to provide services which are provided by the state in other countries, such as (health) insurance, social benefits, regulations on labor safety, etc. In view of the ageing society, the introduction of nationwide state social insurance system is a major headache[40]. Even though the Chinese government seeks to steer away from an employement-based social insurance system that creates lots of costs for the employers[41], the CPC representatives and the trade unions are under a lot of pressure to achieve a satisfying "negotiation result" with the company they are in charge of, so as to lessen the pressure on government funds.

Even if the terms used in Articles 1 and 5 of the Company Law such as "socioeconomic order", "development of social market economy" or "morality" are rather vague, it can not be assumed that they are merely boilerplate language. Rather, these terms reflect the interest of the Communist Party and the Chinese Government to maintain social stability, even at the cost of hindering the maximization of the profits of the enterprise.

In sum, Chinese corporate law is opposed to a pure profit optimization strategy. Corporations in China have restricted autonomy in business decisions. The authorities, especially the Communist Party, exercise control everywhere, regardless of whether the company it is a domestic or foreign, private or state-owned, small or large, etc. This can be an advantage for the company, but it can also be an important obstacle to successful business operations in China.

## Emergence of Corporate Governance Rules for Chinese Companies

### Overview

The term corporate governance originated in the US in the mid-1970's, but still lacks a clear definition. It encompasses all measures for the efficient efficient management of companies and goes beyond traditional concepts such as duty of good faith, loyalty, care, and due diligence; rather boards and managers are required to ensure that the entity they are managing is competitive, ensures efficient operations and allocates its resources adequately[42].

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40 See http://www.clb.org.hk/content/china%E2%80%99s-social-security-system.

41 For pension funds, health insurance, maternity insurance, unemployment insurance, housing subsidies etc. about 40% has to be added to the basic salary (http://www.faz.net/aktuell/wirtschaft/arbeitskosten-china-ist-kein-billigstandort-mehr-12116248.html).

42 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 92.

Up to the early 1980's, corporate governance rules were completely lacking in the PRC, as all "enterprises" were "managed" by the state bureaucracy through production plans and administrative rules. Between 1984 and 1986 first attempts were made to separate the dual roles of the government as the owner and the regulator by giving the directors more leeway and levying taxes to scoop of the profits. However, as a modern company law only emerged 1993, the need of corporate governance[43] rules began to be perceived only recently. Some rules have been copied haphazardly from the West, other rules are distinctly Chinese. Although much has been written about Chinese-style corporate governance, an appropriate and effective system has not been established yet[44].

As far as the legislation is concerned, no set of comprehensive rules can be found. As far as listed companies are concerned, the China Securities Regulatory Commission (CSRC) lists a grand total of 22 regulations that deal with corporate governance issues[45]. For example:

- In 2002, issued the *Code of Corporate Governance for Listed Companies*[46]*,* but it is unclear whether this code has binding effect[47].

- In 2008, the *Basic Regulation of Internal Control*[48] was issued jointly by the Ministry of Finance, the CSRC, the National Audit Office, the Chinese Insurance Regulatory Commission and the Chinese Banking Regulatory Commission. The internal control mechanisms were further regulated by the CSRC in 2010[49]. Again, it is unclear how this regulation is to be enforced[50].

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43 公司治理 *Gōngsī zhìlǐ.*

44 TOMASIC Roman, Corporate Governance in Chinese Companies Going Global, Working Paper, February 3, 2013, available at http://ssrn.com/abstract=2335476, 4.

45 See http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/index.html.

46 上市公司治理准则 *Shàngshì gōngsī zhìlǐ zhǔnzé.* http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/201012/t20101231_189703.html.

47 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 3.

48 企业内部控制基本规范 *Qǐyè nèibù kòngzhì jīběn guīfàn* http://www.mof.gov.cn/zhengwuxinxi/caizhengwengao/caizhengbuwengao2008/caizhengbuwengao20087/200810/t20081030_86252.html.

49 企业内部控制配套指引 *Qǐyè nèibù kòngzhì pèitào zhǐyǐn,* http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/201012/t20101231_189846.html.

50 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 4.

- As early as 2001, the CSRC started to issue regulations on independent directors[51]. Whether independent directors fit into the Chinese legal system with its deep roots of Confucianism and the continuing control of the Communist party remains to be seen.

- On various occasions, the CSRC was also concerned with the organization of the shareholders meeting[52]. The respective rules were last revised in 2016.

