

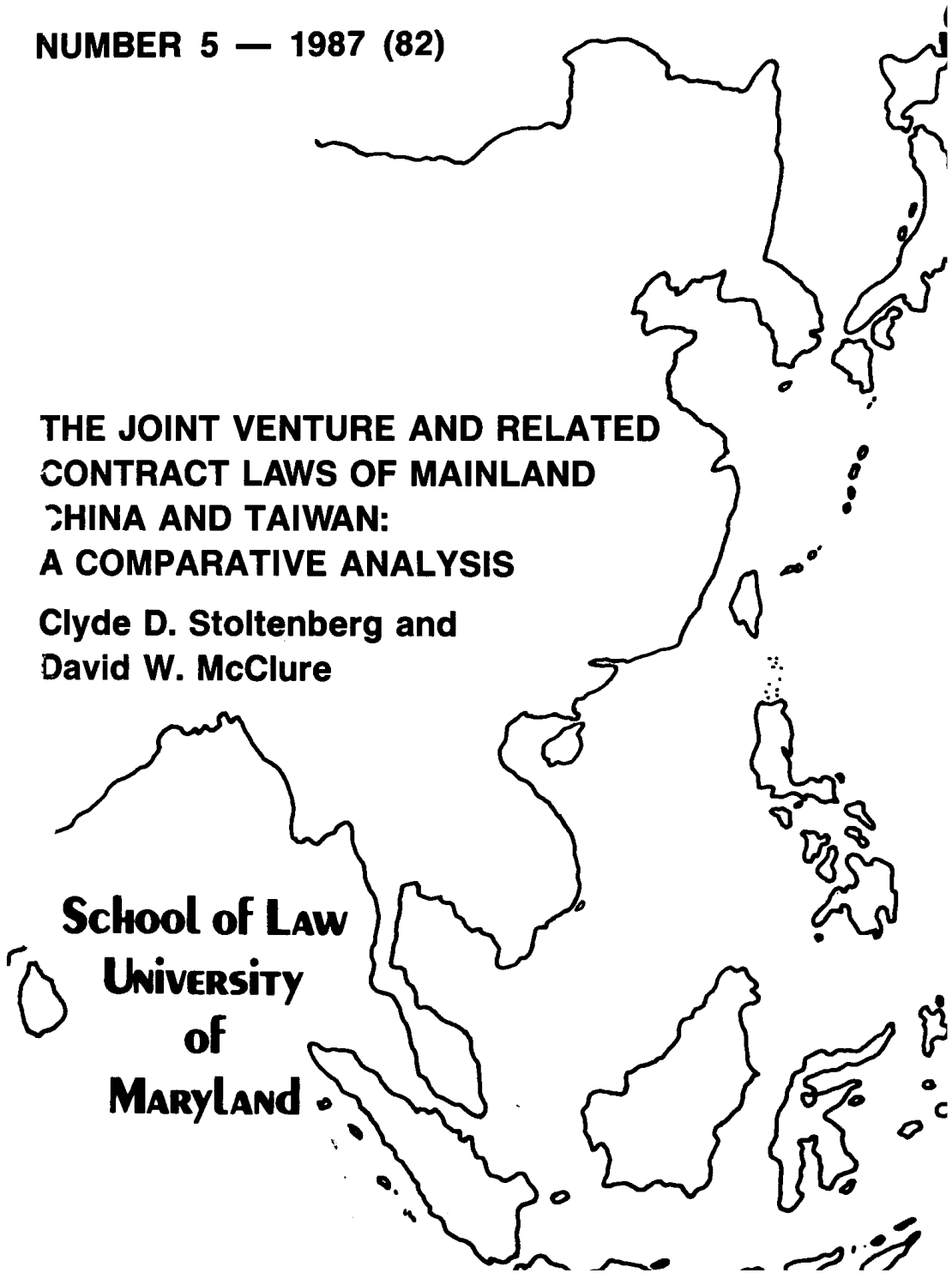
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**THE JOINT VENTURE AND RELATED
CONTRACT LAWS OF MAINLAND
CHINA AND TAIWAN:
A COMPARATIVE ANALYSIS**

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THE JOINT VENTURE AND RELATED CONTRACT LAWS OF MAINLAND CHINA AND TAIWAN: A COMPARATIVE ANALYSIS

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I. INTRODUCTION

Foreign investment and technological transfer can play a positive and important role in the modernization of a developing economy. Of the many countries which have recognized this fact and designed a legal structure to attract and encourage activity by foreign investors, perhaps none has been more successful than the Republic of China on the island of Taiwan. During the past thirty years, Taiwan has risen rapidly to the status of a "newly industrialized economy." This achievement can be traced to a number of unique social, political, cultural, and geographic factors which cannot easily be duplicated in other developing countries. Although it cannot be expected that duplication of Taiwan's success in achieving rapid economic modernization will automatically follow from a duplication of its foreign investment statutes, developing nations with an interest in attracting and exploiting foreign investment can nonetheless benefit from a close analysis of the Taiwan model.

The People's Republic of China (PRC) recently has awakened to the benefits which prudent management of foreign investment can bring to a modernizing country. This new awareness of the need for foreign capital and technological transfer has resulted in the enactment of a number of statutes and regulations specifically intended to stimulate the interest of foreign investors. Although Taiwan's success at modernization is plain for all to see, for the PRC to duplicate Taiwan's model would require the abandonment or significant alteration of fundamental presumptions, which have been held since 1949

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regarding private property, social organization, and the proper role of governments. The PRC is thus approaching economic change and development with great caution, cognizant that too rapid a change may well present a challenge to the communist system itself.

The purpose of this Article is to contrast the foreign investment laws of Taiwan and the PRC as they relate to the establishment of equity joint ventures with foreign participation.¹ The analysis will describe the political background of present economic policies in Taiwan and the PRC, then examine and compare the statutory framework of their joint venture laws. The analysis will make a direct comparison of the joint venture laws as they relate to the selected issues of corporate control of the venture, capital contribution, profit repatriation, taxation, and relevant contract law principles.

II. THE LAW REGULATING JOINT VENTURES IN TAIWAN

A. *The Political Background of Present Economic Policy in Taiwan*

The modern-day laws and legal system of Taiwan are the result of a general reform of China's juridical system which commenced around the turn of the twentieth century. This reform was influenced both by the importation of Western legal thought and institutions into China, and by the teachings of Sun Yat-sen, who incorporated into these imported concepts the best of China's political, legal, and economic traditions.² The civil law systems of Germany and Switzerland were particularly important influences on the development of the civil law of the ROC.³

¹ For a discussion summarizing the legal attributes and general characteristics of joint ventures, see Note, *The New Legal Framework for Joint Ventures in China: Guidelines for Investors*, 16 LAW. & POL'Y INT'L BUS. 1017-19 (1984). For several views on the use of joint ventures in the context of multinational corporate strategy, see Connolly, *Joint Ventures with Third World Multinationals: A New Form of Entry to International Markets*, 19 COLUM. J. WORLD BUS., Summer 1984, at 18; Contractor, *Strategies for Structuring Joint Ventures: A Negotiations Planning Paradigm*, 19 COLUM. J. WORLD BUS., Summer 1984, at 30; Harrigan, *Joint Ventures and Global Strategies*, 19 COLUM. J. WORLD BUS., Summer 1984, at 7; Reynolds, *The "Pinched Shoe" Effect of International Joint Ventures*, 19 COLUM. J. WORLD BUS., Summer 1984, at 23.

² Ma, *General Features of the Law and Legal System of the Republic of China*, in TRADE AND INVESTMENT IN TAIWAN 3 (Ma ed. 1985).

³ *Id.* at 11.

Taiwan's constitution, based upon Sun Yat-Sen's philosophy of the "Three Peoples' Principles," emphasizes that the responsibility of government is to help its citizens improve their individual standards of living, and yet remain minimally intrusive into their personal lives.⁴ Sun felt that foreign investment would play a particularly important role in China's modernization.⁵ Thus, in Taiwan, the legislation designed to stimulate foreign investment is rooted in a legal and economic system adopted in large part from the West, particularly Europe. As a matter of constitutional policy, all industries (except industries such as public utilities, which are considered monopolistic by nature) are open to private development; foreign investment, however, is subject to restriction when deemed essential to balanced development.⁶

After 1949 the Government of Taiwan quickly implemented a plan for rapid economic growth which involved rural reconstruction through modern technology and land reform, and the enactment of new laws meant to stimulate investment by nationals and foreigners.⁷ Two important factors have further stimulated the drive for modernization in Taiwan. The first is the high priority afforded national defense and the creation of an industrial infrastructure to serve defense needs. The second is strong government encouragement of private enterprise and the concurrent development of export markets for products man-

⁴ Wan, *A Comparative Study of Foreign Investment Laws in Taiwan and China*, 11 CAL. W. INT'L L.J. 236, 246-47 (1981).

⁵ *Id.* at 247; see A. GREGOR, *IDEOLOGY AND DEVELOPMENT: SUN YAT-SEN AND THE ECONOMIC HISTORY OF TAIWAN*, 15-18 (1981). For the text of the program developed during the period 1918-19, see SUN, *THE INTERNATIONAL DEVELOPMENT OF CHINA* (1953). For a brief discussion of Dr. Sun's dreams of foreign assistance for China's modernization, see WILBUR, *SUN YAT-SEN: FRUSTRATED PATRIOT*, 96-100 (1976). Sun's welcoming foreign capital probably was generated more by his awareness of China's lack of capital than by his conclusions regarding the past economic relations between China and the West, of which he was quite critical. An example of his ambivalence toward the West's economic involvement in China may be found in the fifth of his 1924 lectures on the Three Peoples' Principles, in which he essentially advised breaking economic relations with foreigners. *Id.* at 96-97.

⁶ Ma, *supra* note 2, at 10.

⁷ *Id.* at 10-11. For an example of recent discussion of the conceptual bases of post-1949 economic development on Taiwan, see Liu, *The Political Basis of the Economic and Social Development in the Republic of China, 1949-1980*, University of Maryland School of Law Occasional Papers/Reprints Series in Contemporary Asian Studies (1985, No. 1). Two papers delivered at the Conference on Chiang Kai-shek and Modern China in Taipei in October of 1986 discuss Chiang Kai-shek's role in economic development and continuities between his policies and Sun Yat-sen's ideas: Gregor and Chang, *Chiang Kai-shek, China, and the Concept of Economic Development*, and Myers, *Economic Policy and Moral Principles: The Case of Chiang Kai-shek*.

ufactured in Taiwan. The framework established to facilitate foreign investment has achieved significant results.⁸

B. The Statutory Framework of the Joint Venture Law

The two cornerstones of Taiwan's legal framework for joint venture participation by foreign investors are the "Statute for Investment by Foreign Nationals" (SIFN) promulgated in 1954, and the "Statute for Encouragement of Investment" (SEI) promulgated in 1960.⁹ An

⁸ Aggregate foreign investment in Taiwan from 1951 to October of 1986 totaled \$5.6 billion, of which \$1.23 billion was invested by overseas Chinese and \$4.37 billion by non-Chinese foreign nationals. Among non-Chinese foreign nationals, the United States is the leading investor in Taiwan, with \$1.8 billion in total investment approvals from 1951 to October of 1986; Japan ranks second with \$1.3 billion. Ni, *ROC Government's Efforts in Promoting Two-Way Investments Between the ROC and the USA*, Paper delivered in Taipei on Dec. 5, 1986, at the 10th Joint Conference of USA-ROC and ROC-USA Economic Councils, at 1-2.

During the first six months of 1986, foreign investment approvals dropped 7.8% to \$245 million. As Japanese firms began looking for ways around the yen's appreciation, however, foreign investment began to pick up steam in July and August. American Institute in Taiwan, *Foreign Economic Trends and Their Implications for the United States* 5 (Oct. 1986). During the period January-August of 1986, Japan was the top investor in Taiwan, with investments totalling \$120.36 million; the United States was second, with investments totalling \$71.35 million. *Asian Wall St. J.*, Oct. 20, 1986, at 3, col. 4.

The promulgation of the Statute for Encouragement of Investment in 1960 appears to have had a dramatic impact on investment patterns. Only \$36 million in overseas investments were made in Taiwan before its promulgation. Annual inflow of overseas capital averaged \$15.8 million annually during 1961-65, and \$84.5 million annually during 1966-70. In 1980 approved overseas investment totalled \$466 million. Cheng, *Taiwan*, in *LEGAL ASPECTS OF DOING BUSINESS IN ASIA AND THE PACIFIC* 359, 363 (Campbell ed. 1985); Lin, *INDUSTRIALIZATION IN TAIWAN, 1946-72* 137 (1973). In recent years a significant portion of all foreign investment has taken the form of joint ventures. Hsu, Li and Wang, *Joint Ventures in the Republic of China: A Study in International Business Cooperation*, in *TRADE AND INVESTMENT IN TAIWAN* 553-54 (Ma ed. 1985).

