CHINA'S NEW COOPERATIVE JOINT VENTURE LAW

Timothy A. Gelatt*

In the decade since the People's Republic of China (PRC) began opening its doors to foreign investment in the late 1970s, several vehicles have been developed through which foreign firms may invest in the PRC to undertake manufacturing or service projects. The first vehicle to be officially offered to foreigners as a means for investment was the "equity" joint venture (EJV), which was given its legislative basis in a brief 1979 statute, since supplemented by detailed implementing regulations and substantial other legislation. The EJV is a limited liability joint venture company formed

* Attorney, Paul, Weiss, Rifkind, Wharton & Garrison; Adjunct Assistant Professor of Law, New York University School of Law. Mr. Gelatt has authored many articles on investment law and practice in China drawing upon his extensive experience since 1980 in negotiating contracts in the PRC. The author is grateful to Yang Xiaoping for assistance in the preparation of the footnotes for this Note.


by one or more Chinese enterprises with one or more foreign entities for a specified period of time,\(^5\) pursuant to a joint venture contract, articles of association and related documents. The parties make contributions in cash and/or in kind\(^6\) to the joint venture company's registered capital in an agreed upon ratio\(^7\) and share profits, losses and distributions upon dissolution in accordance with that ratio.\(^8\) The joint venture company is treated as a "legal person" under Chinese law\(^9\) and pays taxes,\(^10\) signs contracts and


4. Joint Venture Law, supra note 1, art. 4; see also Implementing Rules, supra note 2, art. 19.
5. Joint Venture Law, supra note 1, art. 12; see also Implementing Rules, supra note 2, art. 100.
6. Joint Venture Law, supra note 1, art. 5; see also Implementing Rules, supra note 2, art. 25.
7. Joint Venture Law, supra note 1, art. 4; see also Implementing Rules, supra note 2, arts. 14, 16. Article 14 of the Implementing Rules lists an agreed upon ratio of capital contributions as a mandatory clause in an EJV contract while Article 16 requires that such ratio appear in the joint venture's articles of association.
8. Joint Venture Law, supra note 1, art. 4; see also Implementing Rules, supra note 2, art. 106.
9. Implementing Rules, supra note 2, art. 2; see also infra notes 24 and 25 and accompanying text.
10. See generally Joint Venture Law, supra note 1, art. 7; Implementing Rules, supra note 2, arts. 69-72; JVITL, supra note 3, art. 1.
undertakes other legal and economic activities in the name of the company and not in the names of the joint venture parties.

At the same time as the first Sino-foreign equity joint ventures were being established, Chinese investment officials raised the possibility of wholly foreign-owned enterprises (FOEs) in the PRC. In the early 1980s, a number of small-scale solely foreign enterprises of uncertain legal status were established, primarily by Hong Kong investors, in the special economic zones of the PRC's southern Guangdong Province. In 1986, FOEs were given a legal mandate with the publication of a law that lays down some basic ground rules for these enterprises but leaves their corporate legal status somewhat unclear.

Meanwhile, since the early 1980s, one of the most popular forms of investment by foreign companies in the PRC has been one for which no formal legal basis existed until earlier this year. Variously known as the "cooperative" or "contractual" joint venture (CJV), this investment vehicle seems to have developed not by specific design of the Chinese authorities but as an ad hoc reaction to some of the obstacles the EJV form has posed to the achievement of certain business objectives. For instance, foreign companies which want for a variety of reasons to take out a larger percentage of a joint venture's profits than their contribution to the project's capital would justify have been able to achieve this

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11. The 1980 regulations governing the three special economic zones (SEZs) in Guangdong Province allowed foreign investors to set up wholly foreign-owned enterprises in the SEZs without elaborating in any way on the nature or legal status of such enterprises. See Guangdong Sheng Jingji Tequ Tiaoli, in ZSJFH, supra note 1, at 947 (Regulations on Special Economic Zones in Guangdong Province) (approved Aug. 26, 1980) (trans. in CFEL:1, supra note 1, at 193) [hereinafter Guangdong SEZ Regulations], art. 1.