Besides, various rules affecting corporate governance are to be found dispersed in the Company Law, in particular rules affecting the corporate structure (i.e. the board of directors and the board of supervisors, respectively, the shareholder meeting etc.), the duty of loyalty and the regulation of conflicts of interest.

### Governance by the Government

Despite the various rules affecting corporate governance, governing corporations is still largely seen as the duty of the government. This is due to the policy of maintaining full or controlling ownership in several sectors in order not only to maximize revenues for the state, but also to maintain employment levels, control politically sensitive industries, and to provide jobs for political cadres and their offspring[53].

State Owned Enterprises (SOEs) still dominate the Chinese economy, despite the staggering number of "private" enterprises. There are no signs whatsoever of the state withdrawing from the economy. On the contrary the Chinese government is firmly committed to retaining control national security-related industries, natural monopolies, sectors providing important goods and services to the public, and important enterprises in pillar industries and the high-technology sector; the leverage of the state has even increased, by making use of capital inflows of external investors while maintaining full control of companies[54]. Pursuant to the abovementioned Policy of *Made in China 2025*[55], and out of fear of private industries moving to countries where labour costs are lower, state influence might be even further increased.

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51 关于在上市公司建立独立董事制度的指导意见 *Guānyú zài shàngshì gōngsī jiànlì dúlì dǒngshì zhìdù de zhǐdǎo yìjian,* http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/201012/t20101231_189696.html.

52 上市公司股东大会规则 *Shàngshì gōngsī gǔdōng dàhuì guīzé,* available at http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/201701/t20170111_309312.html.

53 CLARKE Donald C., Corporate Governance in China: An Overview, China Economic Review 14 (2003), 495.

54 CLARKE Donald C., Corporate Governance in China: An Overview, China Economic Review 14 (2003), 497.

55 «中国制造 2025» *Zhōngguó zhìzào 2025,* http://www.gov.cn/zhengce/content/2015-05/19/content_9784.htm.

State influence is by no means limited to SOEs, in fact, it is quite impossible to draw a clear line between SOEs and privatized entities. The traditional notion of associating voting power with control of the entity is completely misleading in the Chinese corporate world, control by the state can also been ensured through indirect and oblique means, such as exercising influence through members of the Chinese Communist Party within the company, contractual agreements with the private shareholders, or by granting generous supply of state funds[56].

### Shareholder Meeting Supremacy?

Theoretically, the shareholder meeting has the supremacy in Chinese firms, and the list of it's rights and duties is impressive[57]. However, given the fact that the major shareholder in large enterprises is mostly the state, and that minority shareholders enjoy no particular protection under the Company Law, not much shareholder activism has been seen so far[58].

State ownership creates a particular problem in China, the phenomen of the "absent owner[59]": The state as a majority owner of thousands of companies is forced to handle the daily business through local representatives who may or may not be independent from the local government[60].

### Independent Directors

In 2001 the China Securities Regulatory Commission (CSRC) issued *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*[61]. The guidelines require all listed companies to introduce independent directors who hold no other posts in the company, and who maintain no relations with the listed company and its major shareholder that might prevent them from making objective judgment independently. At least one third of the board of directors should consist of independent members, one of which should be an accounting professional. Whether such a rule can be implemented in a social system that not only stresses interpersonal hierarchies and backdoor

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56 SAPPIDEEN Razeen, Corporate Governance With Chinese Characteristics: The Case of State Owned Enterprises, Frontiers of Law in China, March 2017, 99 et seq.

57 Articles 37 and 99 Company Law.

58 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 23.

59 所有者缺位 *Suǒyǒuzhě quēwèi.*

60 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 20 et seq.

61 关于在上市公司建立独立董事制度的指导意见 *Guānyú zài shàngshì gōngsī jiànlì dúlì dǒngshì zhìdù de zhǐdǎo yìjian,* http://www.csrc.gov.cn/pub/newsite/flb/flfg/bmgf/ssgs/gszl/201012/t20101231_189696.html.

connections[62] but also insists on the supremacy of the Communist Party, thus creating a "vertical agency problem[63]" remains to be seen.