⁹ For a brief discussion of the Nineteen Point Economic Financial Reform pursuant to which the SEI was enacted, see S. KUO, *THE TAIWAN SUCCESS STORY* 73-74 (1981); Lin, *supra* note 8, at 83-87. A supporting structure of rules and regulations has been developed pursuant to the SEI, including: Enforcement Rules of the SEI, Categories and Criteria for Special Encouragement of Important Productive Enterprises, Criteria for Encouragement of Establishment or Expansion of Industrial Mining Enterprises, and Categories and Criteria of Production Enterprises Eligible for Encouragement. Wang, *The Governmental Environment of Trade and Investment*, in *TRADE AND INVESTMENT IN TAIWAN* 111 (Ma ed. 1985). Another important vehicle facilitating participation by foreigners in the Taiwan economy is the Statute for Technical Cooperation. This statute does not result in an equity interest on the part of the foreign participant; rather, it involves the furnishing of patent rights or know-how in exchange for fixed running royalties. For a description of the statute's provisions and operation, see Hsu, *Encouragement of Foreign In-*

important objective of these statutes is to simplify the process of foreign investment. The government has established in its foreign investment law certain rights and privileges for foreign investors who meet the statutory requirements of the SIFN and the SEI.¹⁰ In addition to the SIFN and SEI and the regulations thereunder, joint ventures are subject also to the Company Law, Factory Law, Water Law, Power Supply Law, Standards Law, Commercial Accounting Law, Income Tax Law, Customs Law, and Patent and Trademark Laws.¹¹

C. Policies of Economic Encouragement

Foreign investment in Taiwan is directed toward specific national goals, and government policy strongly favors the importation of modern technology and capital intensive industry.¹² While encouraging investment of all kinds, the government has extended special privileges to joint ventures whose production will fill domestic needs or whose production for export can be expected to earn foreign exchange.¹³

vestment in the Republic of China, in TRADE AND INVESTMENT IN TAIWAN 290-92 (Ma ed. 1985). Additional statutes include special provisions for investment in Taiwan's export-processing zones and its more recently established science-based industrial park at Hsinchu. See Wang, *supra*, at 111; Department of Commerce, *Marketing in Taiwan* 22-23 (Overseas Business Reports 85-15, 1985); Hsu, *supra* at 322-27.

¹⁰ Hsu, Li and Wang, *supra* note 8, at 555.

¹¹ Wang, *supra* note 9, at 113-15.

¹² Hsu, Li and Wang, *supra* note 8, at 555.

¹³ According to article 5 of the SIFN, overseas investments shall be confined to those which fall in any one of the following categories:

- (1) investments in manufacturing enterprises which make products needed domestically;
- (2) investments in service enterprises which are needed domestically;
- (3) investments in enterprises which have an export market;
- (4) investments which complement important industrial, mining, or communications enterprises;
- (5) investments in enterprises which are engaged in scientific and technical research and development; and,
- (6) investments in other enterprises which are conducive to the economic and social development of Taiwan.

The government's policy guidelines reflect preference for foreign investments with the following characteristics:

- (1) sufficient market abroad for products;
- (2) ability to train highly sophisticated engineers and/or technicians;
- (3) ability to introduce new and advanced technical know-how and managerial skills;
- (4) introduction of large amounts of capital; and,
- (5) promotion of technical cooperation as a means to promote sale of products.

Hsu, Li and Wang, *supra* note 8, at 558.

Specific industries which the government has characterized as "most favorable"

Traditionally, the government has encouraged joint ventures in light industry along with investment in industries specifically identified as vital to national development (such as mining and communications). Only joint ventures in specified industries qualify for the privileges and protections of SIFN.¹⁴ Moreover, the joint venture statutes also encourage investment in industries which the government perceives as vital to national welfare (such as defense industries and industries requiring a high degree of technical know-how).

Another aspect of the policy underlying the joint venture law is the deliberate exclusion from statutory protection of those industries which the government seeks to protect from foreign capital, management, and know-how.¹⁵

for overseas capital investment in Taiwan include:

(1) Machinery manufacturing: Complete plant, high precision machine tools, automotive parts and components, steel mold, castings, precision forging, solar energy equipment, industrial robots, and automatic manufacturing systems;

(2) Electronics and information industry: Sophisticated products for industrial use such as computer hardware and software, and telecommunications equipment and parts and components thereof;

(3) Chemicals: Specialty chemicals including the ingredients of pharmaceuticals, catalysts, stabilizers, accelerators, intermediaries, hardeners, antioxidants, surfactants, and other derivatives for industrial use;

(4) Technical services: Technical know-how or patent rights licensing, technical assistance in plant construction, design and engineering work; and,

(5) Other higher-technology, capital-intensive investments which will bring about higher intersectoral linkage, greater technology intensiveness, higher value-added production, and more efficient use of energy.

A Brief Introduction to the Investment Climate in Taiwan Republic of China, Indus. Dev. & Inv. Center (May, 1986). Occasionally the government will invite foreign and domestic enterprises to form joint ventures for particular products. For example, in December of 1986, the Ministry of Economic Affairs encouraged the formation of joint ventures for 26 industrial products, including seven types of electrical machinery, three types of industrial materials, nine types of information and electronics products, three types of chemical engineering products, and four types of textile products. *China Post*, Dec. 17, 1986, at 7. In addition, the authorities encourage investment in the following service categories: leasing, securities, consulting, advertising, software consulting, large trading companies, inspection services, and engineering. *Marketing in Taiwan*, *supra* note 9, at 23. The Second Annual Report of the United States Executive Branch to Congress in Compliance with the Trade and Tariff Act of 1984 released by the United States Trade Representative in November of 1986, however, recounts a history of service barriers in the areas of banking, insurance, motion pictures, intermodal shipping services, and leasing. *The Economic News*, Nov. 24-30, 1986, at 6-7.

¹⁴ Wan, *supra* note 4, at 252.

¹⁵ For a time, the Government of Taiwan progressively narrowed the fields of investment open to foreigners. It has been argued that foreign investment be limited to the following: (1) industries requiring long-term investment; (2) industries making

D. Bureaucratic Facilitation of the Joint Venture Agreement

Bureaucratic facilitation of the investment application is rather simple. To qualify as a foreign investment-approved (FIA) company with the right to repatriate invested capital and profits, the investor or joint venture entity must file an application with the appropriate office.¹⁶ The application will be acted on within two months.¹⁷ Once

needed technology available to Taiwan; (3) industries manufacturing products entirely for export; (4) industries which introduce entirely new products to Taiwan; and (5) industries manufacturing precision instruments. It also has been argued that the following industries be reserved for Chinese capital: (1) light industries or industries requiring short-term investments with a high rate of return; (2) industries making products sold in domestic markets under foreign trademarks; (3) industries using foreign raw materials with processing done in Taiwan; and (4) industries which manufacture machinery. Liu, *Encouragement of Foreign Investment in ROC*, in *TRADE AND INVESTMENT IN TAIWAN* 266, 276 (Cosway, Ma, Shattuck ed. 1973); see also Hsu, *A PRACTICAL GUIDE FOR CONDUCTING BUSINESS IN THE REPUBLIC OF CHINA* 107 (1982). As Hsu pointed out: "which industries are felt to deserve such protection changes from time to time, according to circumstances. The latest trend is to expand and develop basic industries, including certain heavy industries, and also to encourage and develop highly sophisticated technical industries." Hsu, Li, and Wang, *supra* note 8, at 557.

Investment proposals that will simply introduce capital also have become less attractive due to the inflationary effect of the continuous inflow of capital to Taiwan and the increased availability of local capital. Hsu, *supra* note 9, at 282. In addition, geographic location has become an issue in the government's assessment of investment proposals. *Marketing in Taiwan*, *supra* note 9, at 23. The United States Trade Representative's recent report to Congress, *supra* note 13, comments on two other investment barriers: export performance requirements and local content requirements. Taiwan agreed in September of 1986 to eliminate export performance requirements on future investments, expansions of current investments, and current investments by mid-1987. *The Economic News*, Nov. 24-30, 1986, at 7. Further, in keeping with current economic liberalization efforts, during the Fall of 1986 the Council for Economic Planning and Development of the Executive Yuan finalized guidelines calling for reduction of restrictions on foreign investment. These guidelines include agreement to open more categories to foreign and overseas Chinese investment, subject to approval by the Investment Commission. *China Post*, Nov. 5, 1986, at 7, col. 3.

¹⁶ If the projected enterprise is to be established in an export processing zone, the application must be submitted to the Export Processing Zone Administration of the Ministry of Economic Affairs. Similarly, the Hsinchu Science-Based Industrial Park Administration reviews applications for investment within its jurisdiction. Otherwise, applications should be submitted to the Investment Commission (IC) of the Ministry of Economic Affairs. *Marketing in Taiwan*, *supra* note 9, at 23. A well-developed bureaucracy has been created to facilitate foreign investment. A significant recent development in this bureaucracy has been the opening of a Joint Industrial Investment Service Center to enhance and streamline the services offered to investors. Wang, *supra* note 9, at 128-30. An even more sweeping reform is being considered by the Investment Commission under which foreign investments in certain sectors

approval has been granted, the investment entity must implement its investment in accordance with the plan approved by the Investment Commission.¹⁸

The joint venture application will be reviewed by the government in accordance with the following criteria: 1) degree of technical sophistication and know-how to be imported; 2) potential export market for the product; 3) potential effect on existing industry if approval is granted; and 4) the number of job opportunities created. Industries whose product is 100 percent for export are viewed more favorably than industries or ventures which may compete with existing industries in the domestic market. Moreover, the government welcomes industries with "state of the art" technology above all others.¹⁹

E. Corporate Structure of the Joint Venture

1. Definition and Creation of the Joint Venture

Under Taiwan law a joint venture may be defined as "a special combination of two or more persons where, in some specific venture,

would not need approval, but simply registration with the related investment agencies. China Post, Oct. 18, 1986, at 7, col. 2. This reform is being done pursuant to an order issued by the Minister of Economic Affairs on October 14, 1986, requiring the Investment Commission to screen applications only for large investments. China Post, Oct. 15, 1986, at 12, col. 3.

¹⁷ Statute for Investment by Foreign Nationals, art. 8 (ROC). A potential investor must pay strict attention to the manner in which the foreign investment application is presented to the appropriate government agencies. The investor must persuade the authorities that the project will be beneficial to the economy of Taiwan and thus should be "encouraged" under the statutory incentives program. The application should include a detailed description of the following: the project and its products, potential economic benefits, technology involved, a business plan, a description of the composition of the total capital investment, a plant construction plan, a schedule of projected production and sales, raw materials to be imported and purchased locally, machinery to be imported and purchased locally, evidence substantiating the existence of the investing company (such as a certificate of incorporation), and evidence of the performance or standing of the investor. *Marketing in Taiwan, supra* note 9, at 24.

¹⁸ Statute for Investment by Foreign Nationals, art. 9. After the investment application is approved, foreign investors must complete the following:

- (1) remit capital into Taiwan and notify the IC of the remittance;
- (2) apply to the IC for company registration;
- (3) apply to the local authorities for registration as a profit-seeking enterprise;
- (4) purchase or lease land for plant site;
- (5) apply to the local authorities for the license for construction of factory buildings and for registration of establishment of the factory; and,
- (6) apply to Taipower's regional office for supply of electricity.

Once these steps have been completed, the investor may then import machinery, equipment, and raw materials. *Marketing in Taiwan, supra* note 9, at 24.

¹⁹ Hsu, *supra* note 9, at 282.

a profit is jointly sought without any partnership or corporate designation.”²⁰ For practical purposes, a joint venture is defined broadly enough to include almost any kind of formal cooperation between two or more parties.²¹

A joint venture comes into legal existence with the conclusion of a joint venture agreement. The agreement usually will relate to the joint interests and shared property of the parties as well as to the degree of control of each venturer. The joint interests which are the subject of the joint venture agreement normally relate to the sharing of profits and losses, the nature of the joint control to be exercised, and the existence of fiduciary relationships.²² A joint venture continues its legal existence after incorporation. Under Taiwan law the parties to the joint venture have inter se obligations of a joint and several nature, with the possibility of limiting liability to others if the parties choose the appropriate form of organization for the joint venture.²³

2. *Formal Organization of the Joint Venture*

Under Taiwan law one party's share of the joint venture may be anywhere from one percent to ninety-nine percent. No minimum ownership requirement exists. Where the share of the foreign investor is less than forty-five percent, however, the assets of the venture are subject to expropriation by the government for national defense purposes; where foreign ownership exceeds forty-five percent the venture is protected from expropriation for twenty years.²⁴ There have been no cases of expropriation to date.