13. The FOE Law makes clear that it is not intended to cover "branches" in China of foreign enterprises but only enterprises that are "established within the territory of China in accordance with the relevant laws of China and whose entire capital is invested by foreign investors". FOE Law, supra note 12, art. 2. The PRC does not yet have a company law that defines such concepts as "branch" and "subsidiary." In some respects, the PRC's concept of a FOE seems akin to the Western notion of a wholly-owned foreign subsidiary. The tax treatment of FOEs, however, is inconsistent with this characterization, since FOEs are taxed as "establishments" of foreign enterprises rather than as discrete Chinese corporate entities. See Zhonghua Renmin Gongheguo Waiguo Qiye Suode Shui Fa, in ZSJFH, supra note 1, at 640 (Income Tax Law of the People's Republic of China Concerning Foreign Enterprises) (adopted Dec. 13, 1981) (trans. in CFEL:1, supra note 1, at 64) [hereinafter FEITL], art. 1; see Gelatt, Tax Guide, CHINA BUS. REV. Nov-Dec. 1987, at 18, 25. This tax anomaly may soon be rectified as part of a general reform of the PRC's tax laws for foreign investment enterprises.
goal with a CJV. In the CJV format, as it has developed through practice over the last several years, the foreign and Chinese investors may agree in the joint venture contract on the percentages of profit split for each party, and these percentages may vary over the life of the contract.

As of early 1989, about 7000 CJV contracts had been concluded between Chinese and foreign entities, as opposed to about 9000 EJVs. EJVs only recently began to overtake CJVs in terms of the numbers of contracts concluded - in early 1988, CJV's led EJV's by about 600 contracts. Yet, although CJVs were covered in numerous pieces of PRC legislation on tax, customs duties, and national and local rules to encourage foreign investment, until the promulgation on April 13, 1988 of the Law of

15. As of mid-1984, 1372 CJVs were established whereas only 362 EJVs had been established in China. China Econ. News, Nov. 12, 1984, at 2.
16. See generally, FEITL, supra note 13, art. 1.
18. See, e.g., Zhonghua Renmin Gongheguo Shewai Jingji Hetong Fa, in ZSJFH, supra note 1, at 1205 (Foreign Economic Contract Law of the People's Republic of China) (promulgated Mar. 21, 1985) (trans. in CLFB, supra note 7, ¶ 5-570) [hereinafter FECL].
the PRC on Chinese-Foreign Cooperative Joint Ventures (the CJV Law), no national counterpart to the 1979 law on equity joint ventures or the 1986 law on wholly foreign-owned enterprises existed to define the nature of a CJV or set forth its organizational structure.

As the following analysis of some of the important provisions of the CJV Law will demonstrate, the new statute does little to change the status quo for CJVs as it has developed through prac-


tice. Foreign investors who expected clear answers to the many legal questions posed by CJVs will be disappointed in the new law; but by the same token, those who feared that the law's promulgation would limit some of the negotiating freedom the CJV form has afforded will be reassured. In many respects, the CJV Law is a model of legislated flexibility.

The most vexing legal question posed by CJVs has always been their corporate legal status — or lack thereof. When the investment form first began to appear, many projects seemed to Western lawyers to resemble a partnership arrangement, with the Chinese and foreign investors retaining their separate legal identities rather than forming a distinct joint venture company as in the case of EJVs. The PRC's corporate tax laws governing foreign business and investment activity backed up this analysis of CJVs, by taxing the foreign company involved in a CJV separately on its profits from the venture, 21 with the Chinese investor paying tax on its benefits under separate domestic tax legislation. 22