## Special Rules for Foreign Investors

### Major Laws Regarding Foreign Investment

According to Article 217 of the Company Law, the Company Law in principle also applies to companies established with foreign capital. Although creating a uniform corporate law has been discussed for a long time, foreign investors are still subject to numerous special provisions. In this respect, the Law on Cooperative Joint Ventures (CJV)[64], dating back to 1988, the Law on Equity Joint Ventures (EJV)[65] of 1979, and the Law on Foreign Invested Enterprises (Wholly Foreign-Owned Enterprises, WFOE)[66] of 1986 are relevant[67]. Approximately 80% of companies with foreign capital are now being developed as WFOE[68]. However, depending on the nature of the business to be undertaken in China, it may also be necessary to establish a Joint Venture with a Chinese business partner.

While abandoning the four laws regarding foreign enterprises entirely has been discussed, radical changes have been omitted so far. Only minor changes have been made to those laws recently, in particular a few amendments were made in September 2016[69].

### Tools of a Planning Economy

#### *Approval Regime*

All *Foreign Invested Enterprises (FIE)* are subject to an approval regime. The scope and nature of a project determine whether foreign investments in relevant industries will be subject to the approval of the *Ministry of Commerce (MOFCOM)* or its local branches.

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62 关系 *Guānxi.*

63 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 13.

64 中华人民共和国中外合作经营企业法 *Zhōnghuá Rénmín Gònghéguó Zhōng-wài hézuò jīngyíng qǐyè fǎ.*

65 中华人民共和国中外合资经营企业法 *Zhōnghuá Rénmín Gònghéguó Zhōng-wài hézī jīngyíng qǐyè fǎ.*

66 中华人民共和国外资企业法 *Zhōnghuá Rénmín Gònghéguó wàizī qǐyè fǎ.*

67 In detail see XU Tian/SCHIWOW Emanuel, A Changig Landscape – Update on Foreign Investment Vehicles in China, GesKR 2/2011, 1 et seq.

68 DAVIES Ken, China Investment Policy: An Update, OECD Working Papers on International Investment, 2013/01, OECD Publishing, available at http://dx.doi.org/10.1787/5k469l1hmvbt-en, 14.

69 全国人民代表大会常务委员会关于修改《中华人民共和国外资企业法》等四部法律的决定 *Quánguó Rénmín Dàibiǎo Dàhuì chángwù wěiyuánhuì guānyú xiūgǎi 《Zhōnghuá Rénmín Gònghéguó wàizī qǐyè fǎ》 děng sìbù fǎlǜ de juédìng,* available at http://www.npc.gov.cn/npc/xinwen/2016-09/03/content_1996747.htm.

Recently, the approval regime has been somewhat amended in order to simplify the complex procedures on different levels: On September 3, 2016, the Standing Committee of the National People's Congress passed the *Decision on the Amendment of Four Laws including the Law of the People's Republic of China on Wholly Foreign Owned Enterprises*[70] (Decision). The Decision, which became effective as of October 1, 2016 establishes a "recordal system" for the establishment and administration of corporate changes of foreign invested enterprises incertain industries.

### *Catalog*

The Chinese state exercises its control not only in the form of posting CPC members within the enterprises, but also directly controls investments. Foreign investors who plan to invest in a Chinese company must first check the "Catalog", more precisely the *Catalog for the Guidance of Foreign Investment Industries*[71], which was last revised in 2015. The Catalog sorts foreign investment projects into the "encouraged", "permitted" and "prohibited" categories.

On December 7, 2016, China's National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) released a new draft of the Catalog for public comment until January 6, 2017[72]. According to the new draft a few currently restricted and prohibited sectors might be opened to foreign investors. The draft Catalog groups industries under two main categories: "encouraged", and "prohibited" (the Negative List). Industries not appearing on the list are classified as "permitted". Some industries that are subject to limitations on foreign share ownership are listed in the Negative List, but may still be "encouraged" insofar as they may enjoy preferential policies available to industries listed under the "encouraged" category.

According to the draft Catalog, some foreign investments are now treated the same as domestic investments. The "national treatment" includes sectors such as construction and operation of large-scale theme parks, the construction of golf courses and villas, and other areas that are severely restricted even for Chinese investors.

While some investors may welcome the proposed changes in the catalog, the frequent revisions – the last amendments entered into force in 2015, before that changes were implemented in 2011 – are bound to create confusion even among professionals and administrative agencies.

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70 全国人民代表大会常务委员会关于修改《中华人民共和国外资企业法》等四部法律的决定 *Quánguó Rénmín Dàibiǎo Dàhuì chángwù wěiyuánhuì guānyú xiūgǎi 《Zhōnghuá Rénmín Gònghéguó wàizī qǐyè fǎ》 děng sìbù fǎlǜ de juédìng,* http://www.npc.gov.cn/npc/xinwen/2016-09/03/content_1996747.htm.