Joint ventures are formed under Taiwan's Company Law which recognizes four kinds of companies.²⁵ In theory, the parties may

²⁰ Hsu, Li and Wang, *supra* note 8, at 561.

²¹ *Id.*

²² *Id.* at 562.

²³ *Id.* at 563.

²⁴ Statute for Investment by Foreign Nationals, art. 15. If less than 45% of the capital of a joint venture is held by a foreign investor or investors, the enterprise may be subject to requisitions or expropriation when so required by the "needs of national defense," in which event reasonable compensation will be paid. It may be assumed that the government will be the sole judge of the "needs of national defense." A dispute over the reasonableness of compensation may be submitted to an international agency for arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States. As long as 45% or more of the venture's capital is continuously held by a foreign investor or investors, the venture will be immune from expropriation for 20 years even though the "needs of national defense" would otherwise dictate. Wan, *supra* note 4, at 253.

²⁵ These are the Unlimited Company, Limited Company, Company with Share-

choose any kind of company organization for the joint venture; however, the only type of organization recognized by law for purpose of qualification for privileges under the SIFN is the "company limited by shares."²⁶ One advantage of this organizational format is that in the foreign-invested company listed by shares, the board chairman, directors, managers, and the supervisor all may be non-resident aliens.²⁷

F. Corporate Control of the Joint Venture

1. Voting Rights

Two aspects of corporate control of a joint venture exist under Taiwan's Company Law: voting rights of the shareholders and the inherent powers of the board chairman. In the company limited by shares, the Company Law divides corporate control between the chairman, the board of directors, the shareholders, the general manager, and the supervisor.²⁸ The Company Law effectively separates

holders of Limited and Unlimited Liability, and Company Limited by Shares. For more detailed discussion of each form, see Wang, *Company Law of the Republic of China*, in *TRADE AND INVESTMENT IN TAIWAN* 516-49 (Ma ed. 1985).

²⁶ To qualify for the benefits under the Statute for Encouragement of Investment, the project must be a "productive enterprise." A "productive enterprise" as defined in this Statute must be a "company limited by shares," engaged in one of the following types of operation: manufacturing, handicraft, mining, agriculture, forestry, fishery, animal husbandry, transportation, warehousing, public utility, public facility construction and development, public housing construction, technical services, international tourist hotels, or heavy machinery construction. Statute for Encouragement of Investment, art. 3 (ROC). The Statute for Investment by Foreign Nationals (SIFN) does not restrict the form of business organization. Therefore, if the investor wishes only to repatriate earnings and capital, there is no compulsion to form a "company limited by shares." But the right to elect between a tax holiday and accelerated depreciation, as well as other benefits under the Encouragement Statute, will motivate many investors to form the "company limited by shares" for their Taiwan operations. This form of organization offers the advantage of centralized management with the added possibility of public solicitation of shares to raise additional capital. See Hsu, Li, and Wang, *supra* note 8, at 565; Wang, *supra* note 25, at 523.

A revision of the Statute for Encouragement of Investment (SEI), passed by the Legislative Yuan on January 16, 1987, provides that foreign companies which apply for investment in domestic manufacturing industries according to the SIFN, may enjoy the various kinds of preferential treatment stipulated in the SEI. *China Post*, Jan. 19, 1987, at 7, col. 1. This suggests greater flexibility as to form in the future for the foreign investor in such industries.

²⁷ Statute for Investment by Foreign Nationals, art. 18; see Hsu, *supra* note 9, at 290.

²⁸ For a general discussion of these various participants in a company limited by shares, see Wang, *supra* note 25, at 533-46.

the management functions of the board of directors and ownership by the shareholders, vesting "transaction of business of the company" in the board except to the extent the Company Law or articles of incorporation "provide that certain matters must be resolved at the meeting of the shareholders."²⁹ The amount and type of shares held determine voting rights in the corporation; usually, one vote is attached to one share, and thus, the most effective method of gaining corporate control is to gain shares.³⁰ Either "special" or "common" shares may be issued, however, and holders of "special" shares may have restricted voting rights.³¹

2. Powers of the Chairman

Other than the voting rights exercised by shareholders, the most important aspect of corporate control is the statutory power of the board chairman who is elected by the board of directors. The chairman presides at shareholder and board of directors' meetings, represents the company, and conducts all affairs pertaining to company business.³² Although the Company Law requires the chairman to be of

²⁹ Company Law, art. 202 (ROC).

³⁰ The shareholders meeting is the occasion at which shareholders exercise their voting rights. Shareholders are entitled to have one vote for each share they hold. The Company Law, however, provides that the articles of incorporation must stipulate that if any shareholder has 3% or more of the total number of issued shares, a restriction must be placed in the articles of incorporation which provides that there be 1% reduction in the number of votes. The exercise of voting rights may not be limited, restricted, or impaired by the articles of incorporation or by a resolution of the shareholders. Therefore, there may be restrictions as to the voting right, but not as to the exercise of that right. There is an exception to this rule for shareholders with a personal interest in the matter before the shareholder meeting which may impair the interest of the company; such shareholder may not vote in the matter and may not exercise the voting power on behalf of another shareholder. Hsu, Li, and Wang, *supra* note 8, at 567-68; Wang, *supra* note 25, at 535.

³¹ Special shares may be issued as a means of maintaining the principle of equality among shareholders while meeting the special needs of investors. Only a portion of authorized shares, however, may be issued as special shares. Special shares are of two types. The first is referred to as priority or preferred shares. The priority is not confined to a priority interest in dividends but also appertains to the distribution of assets on dissolution of the company. In addition, special voting rights may be accorded to such preferred shares. This is of special interest to an investor who may want the decision which may affect his interests to be specially protected. The second type of special share is referred to as "disadvantaged" or sometimes "incorporators" shares. The holders of such shares may enjoy fewer rights or have more obligations than the common shareholder. Wang, *supra* note 25, at 532-33.

³² The Company Law provides that the chairman "shall externally represent the company," art. 208, and "have power to conduct all affairs pertaining to the business

Chinese nationality and domiciled in Taiwan, this requirement does not apply if the company is organized as a "company limited by shares."³³

3. *Protection of Minority Shareholders*

Any shareholder or shareholders who own more than three percent of the issued shares may initiate a petition to convene a board meeting.³⁴ A shareholder may object to any board resolution which changes the character of the joint venture and may request that his shares be bought out by the company for the prevailing fair market price.³⁵ Minority shareholders are entitled to maintain their original rights in newly issued shares. Thus, subject to certain limitations, minority shares may not be diluted by the issuance of new shares by majority shareholders.³⁶

G. *Capital Contribution: Intangible Assets*

A foreign investor in a joint venture may wish to make his capital contribution to the enterprise by licensing patent rights or know-how. Although capitalization of intangibles is permissible under Taiwan law,³⁷ the government places the value on intangibles, and the valuation normally is very low.³⁸ The value of equity resulting from the capitalization of patent rights may never exceed twenty percent (fifteen

of the company." art. 57. There appears to be nothing, however, to prevent the joint venture partners from stipulating in the articles of incorporation of the joint venture company that important corporate decisions must rely on a majority or large majority of the votes of the board of directors and/or shareholders meeting.

³³ Wang, *supra* note 25, at 540.

³⁴ Company Law, art. 173.

³⁵ *Id.* arts. 185-88.

³⁶ *Id.* art. 267.

³⁷ In addition to technical know-how or patent rights, article 3 of the SIFN provides for the following kinds of capital: (1) cash in the form of foreign exchange, which is remitted or brought in; (2) imports against self-provided foreign exchange of domestically needed machinery, equipment, raw materials for own use, or of commodities for sale which are permissible imports to raise funds for working capital or plant erection; and, (3) those portions of principal, net profit, interest, or any other income from investment which have been approved for exchange settlement.

³⁸ Hsu, Li, and Wang, *supra* note 8, at 576. The SIFN does not describe or specify what constitutes "technical know-how" or "patent rights" and contains no detailed instructions for the Ministry of Economic Affairs. Under the administrative rules prepared by the Ministry, to qualify for equity capital the technical know-how must be up-to-date, must have commercial value, must be indispensable for the projected enterprise, and must have the capability to produce a product the local industries have hitherto been unable to produce, or to improve the quality, or reduce the production cost of a product now being produced in Taiwan. *Id.* at 577.

percent in the case of know-how) of the actual paid in capital.³⁹ Thus, capitalization of intangibles must be coupled with equity investment in the form of either cash or equipment.⁴⁰

If the foreign party does not wish to capitalize intangibles as equity, it may, subject to government approval, enter into a licensing agreement with the domestic party under the Statute for Technical Cooperation.⁴¹ Under this statute the foreign party may furnish patents or technical know-how in return for a fixed royalty which may be repatriated in foreign currency.⁴²

H. Profit Repatriation, Taxation, and Other Investment Incentives

In joint ventures qualified to do business under the SIFN, the foreign party has the right to apply for exchange settlement of the yearly income of net profit or interest gained on the investment. In addition, at the expiration of one year after commencement of the business operation, the foreign party may apply for exchange settlement at one time against the whole amount of the invested principal as approved and capital gain realized from the investment.⁴³ The right to repatriate capital and earnings resides only in the foreign investor; the joint venture company itself may not repatriate funds.⁴⁴

Taiwan law provides the approved joint venture with a five-year income tax holiday beginning from the date the enterprise begins to

³⁹ *Id.*

⁴⁰ *Id.* In a joint venture the foreign investor may wish to directly capitalize certain tangible assets such as machinery and equipment while the local partner may wish to directly capitalize land and buildings. On the business side there will be hard bargaining as to what value should be assigned to those tangible assets to be capitalized. On the legal side it may be advisable to avoid such direct capitalization since it involves a cumbersome procedure whereby the government authority assesses the value of imported machinery and equipment.

⁴¹ For a discussion of this statute, see Hsu, *supra* note 9, at 290-92.

⁴² See Hsu, Li, and Wang, *supra* note 8, at 578.

⁴³ Statute for Investment by Foreign Nationals, art. 13. No limit is placed on the remittable amount of the annual profits as long as the statutory requirements are met. To determine the remittable amount, foreign exchange authorities will need such data as a balance sheet, or profit and loss statement, and the tax assessment notice. *Id.* art. 14.

⁴⁴ Hsu, Li, and Wang, *supra* note 8, at 583. The economic liberalization guidelines finalized by the Council for Economic Planning and Development during Fall 1986 contemplate permitting foreign and overseas Chinese enterprises in Taiwan to remit a portion of paid-in capital, including loans and capital stock, to other operations. China Post, Nov. 5, 1986, at 7, col. 4.

market its products or to render services.⁴⁵ In 1977 the government amended the SEI to give an enterprise in the capital-intensive or technology-intensive category the option to defer the application of the tax holiday by one to four years, to be decided within two years of start-up.⁴⁶ The joint venture shall deduct all research and development expenses from the taxable income of the current year.⁴⁷ In addition, there are a number of exemptions from, or relaxations of, import duties for machinery, equipment, raw materials, fuel, and semi-finished products imported under specified circumstances.⁴⁸ Based

⁴⁵ A newly established productive enterprise qualified under the categories and criteria of encouragement may choose *either* exemption from profit seeking enterprise (corporate) income tax for five years *or* accelerated depreciation of fixed assets. Statute for Encouragement of Investment, art. 6. The types of enterprises eligible are listed in article 3 of the SEI; additional categories may be requested by filing an application with the relevant government agency.

During the five-year tax holiday, depreciation deductions on fixed assets must be taken regularly at rates shown in the schedule adopted by the Income Tax law. *Id.* art. 6.1. Depreciation deductions would of course reduce profits. If the accelerated depreciation option is chosen, the accelerated depreciation rates are drastically greater than the normal rates prescribed for income tax purposes. If machinery or equipment would have a useful life of 10 years or more under the normal rates, that period may be accelerated to five years; if machinery has a normal life of less than 10 years, it may be shortened by one-half. *Id.* art. 6.2(1). The normal depreciation of buildings, communications, and transportation facilities may be accelerated by one-third. *Id.* art. 6.2(2).

After approval of the application for the tax exemption filed by the joint venture, if the five year total income tax deduction is chosen, the period of tax exemption shall commence on the day its product is first placed on the market (not when plant construction or other preparatory work begins) and continues for five consecutive years. Once the five year period begins to run, it continues to run despite any interruption of production. Wan, *supra* note 4, at 255.

The profit-seeking enterprise income tax payable by productive enterprises in general shall not exceed 25%. To encourage big trading companies, venture capital investment enterprises, and industry in the areas of basic metal production, heavy machinery, and petrochemicals, as well as other important productive enterprises which conform with the needs for development of economic and national defense industries and are capital-intensive and/or technology-intensive in nature, the Statute provides that the profit-seeking enterprise income tax shall not exceed 20% of their annual taxable income. Statute for Encouragement of Investment, art. 15. (Prior to the January 16, 1987 revision of the SEI, a 25% rate applied to big trading companies and venture capital investment enterprises and a 22% rate applied to the other described industries).