By the early 1980s, however, an alternative form of CJV had begun to emerge that appeared to afford investors the best of both worlds — the flexibility on profit sharing and other aspects that the CJV form provides, and the protection of a limited liability joint venture company. These “equity-type” or “type A” CJVs, as they were variously called, looked for all the world like EJVs, but, by virtue of being designated CJVs in the contract, were not subject to the restrictions of the laws and regulations governing EJVs. In some cases, equity-type CJV's were taxed as entities, rather than the partners' being taxed separately as in the “normal” CJV situation. 23

The CJV Law tacitly confirms that CJVs may take two different forms by providing that a “cooperative venture which meets the provisions of Chinese law regarding the conditions for being a


22. Chinese state enterprises are increasingly being subject to income tax and allowed to keep all or a large part of their after-tax profits, rather than simply turning all their profits over to the state as they had previously been required to do. For discussion of these and other domestic tax reform efforts, see Wang Chuanlun, Some Notes on Tax Reform in China, 97 CHINA Q. 53 (1984); Hsiao, Is Fiscal Policy Keeping Pace with Economic Reform?, E. ASIAN EXEC. REP., Dec. 1986, at 16.

23. The relevant tax legislation allows for this possibility. Cooperative venture partners are to pay tax separately in the absence of "separate stipulations" by the tax authorities. FEITL Rules, supra note 21, art. 3.
legal person will acquire the status of a Chinese legal person in accordance with law.” The concept of a “legal person,” which China inherits from its continental law tradition, is defined in the PRC’s 1986 General Principles of Civil Law24 as describing an organization that possesses the capacity for civil rights and civil acts, independently enjoying civil rights and assuming civil responsibilities.25 To gain legal person status, an EJV, CJV or FOE must be registered with the appropriate authorities and (1) be formed in accordance with the relevant PRC law; (2) have the necessary property or funds; (3) have its own name, organization and site; and (4) be capable of assuming civil liability independently.26

The CJV Law provides no guidance on how the parties to a CJV contract may go about ensuring either that their CJV will be treated as a separate legal entity or that it will not. Indeed, after raising the possibility in the above-cited provision that non-legal entity, partnership-type CJVs may still be formed under the new law, the statute goes on to treat registration, taxation, labor, financing, insurance and other issues as if these matters were all to be handled on an enterprise basis, i.e., as if CJVs were all to be treated as legal persons.27 For instance, all CJVs are apparently required to have articles of association, a term which connotes a legal entity structure.28 Still, both the CJV Law and the comments of leading PRC investment officials on the new statute29 indicate that it is possible for the parties to specify explicitly in the contract that a non-legal person format is intended, and for such a provision to be effective upon approval of the PRC investment authorities.

One issue that the new law does not address at all is limited liability. In the past, some foreign companies forming “equity” or legal person-type EJVs have been able to write a limited liability concept into their contracts, and have these provisions approved, thereby presumably imbuing the investors in the CJV by contract

25. Id. art. 37.
26. Id. arts. 37, 41.
27. See generally CJV Law, supra note 20, arts. 5-7, 11-21.
28. See id. at arts. 5, 11, 12; Civil Law Principles, supra note 24, art. 41.
29. [Deputy Bureau Chief of the Foreign Investment Bureau of the Ministry of Foreign Economic Relations and Trade] Chu Baotai Explains the Cooperative Joint Venture Law, Wen Wei Bao (Hong Kong), May 3, 1988, at 31 [hereinafter Chu Baotai].
with the same limited liability afforded EJV parties by law.\textsuperscript{30} By
not mentioning the point, the CJV Law drafters cannot be assumed to have intended to exclude the possibility of limited liability for CJV parties. Article 2 of the law, which confirms the "contractual" nature of CJVs by giving the parties complete freedom to negotiate the distributions of earnings and the sharing of risks and liabilities,\textsuperscript{31} would appear to leave room for the contractual establishment of limited liability.\textsuperscript{32}

In addition to legislating the contractual flexibility the parties to CJVs have always enjoyed with respect to the division of profits and losses, the CJV Law also gives legal confirmation to an approach some companies have used to help solve the perennial problem of foreign exchange balancing in Sino-foreign joint ventures,\textsuperscript{33} namely, the taking of profits by the foreign partner in products produced by the joint enterprise rather than in cash,\textsuperscript{34} an approach not available in the case of EJVs. Although this "compensation trade"\textsuperscript{35} method poses a number of practical and legal problems, not the least of which is arriving at an appropriate valuation of the products, it may be an effective solution for companies that are able to make profitable use of the Chinese-produced products in their own operations or for resale on the international market.