71 外商投资产业指导目录 *Wàishāng tóuzī chǎnyè zhǐdǎo mùlù,* http://www.fdi.gov.cn/1800000121_39_4830_0_7.html.

72 Source: http://wzs.mofcom.gov.cn/article/n/201612/20161202088897.shtml.

There are also sectoral catalogs and/or certain regulations valid for certain zones, such as the Catalog of Priority Industries for Foreign Investments in Central and Western regions[73] last revised in 2017. Prioritized projects are in particular benefiting from tax breaks and other government subsidies[74].

### *Regional Policies*

Preferential policies are not limited to national legislation, several cities and provinces have their own policies regarding foreign investment. While in Shanghai in 2013 a "free trade zone" was created with enticements such as free Internet access and facilitated company registration[75], the city of Beijing in 2014 forbade almost any new new projects from its domestic and foreign investors (except in specially designated zones), in particular industrial enterprises, shopping malls, luxury apartments, golf courses, hotels, office buildings, exhibition buildings, hospitals, universities, call centers, data centers, etc.[76]

### *Other Regulations*

Other regulations targeting foreign companies, such as rules regulating any kind of online content[77] can severely restrict the scope of business.

In addition to the above-mentioned investment rules issued on national, provincial, and city level, the various authorities involved in the approval and supervision of the company's operations have still adopted their own implementing provisions.

## Setting up a Foreign Company in China

Even though the Chinese government seeks to facilitate foreign investment, investing in a Chinese company is still very complicated. This is reflected by the "Ease of Doing Business" ranking issued by the World Bank in 2017, where China ended up on rank 127 out of 190 as far as starting a business is concerned – far behind neighbors such as Singapore (rank 6), South Korea (11), or Taiwan (19)[78]. Setting up an an international company – in most cases a WFOE – in China basically takes three steps:

1. The investor needs to check in advance whether the intended purpose of the company might be approved by the competent authorities, and if yes, in which form, in which place or in

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73 中西部地区外商投资优势产业目录 *Zhōngxībù dìqū wàishāng tóuzī yōushì chǎnyè mùlù.*

74 In detail see KROYMANN Benjamin, Das Kapitalgesellschaftsrecht der VR China, Tübingen 2009, 36 et seq.

75 See http://www.merkur-online.de/aktuelles/wirtschaft/freihandelszone-shanghai-zieht-kaum-internationale-firmen-zr-3245169.html.

76 Beijing Municipality Catalogue of Prohibited and Restricted New Addition Industries (2014 Edition), available at http://www.conventuslaw.com/china-beijing-issues-catalogue-banning-or-restricting-new-addition-projects-in-various-industries/.

77 网络出版服务管理规定 *Wǎngluò chūbǎn fúwù guǎnlǐ guīdìng,* Regulation on Web Publishing Services, available at http://www.miit.gov.cn/n1146295/n1146557/n1146619/c4639081/content.html.

78 Source: http://www.doingbusiness.org/data/exploreeconomies/.

which city district and through which authority at which level. The aforementioned “Catalog”, issued by the Ministry of Commerce (MOFCOM), which is updated every few years, serves as a primary aid. In addition, the possibilities and/or prohibitions resulting from sectoral or locally valid “Catalog” and the other implementing regulations of the authorities have to be kept in mind.

2. In a second step, it is necessary to examine whether the foreign investor is recognized by the Chinese authorities. In principle, the foreign investor must be a company in the form of a legal person. There are numerous proofs, such as a “Certificate of Good Standing”, a business license, the Bank's solvency and account statements, the passport of the authorized signatory, a description of the business activity of the investor, including a financial statement and business activity records in the relevant industry, etc. to be provided. Those documents must be certified by the competent authorities in the country of origin and by the Chinese embassy.

3. A peculiarity of Chinese corporate law is that not only the purpose of the company itself is subject to approval, but also the concrete planned business activity. Appropriate authorization from the competent authority is an integral part of the creation of the company. Specifically, the following documents must be submitted: articles of association, capital and management information (management, local directors and their powers, etc.), feasibility study (business plan and budget), lease agreements for sufficient business premises by a person authorized to lease, job descriptions including the planned salary payments including benefits (the latter are substantial, as mentioned above), passport, CV and photographs of the legal representative of the company and, if necessary, other management personnel, Chinese name of the company, etc., etc.