⁴⁶ *Id.* art. 7.

⁴⁷ *Id.* art. 34.

⁴⁸ Specially designated industries are exempt from import duty on imported productive machinery and equipment, or on components, parts, and materials for manufacturing such machinery and equipment, if they are not produced domestically. Productive enterprises may apply for installment payment of duty on imported

upon policy requirements, the Executive Yuan may permit a productive enterprise to credit five to twenty percent of the amount invested in production equipment for the current year against the profit-seeking enterprise income tax payable for the current year.⁴⁹

I. Relevant Contract Law Principles

1. Choice of Law

Although one would normally expect that the law governing the joint venture agreement would be that of the country in which the venture is situated, there is nothing to prevent the parties from freely stipulating which country's law shall be applicable to the formal agreement and to the resolution of any disputes. If a contract so stipulates, Taiwan courts will apply the law of a foreign country.⁵⁰ An agreement to adopt the law of a communist country, however, will be held invalid. Moreover, a contractual clause which expressly provides that Taiwan law shall be inapplicable to the joint venture agreement will likewise be held invalid, as will any other contractual provision found contrary to public policy and good morals.⁵¹

Should the contract fail to provide for the application of foreign law, Taiwan courts will interpret the joint venture contract in accordance with the Chinese Civil Code. The law applicable to contracts is contained primarily in the second book of the Code, the Book of Obligations.⁵² Parties to contracts governed by Taiwan law should

machinery and equipment, as well as on components, parts, and materials for manufacturing machinery and equipment. Duty paid or payable on imported raw materials used in export products may be refunded or bonded. Import duties on instruments and equipment which are not being produced locally and are brought in for experimentation under a research and development program are exempt. Customs duty on machinery, equipment, and raw materials imported by factories in the Export Processing Zones is exempt. *A Brief Introduction to the Investment Climate in Taiwan Republic of China*, Indus. Dev. & Inv. Center (May 1986).

⁴⁹ *Id.* The revision of the SEI passed by the Legislative Yuan on January 16, 1987, provides that companies or individuals may enjoy tax reductions on 30% of their investments in hi-tech industries designated by the government. *China Post*, Jan. 19, 1987, at 7, col. 2.

⁵⁰ See Yang, *Contract Law of the Republic of China*, in *TRADE AND INVESTMENT IN TAIWAN* 386 (Ma ed. 1985).

⁵¹ *Id.*

⁵² Taiwan's law of contracts does not differ significantly from other civil law jurisdictions. Unlike German law, however, Taiwan law does not distinguish between commercial law and civil law. Matters that generally would be found in the general provisions of a commercial code are included in the Book of Obligations of the Civil Code. Ma, *supra* note 2, at 13.

be aware that contracts are unenforceable unless the court determines that there has been mutual agreement to "essential elements" of the contract. In arriving at this determination, Taiwan courts depend on the principle of "free moral conviction," an interpretive principle which allows the court to look beyond the literal meaning of contract provisions in ascertaining the intent of the parties.⁵³

2. *Dispute Resolution*

a. Litigation to Judgment

In Taiwan civil and criminal procedure are uniformly codified, and any natural person, corporate entity, or other type of juristic person (including non-recognized foreign juristic persons) may initiate civil litigation.⁵⁴ Parties may settle their dispute at any time prior to the rendering of judgment, but in the event the district court renders a judgment, either party may appeal to the appellate court, which is free to initiate a trial de novo. If a party takes an appeal from the appellate court judgment to the Supreme Court, only issues of law will be considered.⁵⁵

b. Reconciliation and Compromise

Under the Chinese Code of Civil Procedure, parties to a dispute may adopt either reconciliation or compromise. Reconciliation is required in suits subject to summary procedure and is effected by the court upon application of a party. Compromise may be initiated by the court during the progress of the proceeding. A settlement made under the jurisdiction of the court has the effect of a final judgment.⁵⁶

⁵³ There is a fundamental difference between the Chinese legal system and common law legal systems. A Taiwan court's decision is heavily dependent on its "free moral conviction." The principle of "free moral conviction" is illustrated in article 222 of the Code of Civil Procedure: "Except where it is otherwise provided, the Court, in rendering a judgment, shall decide on the truth or falsity of facts according to its free moral conviction with due consideration given to all points raised on the oral proceedings as well as the result of the examination of evidence." Another important principle to be considered is that in the interpretation of law, the true intention of the parties must be sought rather than the literal meaning of the words or expressions. See HSU, A PRACTICAL GUIDE FOR CONDUCTING BUSINESS IN THE REPUBLIC OF CHINA 107 (1982).

⁵⁴ Hsu, Li, and Wang, *supra* note 8, at 579-80.

⁵⁵ Ma, *supra* note 2, at 38.

⁵⁶ Thus, legal relations determined by compromise or reconciliation may not be contested by the parties in any future action. Nor may the court make any decision in contravention of what has been determined by compromise or reconciliation. *Id.* at 36.

c. Arbitration

Commercial arbitration of disputes is available under the Statute Governing Commercial Arbitration. An arbitral award has the effect of a judgment rendered by a court, but usually is enforceable only when reduced to a judgment.⁵⁷ Foreign arbitral awards reduced to judgment in foreign countries may be enforced as foreign judgments in Taiwan.⁵⁸

d. Informal Mediation by the Board of Foreign Trade

Another method of dispute resolution in Taiwan is informal mediation by the Ministry of Economic Affairs, Board of Foreign Trade (BOFT). The BOFT has the authority to revoke the import/export licenses of trading companies in Taiwan. Although BOFT decisions are not enforceable as arbitral awards, BOFT mediation has proven quite effective because of the ultimate power to revoke licenses.⁵⁹

3. Liabilities and Remedies

Under the contract law of Taiwan, an award of money damages is the basic remedy for unexcused failure to perform contractual obligations.⁶⁰ The measure of damages equals the losses actually suffered by the party not in breach, including lost profits. A party may receive compensation, however, only for those profits foreseeably

⁵⁷ According to an amendment to the commercial arbitration statute passed by the Legislative Yuan on December 17, 1986, an arbitration award may be enforced without a court execution order if the parties have so agreed in writing and if the subject matter of the award falls within the category of (1) payment of a sum certain in money or other fungible articles or securities, or (2) delivery of a specific movable. *The Economic News*, Jan. 4, 1987, at 8, col. 1.

⁵⁸ Ma, *supra* note 2, at 34-35. Taiwan courts ordinarily recognize and enforce final judgments of foreign courts. The method of enforcement is to apply to the district court to make a decision ordering the execution of the judgment. The court will make such a decision except in the following cases: (1) if, according to Taiwan law, the foreign court concerned has no jurisdiction over the case; (2) if the party defeated is a citizen of Taiwan who has not responded to the action, except where the summons or order necessary for the commencement of the action has been served on the party himself in that foreign country or has been served on him through the judicial assistance of Taiwan; (3) if the judgment of the foreign court is considered to be incompatible with public order or good morals; and, (4) if judgments given by the courts of Taiwan are not reciprocally recognized by the foreign court concerned. *Id.* at 38-39.

⁵⁹ Hsu, *supra* note 48, at 17. For a brief description of the BOFT, see Wang, *supra* note 9, at 136-37.

⁶⁰ Yang, *supra* note 50, at 381. If the defaulted performance is payment of money, interest will be added to the damage award. *Id.* at 382.

lost in the ordinary course of business. Moreover, the court may, at its discretion, adjust the compensation awarded to the injured party if the injured party has failed to mitigate damages or has otherwise contributed to the injury.⁶¹ The court also may reduce the damage award if the injury was unintentional, or if full reparation would be an exceedingly serious economic blow to the breaching party.⁶²

Where money damages are inadequate, an injured party may apply to the court for specific performance.⁶³ Additionally, breach of contract may give the injured party the right of rescission, *i.e.*, a release from all contract obligations not yet performed and restoration of the injured party to his former condition.⁶⁴

III. THE LAW REGULATING JOINT VENTURES IN THE PRC

A. *The Political Background of Present Economic Policy in the PRC*

The Chinese communists long have recognized the importance of foreign investment to China's economic development.⁶⁵ Although Mao turned to the Soviet Union for partnership in the first post-1949 joint ventures in the PRC, he indicated in 1957 that, in theory, capitalist countries of the Western world also could be viewed favorably as a source of modern technology.⁶⁶ Mao's distrust of the West and fear of an economic invasion by Western capitalists were not fully shared by other influential communist leaders. Both Zhou Enlai and Deng Xiaoping spent formative years in Europe, and recognized that some degree of Westernization and foreign investment in China was both necessary and appropriate.⁶⁷ Communist economic policy in the pres-

⁶¹ *Id.*

⁶² *Id.*

⁶³ *Id.* at 379.

⁶⁴ *Id.* at 379-81.

⁶⁵ Wan, *supra* note 4, at 244.

⁶⁶ *Id.* at 249.

⁶⁷ *Id.* at 250. Zhou Enlai is quoted as having made the following statement during a 1938 conversation with James Bertram in Wuhan:

And if in the end we [the Communist Party] do gain the victory, we shall need all the more the economic and technical assistance of more highly developed foreign countries to rebuild China after the war. Any questions that are still outstanding, such as extraterritoriality and the unequal treaties, can then be settled by peaceful agreement. We shall continue to welcome foreign capital investment and foreign enterprise in China.

D. WILSON, ZHOU ENLAI 147 (1984). For a chronological summary of China's trade and economic relations with foreign countries before 1976, see CHINA'S SOCIALIST MODERNIZATION 675-84. (Yu ed. 1984); Rich, *Joint Ventures in China: The Legal Challenge*, 15 INT'L LAW. 183-86 (1981).

ent era of "socialist modernization" calls for the de-emphasis of radical political ideology,⁶⁸ and much of the new economic legislation in the PRC is specifically designed to create a favorable climate for the attraction of foreign capital investment.⁶⁹

⁶⁸ For a discussion and analysis of policy conflict in domestic Chinese commerce since 1949, see D. SOLINGER, *CHINESE BUSINESS UNDER SOCIALISM* 60-123 (1984). Ms. Solinger suggests in the domestic context that the leadership's "perception of the state of the economy at any specific juncture . . . is the most significant determinant of the tendency that dominates at that time, and thus of the policy chosen." *Id.* at 122. The same conclusion seems equally applicable to policy determinations concerning foreign investment in China. See Note, *The Legal Framework for Joint Venture in China: Guidelines for Investors*, 16 *LAW & POL'Y INT'L BUS.* 1009-17 (1984). See generally Reynolds, *China in the International Economy*, in *CHINA'S FOREIGN RELATIONS IN THE 1980s* 71 (H. Harding ed. 1984). This is not to say, however, that dominating tendencies and resulting policies can completely control competing positions and factions representing them at any given time. The basic underlying dilemma has been noted by James Myers. Although all would agree that the basic thrust of Chinese economic policy for the past decade has revolved around the Four Modernizations,

"[m]odernization" by definition requires large-scale cultural transformation to permit and to nurture new ways of seeing and interacting with the empirical world. Such innovation, however, may be incompatible with the degree of control over the institutional sources of innovation which historically has been demanded by the leaders of the Communist Party of China (CPC) and which seems to be required by the ruling explanatory system, Marxism-Leninism-Mao Zedong Thought.

Myers, *China The "Germs" of Modernization*, 25 *ASIAN SURV.* 891, 983 (1985). For further discussion of some of the implications of this dilemma, see, e.g., Backman, *Differing Visions of China's Post-Mao Economy: The Ideas of Chen Yun, Deng Xiaoping, and Zhao Ziyang*, 26 *ASIAN SURV.* 292 (1986); Halpern, *China's Industrial Economic Reforms: The Questions of Strategy*, 25 *ASIAN SURV.* 998 (1985); Kokubun, *The Politics of Foreign Economic Policymaking in China: The Case of Plant Cancellations with Japan*, 105 *CHINA Q.* 19 (1986); Lee, *Enterprise Autonomy Policy in Post-Mao China: A Case Study of Policymaking, 1978-83*, 105 *CHINA Q.* 45 (1986); Simon, *The Challenge of Modernizing Industrial Technology: Implications for Sino-U.S. Relations*, 26 *ASIAN SURV.* 420 (1986); Zweig, *Prosperity and Conflict in Post-Mao Rural China*, 105 *CHINA Q.* 1 (1986). Given the underlying environment of factionalism in Chinese policy-making, one should not be surprised with the frequent shifts of direction. An article appearing in *Asiaweek* observed, "[t]he Chinese Communist Party (CCP) is gunning for a tighter grip on the spiritual life of the people. . . . A damper has been put on China's economic relations with the world." *Applying the Brakes*, *ASIaweek*, Apr. 13, 1986, at 33. Contrast the introduction to an article appearing just over two months later in the same publication: "Since the National People's Congress promulgated an ambitious, forward-looking 7th Five-Year Plan for China two months ago, a still-burgeoning wave of liberalism has swept the land." *A Time to Speak Out*, *ASIaweek*, June 22, 1986, at 47. What lawyers must keep in mind in the midst of all these shifts is that Chinese law "is developed in a socialist context. China is a planned economy and its laws have to accommodate its economic structure." Horsley, *Comments on Laws and Legal Development Affecting Foreign Investment in China*, 3 *CHINA L. REP.* 175, 177 (1986).