The other major respect in which CJVs have afforded investors a greater degree of flexibility than EJVs relates to the forms in

\textsuperscript{30} See Joint Venture Law, supra note 1, art. 4; Implementing Rules, supra note 2, art. 19.

\textsuperscript{31} See CJV Law, supra note 20, art. 2, which reads, "[i]n establishing a cooperative venture, the Chinese and foreign cooperative venturers shall, in accordance with the provisions of this Law, reach agreement in a cooperative venture contract on such matters as the investment or conditions for cooperation, the distribution of earnings or products, the sharing of risks and losses, the manner of operation and management and the ownership of the property upon termination of the cooperative venture."

\textsuperscript{32} A leading PRC foreign investment official has stated that, under the new CJV Law, if a CJV publishes its registered capital and declares itself to be a limited liability company, it will enjoy limited liability. Chu Baotai, supra note 29.

\textsuperscript{33} CJV Law, supra note 20, art. 20 states the standard proposition that CJVs should resolve the balance of foreign exchange receipts and expenditures on their own, though it allows for the possibility of applying to relevant authorities for assistance, "in accordance with State provisions," if a CJV cannot resolve the balance on its own. A number of pieces of PRC legislation provide possible means of assistance to both equity and cooperative ventures to obtain foreign exchange. See, e.g., Foreign Exchange Provisions, supra note 3; Product Export Measures, supra note 19; Import Substitution Measures, supra note 19.

\textsuperscript{34} CJV Law, supra note 20, art. 2.

\textsuperscript{35} For a brief discussion of compensation trade in the PRC, see Cohen and Valentine, Foreign Direct Investment in the PRC: Progress, Problems and Proposals, 1 J. CHINESE L. 182 (1987).
which the parties may contribute to the capital of the enterprise. Contributions to the “registered capital” of an EJV may take the form of cash, equipment, technology or industrial property rights, and, in the case of the Chinese party only, the right to use of the site\textsuperscript{36} on which the joint venture will have its operating facilities.\textsuperscript{37} The term “registered capital” has typically not been used for CJVs — even those of an “equity” nature — but the parties are nonetheless required to agree on what assets each party will offer up to establish the enterprise. In a number of CJVs, the Chinese investor has used the labor force as a “contribution,” handling recruitment and payment of the Chinese personnel needed for the project entirely on its own, rather than making this a joint venture obligation as is required in the case of EJVs.\textsuperscript{38} Also, CJVs have not typically been subject to the informal and in some cases formal guidelines that restrict the percentage of a foreign party’s contribution to an EJV that can take the form of intangibles such as know-how and technology.\textsuperscript{39}

The new law follows the trend developed in practice by referring not to “contributions to capital” but rather to “investment or conditions for cooperation,”\textsuperscript{40} and seems generally to confirm the pre-existing flexibility on this subject. Although labor is not specif-
ically mentioned as a possible “condition for cooperation,” a general catch-all — “and other property rights” — could possibly be interpreted to cover it, and a leading PRC legal official has confirmed that it will. The law adds an interesting alternative to the options open to foreign investors by allowing either the Chinese or the foreign side to bring site use rights to the enterprise. Foreign enterprises may now purchase leases to plots of land for varying periods pursuant to legislation in Shanghai, Shenzhen and other parts of China and could use these as contributions to CJVs under the new law.