Depending on the nature of the project, it takes between two and five months for all the grants of the various granting authorities to be collected. Depending on whether the project is politically desirable or viewed as problematic, the duration of the grant or business start-up procedure can vary considerably.

## Minority Shareholder Protection in Sino-Foreign Equity Joint Ventures

Interestingly, minority shareholder protection plays a greater role in the legislation affecting foreign invested enterprises, and in particular Joint Ventures, than in the Company Law mainly affecting Chinese firms. It was by no means the intent of the Chinese legislator to give a preferential treatment to foreign investors. Rather, in the *Reform and Opening-up* stage of Chinese history, there was much

fear that the State as minority shareholder might be overruled by foreign investors[79]. Despite there having been discussions about corporate governance in general and minority shareholder protection in particular for decades, China is still lagging behind. In the "Ease of Doing Business" ranking of the World Bank, China's rank is 123 out of 190[80].

The following outline on minority shareholder protection is based on the scenario of a Chinese-foreign equity joint venture (EJV) formed by two parties in which the foreign partner holds a minority interest[81]. Furthermore, it's assumed that improvements to the joint venture contract would be acceptable both to the Chinese party and the MOFCOM, admittedly a rather bold assumption[82]. According to Article 4 of the EJV Law the equity joint venture shall take the form of a limited liability company.

Minority shareholder protection measures usually include giving the weaker party voting and decision powers beyond what is delimitated by the stance "one share one vote" on one hand, and giving them an option to sell out their stocks if they are still "oppressed" on the other hand. If things go totally wrong, shareholder litigation for damage compensation will have to be considered.

Another way to protect the minority investor in a joint venture would be to guarantee returns on investment to him. However, Article 4 EJV Law seems to limit the leeway for bargaining as to this point, since the parties are to share profits, risks and losses in proportion to their contributions to the registered capital.

Minority shareholder protection is not just about the law and its enforcement by the government, but also, and primarily, about the use of legal remedies by the minority shareholders themselves[83]. This is especially true for joint ventures, where there is much room for negotiation. Therefore, the focus will be on the leeway given by the law to protect the minority shareholder through the provisions of the joint venture contract and the articles of association of the EJV-company.

The traditional playing field of corporate governance improvements, the shareholders' meeting, isn't even mentioned in the EJV Law. Rather, the provisions of the Company Law apply. Shareholders

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79 LIU Junhai / PIßLER Knut Benjamin, Corporate Governance of Business Organizations in the People's Republic of China: The legal framework after the revision of the Company Law in 2005, Country Report on Corporate Governance delivered to the 18th International Congress of Comparative Law of the International Academy of Comparative Law in Washington DC in 2010, available at http://ssrn.com/abstract=1695888, 5.

80 Source: http://www.doingbusiness.org/data/exploreeconomies/china.

81 In fact, even if the Chinese partner has the minority of shares, he still may have factual control over the joint venture company, so "minority interest" is to bee understood in a broad sense.

82 Seemingly "preferential terms" for the foreign party increase the risk for the JV contract not to get approved, see CHAN Joseph, Venture Capital and Private Equity in China, Beijing 2008, 705 et seq.

83 See HUA Cai, Bonding, Law Enforcement and Corporate Governance in China, Stanford Journal of Law, Business & Finance, Vol. 13:1, Fall 2007, 83 et seq.

holding ten percent or more of the voting rights may call for an interim shareholder meeting (Article 38 Company Law). While the competences of the shareholders meeting are rather of a general nature and does not include making detailed business plans or day-to-day decisions, there remains the option to give the shareholders' meeting more functions in the articles of association (Article 38). However, the board of the joint venture must remain in charge of the material decisions relating to running the business[84]. According to Article 43 of the Company Law, the principle is "one share one vote"; however it is possible to give the minority shareholder some veto rights concerning certain corporate transactions in the articles of association[85]. As a matter of law, decisions concerning the revision of the articles of association, increasing or decreasing the registered capital, merger, split-up, dissolution and change of the form of the company require a supermajority of two thirds or more of the voting rights (Article 44 (2) Company Law).