⁶⁹ Mu, *New Developments in China's Economic Legislation*, 22 *COLUM. J. TRANS-*

Any foreign enterprise with an interest in establishing a joint venture in the PRC should recognize that the principles of equality, mutuality

NAT'L L. 60, 69 (1983). The underlying policy governing China's utilization of foreign funds set forth in the Sixth Five-Year Plan (1981-85), is as follows:

During the Five-Year plan period, we must make good, effective use of foreign funds according to the needs of national construction, to our capacity for installing complete sets of equipment and to our capacity to repay and our ability to handle them in an effort to promote the development of our production and construction. We should use foreign funds mainly to develop energy and transportation, and to modernize our equipment so that foreign funds are used in such a way as to finance the introduction of foreign technology and for technical transformation.

The Sixth Five-Year Plan of the People's Republic of China for Economic and Social Development 161-62 (1984). This approach received additional emphasis in Premier Zhao Ziyang's 1984 Report on the Work of the Government:

To open to the outside world is a correct policy that suits China's actual conditions and that we must resolutely implement. Under the guidance of unified state policies, all localities and departments should be active in carrying out external economic and trade activities. *They should, in particular, be bolder and take bigger strides in using foreign capital and importing advanced foreign technology.*

The Second Session of the Sixth National People's Congress (Main Documents) 24 (1984) (emphasis added). See also Feng, *Mofert's Vice Minister Wei on Foreign Investments*, CHINA TRADE NEWS, July 1985, at 2. Premier Zhao has explained away any seeming inconsistency between the current policy of attracting foreign capital investment and the Chinese Communist Party's historical emphasis on self-reliance, see Reynolds, *The Joint Venture Law of the People's Republic of China: Preliminary Observations*, 14 INT'L LAW. 31 (1980); Clarke, *The U.S.-China Economic Relationship: Entering the Second Decade*, in U.S.-CHINA TRADE RELATIONS, 1983: SIX ESSAYS 5 (D. Bays ed. 1983), quoting China's Economy and Development Principles A Report by Premier Zhao Ziyang 47 (1982), as follows:

By linking our country with the world market, expanding foreign trade, importing advanced technology, utilizing foreign capital and entering into different forms of international economic and technological co-operation, we can use our strong points to make up for our weak points through international exchange on the basis of equality and mutual benefit. Far from impairing our capacity for self-reliant action, this will only serve to enhance it. In economic work, we must abandon once for all the idea of self-sufficiency, which is a characteristic of the natural economy. All ideas and actions based on keeping our door closed to the outside world and sticking to conventions are wrong, and so are ideas and actions based on relying solely on other countries and having blind faith in them.

Some have gone so far as to characterize equity joint ventures as a natural outgrowth of China's historical experience. See Brown, *Sino-Foreign Joint Ventures: Contemporary Developments and Historical Perspective*, J. NORTHEAST ASIAN STUD., Dec. 1982, at 25. Of the Seventh Five-Year Plan (1986-1990), a knowledgeable commentator has observed:

Foreign economic relations play an important role in this FYP. However, a careful comparison of this FYP with the Sixth FYP indicates that foreign commerce is not expected to develop as rapidly as it did between 1979 and

of benefit, and respect for the sovereignty of China are prerequisites to the extension of any privileges to do business in the PRC.⁷⁰ For its part, the PRC Government has reassured the international business community that it will respect private property rights of foreigners in the PRC, and the government has amended the national constitution to provide specific protection for the property of foreign economic enterprises.⁷¹

1985. For example, the Sixth FYP labeled the 'energetic development of economic relations and trade with foreign countries' one of the 10 'fundamental tasks' of the plan. The Seventh FYP has three 'major tasks,' none of which involve foreign countries directly.

Nevertheless, the Seventh FYP is based squarely on the assumption that China's door will remain open through 1990 and beyond.

Denny, *China's Seventh Five-Year Plan*, CHINA BUS. REV., July-Aug. 1986, at 12, 14.

⁷⁰ Clarke, *supra* note 69, at 7; Mu, *supra* note 69, at 68.

⁷¹ Mu, *supra* note 69, at 69. Article 32 of the 1982 constitution provides, in relevant part, that "China protects the lawful rights and interests of foreigners within Chinese territory." CONST. art. 32 (P.R.C. 1982). More specifically, article 18 provides that "China permits foreign enterprises, other foreign economic organizations and individual foreigners to invest in China and to enter into various forms of economic co-operation with Chinese enterprises and other economic organizations in accordance with the law of the People's Republic of China". *Id.* art. 18. The same article further provides that such foreign entities' "lawful rights and interests are protected by the law of the People's Republic of China." *Id.* See also Gu, *Foreign Investors Run Little Risk*, INTERTRADE, Jan. 1985, at 55-59. But see Fenwick, *Equity Joint Ventures in the People's Republic of China: An Assessment of the First Five Years*, 40 BUS. LAW. 369-75 (1985). China has entered into bilateral investment protection agreements with a number of countries. In terms of structure, they are similar to those signed among other countries in the world, including coverage of the following: (1) definition of investments and investors; (2) treatment accorded to investment and activities related to investment in the host country; (3) conditions to be followed in case of expropriation, nationalization or similar measure to be taken against investment in the host country; (4) guarantee for repatriation of capital and returns related to the investment; (5) investment insurance and subrogation; and (6) settlement of disputes. CHINA TRADE NEWS, Dec. 1984, at 23, col. 1. In a recent interview, however, the general director of the Ministry of Foreign Economic Relations and Trade's Treaties and Law Department pointed out several substantive distinctions between the agreements signed by China and those signed among other countries: (1) the Chinese agreements contain only a most-favored nation treatment provision, rather than a national treatment provision in regard to treatment granted to investors; (2) with respect to compensation for expropriation, nationalization, or other measures taken against investments, the Chinese agreements do not adopt the wording "prompt, adequate and effective compensation," which the developed countries maintain; (3) concerning the transfer of capital and returns, as well as other proceeds and gains, China has no objection to the stipulation of "free transfer," but holds that in countries where there are laws or regulations on control of foreign exchange those laws and regulations shall stand in force; and (4) because China is not a signatory to the Convention on the Settlement of Disputes Between States and

The new economic legislation allows the formation of several kinds of arrangements for foreign investment, and the Chinese have, in fact, entered into numerous different kinds of bilateral investment agreements.⁷² The officially preferred method of foreign investment

Nationals of Other States, it will not participate in submission of disputes for arbitration to the International Center for Settlement of Investment Disputes. *Id.* at cols. 1, 2. For discussion of the steps an investor might take to protect its investment in China, see Shanks, *Investment Protection in China—Overseas Private Investment Corporation Political Risk Insurance*, in *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA* 1985 457 (E. Theroux ed. 1985); WILLIAMS, *PROTECTING INVESTMENTS IN CHINA*, *id.* at 431 (E. Theroux ed. 1985); Marra, *OPIC Programs in China and Problems Faced by Investors*, 3 *CHINA L. REP.* 170 (1986).

⁷² In addition to equity joint ventures, other forms of investment existing in China include: contractual joint ventures; joint ventures in the Special Economic Zones; and joint ventures involving petroleum, natural gas, and resource exploitation. These categories of joint ventures are either partially or completely excluded from the joint venture laws and regulations. They are dealt with in separate or specialized legislation. Fenwick, *supra* note 71, at 840 n.5. By the end of 1983, foreign investors had participated in 190 equity joint ventures, 101 of which are in the Special Economic Zones. Total investment in these projects came to \$786.88 million, of which \$315.43 million was invested by foreign businesses. CHINA INTERNATIONAL ECONOMIC CONSULTANTS, INC., *THE CHINA INVESTMENT GUIDE 1984/85* 305 (1984) [hereinafter *CHINA INVESTMENT GUIDE*]. By the end of 1983, a total of 1,047 China-foreign contractual joint ventures worth more than \$2,900 million had been established, accounting for 45% of the direct foreign investment in China. *Id.* at 307. Compensation trade with foreign investors concluded by the end of 1983 represented total investment of \$930 million in imported technology and equipment. *Id.* In 1984 2,050 agreements and contracts were signed with companies outside China, and 700 more joint ventures were approved. *Reforms Invigorate 1984 Economy*, *BEIJING REV.*, Mar. 11, 1985, at 17. During the first half of 1985, China signed 687 joint venture agreements involving \$3.1 billion in foreign capital. *Wall St. J.*, July 25, 1985, at 20, col. 6. As of mid-1986 the total number of joint venture agreements negotiated reached approximately 2,500. Sterba, *Firms Doing Business in China are Stymied by Cost and Hassle*, *Wall St. J.*, July 17, 1986, at 12, col. 3. From 1979 through 1984 United States firms executed agreements committing some \$100 billion to approximately 60 equity joint ventures; in the first four months of 1985, the number of United States ventures contracted had risen to about 90, most of them involving manufacturing. *U.S. Manufacturing Equity Joint Ventures in China*, *CHINA BUS. REV.*, May-June 1985, at 33. The amount of equity investment actually made by United States firms by the end of 1985, however, has been variously reported to be from only \$1.4 billion to \$2.1 billion. Burns, *Why Investors Are Sour on China*, *N.Y. Times*, June 8, 1986, at F7, col. 1; Sterba, *Firms Doing Business in China are Stymied by Cost and Hassle*, *Wall St. J.*, July 17, 1986, at 14, col. 1; *CHINA TRADE NEWS*, July 15, 1986, at 1. In addition, China has drawn up a law on enterprises wholly owned by foreign investors. For a text of the statute (adopted on April 12, 1986) and explanation, see Torbert, *Wholly Foreign-Owned Enterprises Come of Age*, *CHINA BUS. REV.*, July-Aug. 1986, at 50. For a good general discussion of the forms of cooperation which have emerged, see *ECONOMIC AND SOCIAL COMMISSION FOR ASIA AND THE PACIFIC, GUIDEBOOK ON TRADING WITH THE PEOPLE'S*

in the PRC, however, is the equity joint venture.⁷³ This format allows a degree of enterprise autonomy without total relinquishment of control by the authorities. Moreover, the government perceives the equity joint venture as being the most rapid method of acquiring foreign technological know-how and managerial skill.

B. The Statutory Framework of the Joint Venture Law

A "joint venture" under PRC law is the contractual formation by a foreign investor and a domestic Chinese party of a single economic entity where the contracting parties share the profits and risks of that entity (or "joint venture") in proportion to their relative investment in the capital of the venture.⁷⁴

The Joint Venture Law promulgated in 1979 was less than comprehensive. This Law leaves most of the important details of the venture to the negotiation of the parties (subject to government approval).⁷⁵ Since the promulgation of this Law, a more defined

REPUBLIC OF CHINA 167 (1984); WANG, CHINA'S MODERNIZATION AND TRANSNATIONAL CORPORATIONS 69 (1984); Horsley, *Investing in China in 1985*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 1985 145, 155 (E. Theroux ed. 1985); Moser, *Foreign Investment in China: The Legal Framework*, in FOREIGN TRADE, INVESTMENT AND THE LAW IN THE PEOPLE'S REPUBLIC OF CHINA 106 (M. Moser ed. 1984). For a thoughtful consideration of the advantages and disadvantages of selecting one form or another, see Cohen, *Some Problems of Investing in China*, in LEGAL ASPECTS OF DOING BUSINESS IN CHINA 1983 72-78 (J. Cohen ed. 1983).

⁷³ Mu, *supra* note 69, at 69.

⁷⁴ Wan, *supra* note 4, at 269.

⁷⁵ The Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment was adopted by the Second Session of the Fifth National People's Congress on July 1, 1979. An unofficial text of the law may be found in BEIJING REV., July 20, 1979, at 24-26 [hereinafter Joint Venture Law].

Commentators have characterized the 1979 Law as a compromise to resolve the dilemma confronted by China's economic and legal planners at the time:

If they sought to stimulate foreign interest by immediately promulgating detailed laws that would address all the problems that every foreign investment encounters, experience might prove those laws to be embarrassing, inadequate and even unfavorable to China. Yet if they failed to enact detailed laws, foreign business people might hesitate to invest because of the consequent lack of legal certainty.