One traditional difference between CJVs and EJVs that has always seemed to be more one of form than substance has been that, while EJVs are required by law to establish a board of directors, CJVs typically are run by a “joint management committee” with representatives from each party. The new CJV Law gives the parties a choice between having a board of directors or a joint management organ. The law also adds an element of flexibility unavailable in the EJV context by allowing either the Chinese or the foreign partner to provide the chairman of the board or joint management organ, requiring only that, whichever party assumes the chairmanship, the other party have the right to appoint the deputy. Under the EJV Law as it currently stands, the Chinese party has the sole right to appoint the chairman and the foreign party the vice-chairman, though a revision to this rule is currently under consideration.

On taxation, the new law is a model of vaguery. Article 21 states simply that “cooperative ventures shall pay taxes in accordance with State provisions regarding taxation and may also enjoy preferential treatment of reduction of and exemption from

41. Statement of PRC investment official to author’s colleague in Hong Kong, May 1988.
42. See CJV Law, supra note 20, art. 8.
45. Joint Venture Law, supra note 1, art. 6; Implementing Rules, supra note 2, arts. 33, 34.
46. Joint Venture Law, supra note 1, art. 6.
47. Comment of PRC investment official to author’s colleague in Hong Kong, May 1988.
The implication that a CJV is to pay tax as an enterprise is confusing in light of the typical practice discussed above, but more likely reflects inaccurate drafting than a change in policy. The reference to unspecified preferential treatment may be fleshed out in the implementing regulations that will eventually be issued under the CJV Law. Under the various legislation that has been promulgated on a central and local level in the PRC in the last couple of years to encourage foreign investment, and under the legislation governing the PRC's special economic zones and fourteen coastal cities earmarked for foreign investment, all types of "foreign investment enterprises" - EJVs, CJVs and FOEs - are
granted identical tax advantages in terms of possible lowered tax rates, additional tax holidays, and certain exemptions from import and export taxes and duties.\textsuperscript{55} Under China's national tax legislation, however, which applies in the absence of any special local or national legislation on point,\textsuperscript{56} investors in CJVs fare considerably worse on tax benefits than those in EJVs, paying generally higher tax and being entitled to tax holidays only in rare circumstances.\textsuperscript{57} The PRC is currently reforming its tax system for foreign investment with the aim of formulating one comprehensive tax law to govern all foreign investment enterprises, affording each type of venture equivalent rates and benefits.

Under the legislation governing EJVs, it is not permitted for the foreign investor to recover its capital investment \textit{per se} during the term of the company.\textsuperscript{58} When an EJV's term expires, the law provides for a liquidation process in which, theoretically, the foreign party receives its proportional share of the equity after payment of the company's debts.\textsuperscript{59} The CJV Law, in keeping with past practice, allows the parties to negotiate a provision under which the foreign investor recovers its investment during the term of the project and all assets then belong to the Chinese party upon expi-
If such investment is to be recovered before the payment of tax on CJV profits, as has been negotiated in a number of projects in the past, the approval of the tax authorities must be obtained in advance.

A provision of the CJV Law on which interpretation is sorely needed is one providing that, when the agreement provides for the foreign party to recover its investment during the term of the venture, "the Chinese and foreign cooperative venturers shall, in accordance with the provisions of relevant laws and the agreements in the cooperative venture contract, assume responsibility for the liabilities of the cooperative venture." The concern lying behind this provision is clear, namely, the need to ensure that CJV creditors are appropriately protected in the situation where the capital of the "enterprise" has been effectively reduced. But the law gives no clue as to how the drafters intend for this problem to be solved. The implication seems to be that the foreign party will retain some responsibility, even after it has withdrawn its investment. Will the parties be entirely free to agree in the contract how this responsibility will be determined? No "relevant laws" promulgated thus far appear to provide any guidance.