According to Article 6 of the EJV Law, a board of directors needs to be set up to discuss and decide all major issues of the joint venture. The number of directors to be elected by each party (rather than through the shareholders' meeting like in a normal limited liability company) needs to be stipulated in the in the joint venture contract and the articles of association, and the posts of chairman and vice-chairman shall be evenly distributed among the parties. Article 6 EJV Law as well as the Articles 45, 47 and 49 of the Company Law give the shareholders some leeway in the articles of association as to how the board of directors is to be composed, as to the functions it takes on and as to how the voting is to be carried out. For the board of directors it is strictly "one man one vote" (Article 49 (3) Company Law), so the composition of the board needs to be well balanced in order to allow for the protection of the minority shareholder.

While under Article 50 Company Law it is the board of directors' function to hire the general manager and the manager's duty to hire the vice managers, Article 6 stipulates that the offices of general managers and vice-general manager are to be appointed by the parties in a balanced way.

An option is to set up a board of supervisors (Article 51 to 57 Company Law). Whether the benefits of having a board of supervisors outweigh the cost, or not, is up to the joint venture partners to decide. In practice the board of supervisors has proven to be of little use[86].

Another option is to reserve some board seats for so called "independent directors". However, this measure doesn't seem to be very effective to enhance corporate governance in practice[87].

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84 CHAN Joseph, Venture Capital and Private Equity in China, Beijing 2008, 713 et seq.
85 CHAN Joseph, Venture Capital and Private Equity in China, Beijing 2008, 706.
86 CLARKE Donald C., Three Concepts of the Independent Director, 32 Delaware Journal of Corporate Law 1/2007, 73 et seq.
87 CLARKE Donald C., Three Concepts of the Independent Director, 32 Delaware Journal of Corporate Law 1/2007, 75 et seq.; HUA Cai, Bonding, Law Enforcement and Corporate Governance in China, Stanford

Possibly, while taking care of all the formalities in the setup of the joint venture, the parties may forget to pay enough attention to "soft factors". The power of the minority shareholder on paper should mach up with the power in fact. Just having the right to nominate the chairman of the board of directors or the general manager doesn't necessarily mean the persons appointed will have a say in the running of the company. Minority shareholders' rights can also be thwarted by insufficient presence or insufficient (intercultural) communication skills of the management.

According to Article 34 (1) of the Company Law shareholders are entitled to consult and copy the articles of association, minutes of shareholders' meetings, resolutions of the meetings of the board of directors and of the board of supervisors, as well as financial reports. Shareholders also may request the accounting books, however, according to Article 34 (2) Company Law, access may be denied if there are justifiable reasons.

What could be accomplished with the minutes of the meetings of the boards of directors and supervisors is not quite clear, as the shareholders usually shouldn't be allowed to interfere with their business decisions. What might be helpful is some insight into the accounting information of the company. Tunnelling (defined as expropriation of minority shareholders by the controlling shareholders[88]) and cooking the books will usually leave some traces in the accounting information[89], if one bothers to take a closer look. The China Accounting Standards (CAS) as of December 31, 2007, which were largely modelled on the "European" International Financial Reporting Standards (IFRS)[90] seem to be quite state of the art[91].

The right of insight to the accounting information may even be further specified in the Joint Venture agreement, i.e. giving the investor access to monthly accounting data[92].

If (possible) conflicts in a Joint Venture can't be solved by giving the minority shareholder adequate participation rights, the second best remedy is probably the "exit" option, meaning the shareholder leaves the company. There are probably no benefits to the Joint Venture if the dissatisfied minority shareholder is kept locked in while the relationship between the shareholders has gone awry. Ideally,

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Journal of Law, Business & Finance, Vol. 13:1, Fall 2007, 96 et seq. For listed companies, independent directors would be requested under *the Guidance Opinion on the Establishment of an Independent Director System in Listed Companies*.

88 JIANG Guohua / LEE Charles M.C. / YUE Heng: Tunneling in China: The Remarkable Case of Inter-Corporate Loan, SSRN Working Paper (http://ssrn.com/abstract=1154314), May 2008, 1.

89 JIANG Guohua / LEE Charles M.C. / YUE Heng: Tunneling in China: The Remarkable Case of Inter-Corporate Loan, SSRN Working Paper (http://ssrn.com/abstract=1154314), May 2008, 26.

90 CHEN Baolang (ed.), China Accounting Standards (CAS) – Summery, Changes and Comparison, Beijing 2008, 207 et seq.

91 Probably a bit too much artistry has been used lately in accounting, however, that's not a problem to be discussed here.