Cohen and Horsley, *The New JV Regulation*, CHINA BUS. REV., Nov.-Dec. 1983, at 44. See also Note, *supra* note 68, at 1023-25. For general commentaries on the Joint Venture Law at its inception, see Cohen, Huang, and Nee, *China's New Joint Venture Law*, in A NEW LOOK AT LEGAL ASPECTS OF DOING BUSINESS IN CHINA 195 (1979); Hsia and Hahn, *China's Joint Venture Law: Part I*, 1 CHINA L. REP. 5-23, 61-83 (1981); Reynolds, *The Joint Venture Law of the People's Republic of China: Preliminary Observations*, 14 INT'L LAW. 31 (1980). For later commentary on the law analyzing problems and contradictions in its application, see Cohen, *supra* note 72, at 83-113; Fenwick, *supra* note 71, at 855; Rich, *Joint Ventures in China: The Legal Challenge*, 15 INT'L LAW. 183 (1981).

statutory framework for the establishment and operation of joint ventures in the PRC has gradually emerged. This framework includes statutes concerning the registration and taxation of joint ventures, establishment of resident representative offices, operations in the special economic zones, and a statute promulgated in 1983 which supplements and clarifies certain aspects of the basic 1979 joint venture law.

The 1983 Implementing Regulations to the Joint Venture Law identify industries in which joint ventures are authorized, specify necessary elements of the joint venture contract, and provide more specific details on the operation and organization of the venture.⁷⁶ The most recent development of significance was the State Council's promulgation on October 11, 1986, of additional Provisions for the Encouragement of Foreign Investment. Through these Provisions the State Council attempted to solve some of the problems which foreign investors had experienced under the existing framework. The joint ventures covered by these new Provisions include certain production enterprises whose products are mainly for export and production enterprises possessing advanced technology. In addition to such statutes and regulations, those negotiating joint ventures also must be attentive to a variety of applicable "provisional" regulations, special notices, and circulars outstanding at any given time, as well as to the opportunity to negotiate directly with the authorities for special treatment in appropriate circumstances.⁷⁷

C. *Bureaucratic Facilitation of the Agreement*

The Ministry of Foreign Economic Relations and Trade (MOFERT) has overall authority for the examination and approval of the venture. MOFERT may "entrust" this authority to provincial governments, municipalities, or any relevant ministries or bureaus under the State Council.⁷⁸ MOFERT has designated the following bureaucracies to

⁷⁶ See CHINA INVESTMENT GUIDE, *supra* note 72, at 322; Cohen, *supra* note 75, at 68-71; Fenwick, *supra* note 71, at 840 n.4. The Regulations for the Implementation of the Law of The People's Republic of China on Joint Ventures Using Chinese and Foreign Investment were promulgated by the State Council on September 20, 1983, reprinted in BEIJING REV., Oct. 10, 1983, at I-XVI [hereinafter Implementing Regulations].

⁷⁷ Horsley, *supra* note 68, at 176-77.

⁷⁸ Implementing Regulations, *supra* note 76, at ch. 2, art. 8 (1983). In order for MOFERT to entrust its examination and approval power to other organizations, the joint venture must comply with two conditions: (1) the total amount of investment

approve and facilitate the establishment of joint ventures: 1) the

must be within the limit set by the State Council and the Chinese participants' source of capital ascertained; and (2) no additional allocations of raw materials by the state may be required, and the national balance of fuel, power, transportation, and foreign trade export quotas must not be affected. *Id.* Inasmuch as the scope of approving authority is almost constantly changing, it is important for foreign investors to determine early in their discussions with potential Chinese partners what the approval authority will be. Foreign investors should make sure that the relevant government department is aware of the venture being discussed and has given the Chinese investors permission to proceed with negotiations. Horsley, *supra* note 72, at 190-91; see also Moser, *supra* note 72, at 107-08. In June of 1985 Liu Chu, The Deputy Director of MOFERT's Department of Treaties and Law, summarized approval authority as follows:

According to the Regulations, projects established with foreign investment, with the amount of total investment below US \$5 million can be approved by provinces, municipalities and autonomous regions themselves as well as Chongqing, Shenyang and Wuhan, among which Beijing and Liaoning province can approve projects with total amount of investment below US \$10 million, on condition that they can self balance the funds, energy, transportation, raw materials and other production and construction conditions.

As for the coastal cities which have been further opened by China (i.e., Dalian, Qinhuangdao, Tianjin, Yantai, Qingdao, Lianyungang, Nantong, Shanghai, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai), Tianjin and Shanghai can approve production projects with total amount of investment below US \$30 million; Dalian and Guangzhou US \$10 million; and other coastal cities US \$5 million, on condition that their construction and production factors needn't be met by the state, products needn't be sold exclusively by the state, exports do not take the state-quotas, and repayment can be made by themselves.

The non-production projects which mainly rely on self-borrowed and self-repayed foreign funds, self-raised funds, materials and imported equipments and do not need the national overall balance can be approved by provinces, municipalities and autonomous regions as well as the further opened coastal cities.

Liu, *An Insight Into the New Developments in China*, in 1985 CHINA UPDATE B5-6 (Institute for Int'l Res. 1985). See also Horsley, *supra* note 72, at 190-91. The next month, however, it was reported that Beijing would be cutting back on local autonomy and insisting "that all joint ventures would have to be weighed carefully in view of a fall in China's foreign exchange reserves." Sterba, *Will China Continue to Take Deng's Road After His Reign Ends?*, Wall St. J., July 23, 1985, at 1B, col. 3; see *infra* note 107. The Chinese announced on July 15, 1985, that "10 of the 14 coastal cities opened to foreign investors in April of last year are going to 'slow down' the signing of contracts with outsiders." Burns, *China's "Open Door" to West Begins to Close*, N.Y. Times, Aug. 4, 1985, at 16, col. 4.

A law professor at Shanghai Fudan University described the scenario for establishing a joint venture in Shanghai as follows:

In Shanghai, the bureau in-charge or district/county governments are empowered to examine and approve the feasibility studies, report, contract, articles of association and other related documents of joint venture projects

China International Trust and Investment Corporation; 2) the Beijing Economic Development Corporation; 3) the Fujian Investment and Enterprise Corporation; 4) the Foreign Investment Bureau (FIB); and 5) the General Administration for Industry and Commerce (GAIC).⁷⁹

if the proposal has already been approved at municipal level, providing the total investment does not exceed \$5 million (U.S. \$2 million for district/county projects). These must also meet the requirements that no new factory premises are needed and that power and, raw materials supplies, and the marketing of products can be self-managed and the balance of foreign exchanges maintained. For those production projects involving a total investment of between \$5-30 million, and products which are in short supply nationally, proposals should be forwarded by the bureau in charge of district/county government to the relevant municipal department for examination and approval. These should also meet the requirements that the infrastructure, energy and raw materials supplies, and the marketing of products can all be arranged within the municipality's overall plan. The proposal should be filed simultaneously with the State Council. Projects involving more than \$30 million of investment must obtain MOFERT's approval.

Dong, *Potential Investors' Queries Answered*, INTERTRADE, Jan. 1985, at 54.

For an analysis of the changing structure of China's institutional apparatus and resulting problems, see Lubman, *Trade Contracts and Technology Licensing*, in LEGAL ASPECTS OF DOING BUSINESS IN CHINA 16 (Cohen, ed. 1983). See also Theroux, *Licensing Technology and Know-How to China*, in LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 21 (E. Theroux ed. 1985); Wang, *supra* note 72, at 91. The following comments of Tianjin Liming Cosmetics Company's general manager reveal the problems posed by the gap between central and local approval authorities:

I'd like first to point out that Liming could not have come into existence without the energetic support of the Chinese Central Government and the Tianjin Municipal Government. But . . . things definitely need improvement . . . [T]here are too many mothers-in-law. We recorded an incident where we had to go through 22 offices to get a small matter settled. *The best way would be to have a local institution directly handle all matters related to joint ventures, and the Central Government must grant such an institution sufficient authority. Otherwise no foreign investors will be interested to set up joint ventures here.*

Hao and Zhang, *An Almost Unique Set-up*, INTERTRADE, Oct. 1984, at 56 (emphasis added).

Article 17 of the October 1986 Provisions for Encouragement of Foreign Investment speaks to this problem by exhorting the various authorities involved to "strengthen the co-ordination of their work, improve efficiency in handling matters and . . . promptly examine and approve matters . . . that require response and resolution." China Daily, Oct. 14, 1986, at 2. The examination and approval authorities are directed to approve or disapprove all documents within three months from the date of receipt. *Id.*

⁷⁹ Cohen, Huang, and Nee, *supra* note 75, at 199-200. The Foreign Investment Bureau, now a part of MOFERT, was formerly known as the Foreign Investment Commission. Moser, *supra* note 72, at 107.

After submission of an initial feasibility study of the venture to the "department in charge," the designated approval authority must give its final approval to the proposal.⁸⁰ In most cases the approving

⁸⁰ Implementing Regulations, *supra* note 76, at ch. 2, art. 9, § 1. For a good, recent step-by-step guide to finalizing a contract in China, see Lee and Ness, *Investment Approval*, CHINA BUS. REV., May-June 1986, at 14. When applying for approval of a joint venture, the Chinese party must submit the following documents to the approval authority: (1) a formal application for approval; (2) a copy of the feasibility study; (3) executed copies of the joint venture agreement, the joint venture contract and the company charter; (4) a list of the names of the persons appointed to the board of directors of the joint venture; and (5) signed opinions regarding the establishment of the joint venture from the superior unit of the Chinese joint venture partner. Implementing Regulations, *supra* note 76, at ch. 2, art. 9, § 2. Although the Joint Venture Law does not contain a feasibility study requirement and the Implementing Regulations fail to outline what the study should contain, lawyers representing foreign investors have been commenting recently on the emerging importance of the feasibility study. Cohen, *Negotiating with The Chinese-Problem Areas, Latest Developments in Contract Negotiation, Dispute Resolution*, in 1985 CHINA UPDATE P-1 (Institute for Int'l Res. 1985); Horsley, *supra* note 72, at 194-99. Although no official guidelines on the required contents of joint feasibility studies have been issued, it has been reported that unofficial documents exist setting forth rather detailed specifications requiring information on the following areas: (1) products to be manufactured; (2) supplies required; (3) technology and equipment to be used; (4) personnel requirements and training; (5) foreign exchange requirements and sources and domestic capital utilization; and, (6) financial analyses. *Id.* at 195-96. In a recent interview a MOFERT official suggested that project proposals and preliminary feasibility study reports should contain the following:

1. The basic conditions of the Chinese partner, existing products, production scale, the sales of products and their comparison with foreign products of the same category;
2. The basic conditions of the foreign partner, the scale of production, the quality of products, and the market place;
3. Requirements of both the Chinese and the foreign partners in the proposed venture;
4. The joint venture's production scale and the plans for its development;
5. The technology to be used and the sources of technology and equipment;
6. The quality of products and marketing situation and market prediction;
7. Total amount of investment in the joint venture and the source and composition of funds;
8. The income and expenditures of foreign exchange;
9. Economic benefits and the proportion and amount shared by both Chinese and foreign partners;
10. The number of workers and staff members, wage standards, and welfare services;
11. The contract life and the method of handling the property when the joint ventures is dissolved;
12. The source of major raw and semi-finished materials; and,
13. The existing problems which need help from the competent authority for their solution.

CHINA TRADE NEWS, June 15, 1986, at 6. The subsequent feasibility study report

authority will be the FIB, which must either approve or reject the proposal within three months.⁸¹ If approved, parties must apply for

should include:

1. Chinese and foreign name and legal address of the joint venture;
2. Production scale, output, specifications, models of the products, and development scale planned for the future of the joint venture;
3. Sources of raw materials and spare parts, quantity, and prices;
4. Technology and equipment to be adopted, and their suppliers and prices;
5. License fees, means of payment, and duration;
6. Area of the joint venture, standard of land use fee, means of payment;
7. Preparations for the joint venture, time limit of construction, and estimation of preparations and construction costs;
8. Sales of products, proportion of products sold on Chinese and foreign markets, way of sales, and the trademark to be used;
9. Revenue and expenditure of foreign exchanges and how to solve the problem of unbalanced foreign exchanges when and if it occurs;
10. Number of staff and workers;
11. Setting up of management organization and source of employees;
12. Standards of wages of staff and workers and welfare treatment;
13. Total amount of investment of the joint venture, volume of subscribed capital, and shares of the parties to the joint venture;
14. Volume, source, and guarantee of loans;
15. Distribution of profits and shares of the parties to the joint venture;
16. Analysis of economic results including cost estimation, profit rate, and time limit of recovery of investment;
17. Annual volume of taxes paid to the state and local government;
18. Associated facilities and costs;
19. Duration of the joint venture;
20. Overall evaluation; and,
21. Problems needing assistance from the Chinese Government departments.