Whether or not the foreign party has recovered its investment prior to expiration of the venture term, the CJV Law provides for a "liquidation" or expiration similar to that stipulated for EJVs. Like the EJV legislation, the law neither specifically mentions nor explicitly precludes the possibility, rather than "liquidating" the enterprise, of the Chinese party's buying out the foreign party's interest. This is an approach many foreign investors find fairer than liquidation in light of the fact that the Chinese party will in most cases continue to carry on the business independently after expiration of the joint venture contract and continue to benefit from the accumulated know-how and good will derived over the

60. CJV Law, supra note 20, art. 22.
61. Id.
62. Id.
63. One leading PRC investment official has suggested that the parties may agree in the contract on how to share debts after the foreign party has withdrawn its investment, but that the foreign investor must provide security of some kind for such debts. Chu Baotai, supra note 29. Another official has suggested that the foreign investor in this situation may be required to return the portion of the investment it has recovered to satisfy joint venture debts, but would not be liable beyond that amount. Comment of PRC investment official to author's colleague, Hong Kong, May 1988.
64. CJV Law, supra note 20, art. 24. For the rules on EJV liquidation, see Implementing Rules, supra note 24, arts. 102-108.
years from the foreign party’s participation. Just as many foreign companies have been able to negotiate buy-out clauses in EJV contracts, presumably, under the CJV Law, investors will be able to agree on similar arrangements despite the silence of the law, and enforce them upon governmental approval.

The CJV Law, like the EJV Law and the law on FOEs before it, indicates that ventures are expected to have a fixed term but provides no guidelines on what are acceptable periods. As with EJVs, this issue will no doubt be covered in the implementing regulations. CJVs have tended in the past to have shorter terms than EJVs, in part because of the nature of operations for which the CJV form has frequently been employed — hotels and other foreign-exchange earning service projects in which the foreign partner is allowed to recover its investment and the Chinese party to take over sole ownership as soon as possible.

While neither Chinese nor foreign investors are eager to think about disputes when just entering into an investment relationship, potential participants in CJV contracts will want to take cognizance of the new law’s provisions on dispute resolution, which differ in an interesting way from the comparable rules for EJVs. The EJV legislation requires that, before the parties may take a dispute to arbitration, they must attempt to resolve the matter through “friendly consultations.” The CJV Law allows the parties to submit a dispute directly to arbitration - inside or outside of China - if they “do not want to resolve the matter through consultation or mediation.” This provision - consistent with one in the PRC Foreign Economic Contracts Law that governs all Chinese-foreign contractual arrangements - reflects a new Chinese awareness that, while informal inter-party dispute resolution is still to be encouraged, it may in some cases be preferable to take a serious problem straight to a neutral forum to have it resolved expeditiously.

The CJV Law follows in the now almost ten-year tradition of

65. See Gelatt, supra note 39, at 246, 247.
66. See CJV Law, supra note 20, art. 25.
68. Joint Venture Law, supra note 1, arts. 6, 14; Implementing Rules, supra note 2, art. 109.
69. CJV Law, supra note 20, art. 26.
70. FECL, supra note 18, art. 37.
PRC foreign economic statutes by painting a broad outline and leaving many issues unanswered. The implementing regulations and other supplementary rules and interpretations that will gradually emerge should answer many of these questions. The basic domestic company law being prepared by the PRC may shed light on some of the basic corporate legal points left open by the new law. As more and more projects are negotiated and concluded, foreign investors and lawyers will find no substitute for the ever-accumulating body of practical experience being established by both Chinese and foreign enterprises. Though difficult to document, the large number of investment ventures of all types already operating in the PRC, and those still being developed, serve as a kind of informal "common law," as the provision one company negotiates and has approved becomes a precedent for another company. Given the still incomplete nature of statutory law - particularly for CJVs - practice, as a popular Chinese catch phrase puts it, remains in many cases the sole criterion of truth.

71. See text accompanying supra note 14; compare Cohen & Valentine, supra note 35, at 179.