92 CHAN Joseph, Venture Capital and Private Equity in China, Beijing 2008, 706.

the exit shouldn't lead to the break-up of the JV's business venture, as this usually leads to more damage to both parties than strictly necessary. This means the shares have to be bought by the majority shareholder, a third party or the company itself.

Exit poses no major problem if the stocks of the joint venture are traded publicly. In this case the minority shareholder can simply sell his shares on the markets. Then again, in the classical version the joint venture is a close company, which makes exit more difficult. Ideally, the rules for exit are set forth in the joint venture contract, as there are quite a lot of delicate issues involved. For instance, possible buyers for the minority shareholder's shares often tend to be from the same line of business as one or both of the joint venture partners.

A way of enhancing exit is to include "registration rights" in the joint venture agreement. One form of registration right is the "demand right", giving the (minority) shareholder the right to request that the company goes public under certain circumstances. The other form of registration right is the so called "piggyback right", giving the right to the minority shareholder to participate in an IPO if the company itself or the majority shareholder decides for a public offering[93].

Even if there's no contractual right for exit, there still remains room for bargaining, as a joint venture in deadlock will probably not be very satisfactory for either party, as all the energies are spent for fighting each other instead of focusing on making money. If exit cannot be achieved on a contractual basis, the options offered by the company law will have to be considered.

Article 72 of the Company Law is quite useful: Even if the transfer of stock is only possible with the consent of the majority of the shareholders, such consent is deemed as given if the shareholders refusing the permission for the transfer are not willing to purchase the stocks themselves.

Under certain circumstances described in Article 75 Company Law[94], there is a "redemption right" meaning the company may buy the stocks of the minority shareholder at a "reasonable" price, if the shareholder has voiced his dissent in resolutions of the shareholders' meeting and one of the following circumstances is given:

> If the company failed to pay dividends for five consecutive years, even though the company made profits;
>
> In the case of merger, division or transfer of major assets of the company;
>
> When the business term of as specified in the articles of association has expired and the majority decided to continue operation by changing the articles of association.

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93 CHAN Joseph, Venture Capital and Private Equity in China, Beijing 2008, 707.

94 This provision has been criticized because it limits the redemption rights to very few situations (TANG Xin, Protecting Minority Shareholders in China, A task for both legislation and enforcement, in: Kanda/Kim/Milhaupt, Transforming Corporate Governance in China, London/New York 2008, 145).

In the worst case scenario, a joint venture in deadlock will have to be dissolved pursuing to Article 14 EJV Law.

Violations of the minority shareholders' rights are likely to constitute a breach of contract by the majority shareholder, entitling the minority shareholder to ask for termination of the contract and damage compensation (Article 14 EJV Law).

Usually, issues referring to the joint venture agreement will be dissolved through arbitration, unless the parties failed to stipulate an arbitration clause (Article 15 EJV Law). To protect the minority shareholders' interests in arbitration, it might be wise to provide arbitration outside of China, as there remain some concerns about the impartiality of arbitration tribunals in China as well as to the quality of the judgements rendered. Namely, while the short duration of Chinese arbitration compares favourably to foreign arbitration institutions at a first glance, it is not quite sure whether rushing things is really good for more complex disputes[95]. If the arbitration is to be held in China, provisions in the arbitration agreement on the choice of arbitrators need to be considered; otherwise it will heavily lean on Chinese arbitrators[96], who might be more inclined to rule in favour of the Chinese majority holder.

## Conclusion

Even if the Chinese corporate law, which came into force twenty years ago, at first sight is very similar to its Western model, it soon becomes clear that it operates under very different premises. In particular, the Chinese legislature is still going from the all-round state enterprise. Even if private companies are tolerated and foreign investment is welcome, this does not mean that this would be granted full autonomy. Rather, the state or the Communist Party is omnipresent and directs investment in the desired direction. Furthermore, rules on corporate governance are rather underdeveloped and protection of minority shareholders is as good as nonexistent. Anyone who wants to take up a business in China should be aware of these obstacles and stumbling blocks, and also adhere to a lengthy approval procedure. Especially when forced to enter into a joint venture with a Chinese company, special attention has to be paid to the protection of the minority shareholder.

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95 DARWAZEH/MOSER and MOSER/YUEN in: MOSER Michael (ed.), Managing Business Disputes in Today's China, The Netherlands 2007, 82 and 89.

96 DARWAZEH/MOSER in: MOSER Michael (ed.), Managing Business Disputes in Today's China, The Netherlands 2007, 82.

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