Although the Implementing Regulations do not assign responsibility for the cost of preparing the feasibility study, it has been reported that the Chinese tend to be flexible about sharing the cost, especially if they can avoid out-of-pocket expenses, such as assigning their manpower to compile necessary data. Cohen, *supra* note 75, at 97. In the same interview mentioned above, the MOFERT official advises that "in drawing up the feasibility study report, the parties involved should clearly define how the necessary expenses will be shared." CHINA TRADE NEWS, June 15, 1986, at 6. He observes that generally expenses are handled in one of the following ways:

1. That each partner should pay for whatever expenses it incurs;
2. That expenses in China will be paid by the Chinese partner while expenses outside China will be paid by the foreign partner; or
3. That, after the establishment of the joint venture, the parties involved may discuss and decide that the expenses may be taken as part of the funds they are undertaking to contribute.

Id.

⁸¹ Cohen, *supra* note 75, at 204. "Although the Act gives the authorities three months in which to act on the application, in practice the authorities will have reviewed most if not all of the documents for which they have received tacit approval from the authorities." Chang and Pow, *Trade and Investment Law and Practice in the People's Republic of China*, 3 CHINA L. REP. 5, 30 (1985).

and commence operations under a license from the GAIC.⁸²

D. *Governing Law*

According to the 1983 Implementing Regulations, joint ventures are Chinese legal persons subject to the jurisdiction and protection of Chinese law. Article 2 of the 1979 Joint Venture Law protects "by legislation in force" resources invested by the foreign party. The other rights and interests of the foreign party are protected in accordance with the joint venture contract and articles of association, provided that there is no conflict with PRC law.⁸³

Although Chinese law governs the joint venture,⁸⁴ parties may agree that internal disputes be governed by the rules and procedures of independent arbitral bodies either in the PRC, in the country of the

⁸² Cohen, *supra* note 75, at 200. The procedures for effecting registration are set forth in the Measures for the Registration of Joint Ventures Using Chinese and Foreign Investment, promulgated by the State Council on July 26, 1980. See Moser, *supra* note 72, at 124. The registration fee is 0.1% on registered capital of up to RMB 10 million and 0.05% on registered capital in excess of RMB 10 million. Chang and Pow, *supra* note 81, at 31. Even after approval and registration have been completed, MOFERT, the department in charge of the venture, and the registering agent all have authority to regulate, guide, assist, and exercise supervision over the joint venture. Cohen and Horsley, *supra* note 75, at 45. See also Implementing Regulations, *supra* note 76, at ch. 1., arts. 6-7; ch. 2, art. 8; ch. 8, arts. 54-68.

⁸³ Cohen, *supra* note 75, at 207. At the time of enactment of the Joint Venture Law, there was little other relevant legislation. *Id.* at 206. Since then, a body of law and regulations applicable to joint ventures has evolved which, "when viewed as a whole, provide[s] for a fairly systematic regulatory regime." Moser, *supra* note 72, at 116. See also CHINA INVESTMENT GUIDE, *supra* note 72, at 322-23.

⁸⁴ Implementing Regulations, *supra* note 76, at ch. 2, art. 15. This express provision may have had the effect of closing the gap in the Joint Venture Law which had allowed the parties to compromise and not spell out the governing law, leaving the choice of law to the arbitration tribunal in case of a dispute. Cohen and Horsley, *supra* note 75, at 47. See Cohen, *supra* note 75, at 110. *But see* Dong, *Potential Investors' Queries Answered-Part II*, INTERTRADE, Feb. 1985, at 23, in which Professor Dong makes the following response to an inquiry as to whether it is possible to arbitrate by applying the law of a third country:

Disputes arising from the operation of joint ventures should in general be resolved as stipulated in the contract. With joint venture contracts, if clauses from specific laws are to be quoted, these can only be from relevant Chinese laws and not imported from any other state. If the foreign partner objects to these clauses they can be dropped as China to date has not legislated that joint venture contracts should specify legal clauses. In the case of a dispute, the two partners can appoint an arbitrator who may then make reference to the appropriate law justified by the nature of the dispute.

sued party, or in a third country.⁸⁵ Disputes may be settled in foreign courts, however, and not solely by arbitration, if friendly consultation or mediation cannot achieve resolution.⁸⁶ If there is no written arbitration agreement between the parties, any party may file suit in the Chinese courts, which have been open to foreigners since enactment in 1983 of the trial Civil Procedure Law. The Regulations, however, do not provide for suit in foreign courts.⁸⁷

The power to amend or repeal the joint venture "legislation in force" rests in the National People's Congress and its Standing Committee.⁸⁸ Both the Standing Committee and the State Council have the authority to interpret the Joint Venture Law, but for practical purposes, this power has been delegated to the FIC.⁸⁹ Since the PRC has neither comprehensive substantive law nor a fully developed legal system to deal with problems which may arise in the venture, parties should draft the articles of association with care to provide for both a substantive and procedural law to govern dispute resolution and to provide for termination of the agreement under specified conditions (such as changes in the law which materially affect the agreement). Indeed, one commentator has suggested that foreign parties should bargain for a special agreement from government authorities that any subsequent changes in the law be inapplicable to the agreement.⁹⁰

⁸⁵ Implementing Regulations, *supra* note 76, at ch. 15, art. 110.

⁸⁶ *Id.* art. 109.

⁸⁷ *Id.* art. 111.

⁸⁸ Mu, *supra* note 69, at 63, 64.

⁸⁹ Cohen, Huang, and Nee, *supra* note 79, at 205.

⁹⁰ *Id.* at 204-05. *But see* Dong, *supra* note 78, at 54, in which Professor Dong gives the following response concerning investment protection in the event of adverse future alterations to Chinese law:

To ensure the consistency of Chinese Law, all mandatory legal provisions promulgated by the State which supercede existing laws shall be enforced throughout the entire country. Thus, all foreign investors with establishments in China must abide by the rules and Regulations currently in force irrespective of their content. Judging from the present policy of promoting foreign investment in the country, it is envisaged that the Chinese legislature will take full consideration of the lawful interests of foreign investors when drafting new laws.

See also Moser, *supra* note 72, at 118. Other commentators have suggested that although "foreign investors have been able to continue to enjoy any favorable tax treatment which they successfully negotiated into their contracts prior to the promulgation of tax laws which prescribe higher rates of tax . . . the same generous treatment cannot be expected in other areas." Chang and Pow, *supra* note 81, at 28. Thus, foreign investors might be well advised "to secure in their contracts a right to renegotiate if their transactions suffer adverse economic consequences due to the promulgation of new laws." *Id.*

E. Corporate Structure of the Joint Venture

Joint ventures in the PRC are to take the form of a "limited liability company"⁹¹ with the foreign party holding not less than twenty-five percent of the registered capital. In theory, a foreign party could hold up to ninety-nine percent of the registered capital of the venture. Although profits and losses are to be shared in proportion to each party's contribution to the registered capital, majority control of joint venture assets does not necessarily lead to corporate control of the venture's operations.⁹² The Chinese party must appoint the

⁹¹ China presently has no Company Law. Relevant law of business organizations will be covered in the Civil Code now being prepared. Article 19 of the Joint Venture Law simply provides that the liability of parties is to be "limited to the amount of capital contribution subscribed by each." Article 4 provides that the parties "shall share the profits, risks and losses in proportion to their respective contributions to the registered capital." See Moser, *supra* note 72, at 117. See also Chang and Pow, *supra* note 81, at 28-29. In terms of practice, one Chinese commentator stated: "The stipulations laid down in the *Chinese Joint Venture Law* are completely in line with the international concept of a limited liability company. The Chinese legal community accepts this concept too." Dong, *supra* note 84, at 23.

⁹² Note, *Foreign Investment in the People's Republic of China: Compensation Trade, Joint Ventures, Industrial Property Protection and Dispute Settlement*, 10 GA. J. INT'L AND COMP. L. 233, 247 (1980). One commentator has analyzed the problems of achieving control as follows:

[I]n addition to the fact that most foreigners have at best been able to take a 50 percent interest, it is questionable how much practical control a foreigner can exercise in the joint venture context. [Certain major specified] [d]ecisions . . . require unanimous approval of the board and all other major decisions are to be made "in accordance with the principles of equality and mutual benefit." Management positions in joint ventures are to be allocated, and rotated, between the Chinese and foreign parties. Moreover, in the interest of long-term harmony, it is unlikely that a foreign investor would want to force a given decision upon its Chinese partner.

Horsley, *supra* note 72, at 188-89.

The allocation and rotation of management positions also has limited the capacity of any one partner to achieve effective control:

What has evolved in practice is that in most joint ventures the foreign side appoints the top management positions . . . and the Chinese side appoints the corresponding deputies As a result of this bifurcated structure, managerial decisions must generally be based on agreement between the expatriate manager and his deputy. Therefore, the scope for independent decision-making by foreign managerial personnel is usually quite limited.

Moser, *supra* note 72, at 125. See generally *Implementing Regulations*, *supra* note 76, at ch. 5, arts. 38-40.

The *Implementing Regulations* provide yet another impediment to either party's achieving practical control by prohibiting "[t]he general manager or deputy general managers . . . [from holding] posts concurrently as general manager or deputy general

board chairman, and in any case, both parties are expected to work with government agencies and in accordance with the overall plan.⁹³

The 1983 joint venture Implementing Regulations provide that the board of directors of the venture is its highest authority, and thus has the power to decide all major issues. Each party may appoint directors in proportion to the amount of investment contributed.⁹⁴ The board has the authority to make important decisions in areas such as expansion, production, and profit distribution, but these decisions are to be made through a process of consultation rather than voting. Therefore, decision-making power is not necessarily in accordance with each party's proportion of capital contribution.⁹⁵

managers of other economic organizations" or having "any connections with other economic organizations in commercial competition with their own joint venture." Implementing Regulations, *supra* note 76, ch. 5, art. 40.

⁹³ Note, *supra* note 92, at 247. See Implementing Regulations, *supra* note 76, at ch. 8, arts. 54-68.

⁹⁴ Implementing Regulations, *supra* note 76, ch. 5, arts. 33-34. In practice, joint venture boards typically consist of nine representatives, five of whom are Chinese, including the chairman. Leung, *Western Joint Ventures in China Encounter Delays, Foreign-Exchange Block*, Wall St. J., Mar. 18, 1985, at 38, col. 3.

⁹⁵ Cohen, Huang, and Nee, *supra* note 75, at 216.

[D]ecisions [not requiring unanimity] may be made in the manner specified in the joint venture's charter. The mechanism usually adopted is majority voting, but this has not generally proved to be workable. In practice, Chinese negotiators will usually insist that seats on the board be allocated equally between the parties. As a consequence, each side's appointees tend to vote as a block requiring, in effect, that all decisions made by the board be unanimous.

Moser, *supra* note 72, at 125. See also Chang and Pow, *supra* note 81, at 31.

Foreign investors' reactions to the working of their joint venture board vary. A European investor characterized his board as "a circus for people to make speeches. . . . They are sensible people, but they will make all sorts of crazy suggestions to see how much you're willing to concede before they compromise. All these take time." Leung, *supra* note 94, at 38, col. 3. In contrast, a United States citizen described his board as follows: "Mine is a cohesive and enthusiastic group. They see their own future in the joint venture as separate from that of the state's." *Id.*

The former director of China Operations for Otis Elevator Company made the following observations on the board, based on his experience with the company's joint venture in Tianjin:

Many of the difficulties with decision-making authority stem from the way that the joint venture's board is structured. The board is a new entity in the Chinese system, whose role, function, and powers are not well defined in legislation and totally unrefined in practice. Although the board is the higher authority within the joint venture, the joint venture is subject to the laws of China, and those laws, of course, are administered by bureaucrats.

But the major problem is that because the board is new, all sides fall

Certain decisions, such as amendments to articles of association, termination of the venture, or increases in the registered capital of the venture, require unanimous agreement by the board.⁹⁶

F. Capital Contribution

Capital contributions to the venture may be in the form of cash, buildings, premises, industrial property, know-how, or the right to use of the site, and such contributions must comply with current debt-equity ratio guidelines.⁹⁷ Valuation of buildings, premises, industrial property, or know-how can either be negotiated by the parties or determined by a third party acceptable to both parties. The government, however, unilaterally will determine valuation.⁹⁸ If the right

back on old alliances and leave the new system to founder. The Chinese and the MNC supply the chairman and vice chairman respectively; each partner is represented on the board in proportion to its share in the venture. Beyond that very clear delineation of power, however, lies a complex web of allegiances and authority. . . . Even if the joint venture board makes a decision, the bureaucracy often countermands it and the foreign partner may never know what's going on, much less why.

Hendryx, *The China Trade: Making the Deal Work*, HARV. BUS. REV., July-Aug. 1986, at 75, 83. The Otis Elevator director suggests that the joint venture must "assert the sovereignty of the board and limit the role of the bureaucracy. . . . [T]he main route to effective decision making must come from foreign managers winning greater autonomy for the board and, failing that, asserting themselves before the bureaucracy." *Id.* at 84. Article 15 of the October 1986 Provisions for the Encouragement of Foreign Investment may provide some assistance by exhorting the various government authorities to "guarantee the right of autonomy of enterprises with foreign investment and . . . support enterprises with foreign investment in managing themselves in accordance with international advanced scientific methods." China Daily, Oct. 14, 1986, at 2.

⁹⁶ Implementing Regulations, *supra* note 76, at ch. 5, art. 36.

⁹⁷ *Id.* at ch. 4, art. 25. No mention is made of contributions of services or training by the foreign investor. The debt-equity ratio guidelines effectuated in late 1985 stipulate:

(1) In joint ventures with an investment of \$3 million or less, no debt is allowed to finance paid-in capital;

(2) With investments of \$3 million to \$10 million, the amount of debt cannot exceed the equity investment;

(3) From \$10 million to \$30 million, the debt cannot be more than double the equity;

(4) For \$30 million and over, the debt limit is triple the equity investment.

Tharp, *China Sets Equity Requirements for Its Partners in Joint Ventures*, Wall St. J., Dec. 19, 1985, at 33, col. 2.

⁹⁸ Implementing Regulations, *supra* note 76, at ch. 4, art. 25; ch. 7, arts. 48-49. With respect to in-kind contributions, one commentator described the typical course of the valuation process as follows:

In general, Chinese negotiators have tended to adopt the strategy of first

to use the site is not capitalized, then the joint venture will have to pay for such right.⁹⁹

Article 5 of the 1979 Joint Venture Law states that a foreign party must compensate the joint venture for any losses attributable to the contribution by the foreign party of "outdated" technology or equipment. Article 28 of the 1983 Implementing Regulations specifies the kinds of technology acceptable to the government for capitalization into the venture. Generally this technology must be capable of manufacturing new products, improving performance of old products, and raising productivity, or capable of providing savings in the use of raw materials or energy.¹⁰⁰ Furthermore, technology acquired by

eliciting from the foreign side the proposed valuation of its in-kind contributions and then matching that amount by assigning an equal, and usually highly inflated, value to its contributions of factory buildings and land-use rights. Based on the principle of 'equality and mutual benefit,' the Chinese will then demand reductions in the valuation proposed by the foreign side before they will accept a reduction in the value of their own contributions.

Moser, *supra* note 72, at 121-22.

It also has been suggested that because the local government receives the site use fee, it will have a strong interest in setting a high value. Note, *supra* note 68, at 1030. Although it is possible that the local government could view its valuation power as an opportunity to seek an exorbitant site use fee, its basic instincts would probably be tempered by its desire that the joint venture succeed. For additional discussion and explanation of land use fees, see Chu and Dong, *How to Acquire a Site for Business in China*, INTERTRADE, Nov., 1985, at 52-53; Dong, *Potential Investor's Queries Answered Part 7*, INTERTRADE, Sept., 1985, at 31. Article 4 of the October 1986 Provisions for the Encouragement of Foreign Investment now provides uniform standards according to which site use fees are to be computed and charged. These standards do not apply, however, to enterprises "located in busy urban sectors of large cities." China Daily, Oct. 14, 1986, at 2. Article 4 also gives local people's governments the express right to exempt enterprises from site use fees for specified periods of time. *Id.*

The fact that valuation is subject to final verification by a Chinese registered accountant also poses a potential problem. Implementing Regulations, *supra* note 76, at ch. 4, art. 32. Although this requirement might promote a fair assessment by the parties, it could result in the rejection of the parties' agreed valuation. Note, *supra* note 68, at 1030. However, the publication of guidelines and procedures for the auditing of joint ventures and their provisions on valuation of fixed assets, intangibles, and inventory give the foreign investor some basis for understanding and anticipating the approach to be taken by the Chinese. See Li and Pang, *What Sino Foreign Joint Venture Should Prepare for Auditing*, INTERTRADE, May-June 1985, at 60-62. An English version of the Accounting Regulations of the People's Republic of China for the Joint Ventures Using Chinese and Foreign Investment, promulgated by the Ministry of Finance on March 4, 1985, may be found in the June 11-14, 1985 issues of China Daily.

⁹⁹ Cohen, Huang, and Nee, *supra* note 75, at 213.

¹⁰⁰ Implementing Regulations, *supra* note 76, at ch. 4, art. 28.

the joint venture should be “appropriate and advanced” enough to lead to the manufacture of goods competitive in international markets.¹⁰¹ As to the machinery and equipment, it must be indispensable to the production of the joint venture, unable to be satisfactorily manufactured by the Chinese, and priced no higher than the current international market price for similar equipment or materials.¹⁰²

G. Profit Distribution, Repatriation, and Taxation

1. Distribution

After payment of taxes the board of directors distributes profits of the venture first to allocations for reserve funds, bonus funds, and expansion funds.¹⁰³ If necessary, funds will be dedicated to making up losses of the joint venture incurred in the previous year.¹⁰⁴ If the board of directors decides to distribute the remaining profits, the

¹⁰¹ *Id.* at ch. 6, art. 44. If technology is not furnished as a capital contribution but through a technology transfer contract, the technology must be appropriate and advanced. The terms of the transfer must comply with the requirements set forth in the Regulations for such transactions and must be approved by both the department in charge and MOFERT, or its authorized agent. *Id.* ch. 6, arts. 43-46; Dong, *Potential Investor's Queries Answered*, INTERTRADE, Nov. 1985, at 50-51. Care should be taken to comply with the Regulations of the PRC on Technology Contract Administration promulgated by the State Council in May 1985. For the text of the Regulations, see INTERTRADE, July 1985, at 67-68.

¹⁰² Implementing Regulations, *supra* note 76, at ch. 4, art. 27.

¹⁰³ *Id.* at ch. 11, art. 87. The three funds are defined in the Implementing Regulations' definitions of key terms. The actual amounts allocated to the funds are usually arrived at through negotiation as a fixed percentage (usually 15% or less, but sometimes as high as 20%) of the after-tax net profit. If no specific figure is selected, the board must determine the amounts. Cohen, *supra* note 75, at 117; Moser, *supra* note 72, at 134.

Foreign investors also should be familiar with the accounting guidelines' provisions on the profit and loss account and statement of retained earnings. Li and Pang, *supra* note 98, at 61-62. Neither the Joint Venture Law nor the Implementing Regulations impose direct restrictions as to what may constitute a reasonable profit. Obviously, however, governing standards and procedures for setting prices for materials purchased and for services needed in China by joint ventures and for sales prices of joint ventures' products sold in the Chinese domestic market would affect profits. See Implementing Regulations, *supra* note 76, at ch. 8, arts. 65-66; Chang said Pow, *supra* note 81, at 38-39. Although China encourages joint ventures to sell their products on the international market, domestic sales are permitted under certain circumstances, Implementing Regulations, *supra* note 76, at arts. 60-61, 64. See Horseley, *supra* note 72, at 177-83; Note, *supra* note 68, at 1031-32.

¹⁰⁴ Profits cannot be distributed unless previous years' losses have been made up. Implementing Regulations, *supra* note 76, at ch. 11, art. 88.

distribution will be in proportion to the investment of the parties.¹⁰⁵

2. *Repatriation*

The foreign party may remit the following funds through the Bank of China: 1) proportionate share of net profits; 2) proportionate share of net funds when the venture concludes operations; 3) any royalty or licensing fees; and 4) salaries and other legitimate income.¹⁰⁶ The foreign party must accomplish all remittances in accordance with applicable foreign exchange regulations.¹⁰⁷

¹⁰⁵ The board of directors may retain current profits for distribution in later years, *id.*, or, upon the approval authority's consent, use the profits to increase the joint venture's capital for production expansion. *Id.* ch. 11, art. 87(2).

¹⁰⁶ Cohen, Huang, and Nee, *supra* note 75, at 227-28.

¹⁰⁷ Recent comments of foreign investors seem to indicate that China's foreign exchange restrictions are perhaps the most serious problem confronting joint ventures at the present time. *See, e.g.*, Wall St. J., Mar. 18, 1985, at 38, col. 1. As a result of China's foreign exchange control practice, a joint venture operating in the country may not convert Renminbi freely into exchange. A lengthy series of regulations exist to which the joint venture regulations expressly subject joint ventures. Implementing Regulations, *supra* note 76, at ch. 10, art. 73. The basic law may be found in the Interim Regulations on Foreign Exchange Control, promulgated by the State Council in December, 1980; also relevant are subsequent enactments, including the Rules for the Implementation of Foreign Exchange Controls Relating to Individuals, the Rules for the Implementation of Exchange Control Regulations Relating to Enterprises with Overseas Chinese Capital, Enterprises with Foreign Capital and Chinese-Foreign Joint Ventures, the Bank of China Regulations for Foreign Currency Deposits, and the Regulations of the Bank of China for Providing Short-Term Foreign Exchange Loans. Texts may be found in CHINA INVESTMENT GUIDE, *supra* note 72, at 487-511. China's most recent effort to deal with the issue may be found in the Provisions of the State Council on the Question of the Balancing of Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures. A text of these provisions, enacted in January of 1986, may be found in 13 CHINA BUS. REV. 31-32 (May-June 1986); commentary appears in Gelatt, *The Foreign Exchange Quandary*, 13 CHINA BUS. REV. 28-31 (May-June 1986); Gu Ming *Assesses China's New Forex Regulations*, INTERTRADE, Apr. 1986, at 45-46; Shao, *Legal Guidelines for Investors*, INTERTRADE (Supp.), May 1986, at 15-16.

The Implementing Regulations, *supra* note 76, at ch. 10, art. 75, require a joint venture in general to keep balance between its foreign exchange income and expenses. The mechanics of this requirement means that the company will open a foreign exchange account with the Bank of China for the deposit of foreign exchange earnings and will pay out of the account all its foreign exchange expenditures, such as payment for imports of raw materials and equipment, wages for expatriate staff, and expenses for overseas training and study tours. *Id.* art. 74. This system poses "significant problems for investors who look upon joint ventures primarily as a vehicle for entry into the Chinese domestic market, and [it is] one of the major reasons why most joint ventures established to date have felt compelled to export all but a small portion of their products." Moser, *supra* note 72, at 131-32; *see*

3. Taxation

The PRC has three very important taxation statutes applicable to equity joint ventures: 1) The Income Tax Law of the People's Republic

also Chang and Pow, *supra* note 81, at 37-38.

Although the Chinese Government usually will not provide foreign exchange subsidies, in cases where the joint venture sells its products mainly on the domestic market and there is difficulty in maintaining a foreign exchange balance, the outstanding amount can be made up for with foreign exchange retained by the relevant provincial, municipal or regional government, or state department in accordance with an approved feasibility studies report or the joint venture contract. If the local government or supervisory department cannot solve the problem, arrangement will be made through state planning upon approval by MOFERT and the State Planning Commission, Implementing Regulations, *supra* note 76, at ch. 10, art. 75. *But see* Horsley, *supra* note 72, at 185-87 (discussing the practical and procedural questions raised by the promise of Chinese Government assistance in making up foreign exchange deficiencies). Only a handful of such undertakings have occurred at either the provincial or central government level. Horsley, *Comments on Laws and Legal Developments Affecting Foreign Investment in China*, 3 CHINA LAW REP. 178 (1986). Moreover, officials of the State Administration of Foreign Exchange have interpreted Article 75 "not . . . to promise that local governments or the central government would actually sell the joint venture foreign exchange, but that merely holds out the promise that the Chinese government will help the venture earn foreign exchange." *Id.*

Some additional assistance is provided by the foreign exchange rules' provision, art 12. CHINA INVESTMENT GUIDE, *supra* note 72, at 499-500. This provision provides that foreign exchange may be used as the currency of settlement between joint ventures and Chinese domestic enterprises when the products sold by a joint venture are import substitutes, and when the buyer is a Chinese unit engaged in foreign trade business, where the products constitute items required for the production of import or export goods handled by Chinese units engaged in foreign trade business, in construction contracts, and in other cases approved by the State General Administration of Exchange Control. According to recent reports, this policy with respect to import substitution joint ventures is receiving continued emphasis from the government. *Asian Wall St. J.*, Dec. 23, 1986, at 1, col. 6.

Finally, article 14 of the October 1986 Provisions for the Encouragement of Foreign Investment allows enterprises with foreign investment to "mutually adjust their foreign exchange surpluses and deficiencies among each other." *China Daily*, Oct. 14, 1986, at 2. Whether there are enough joint ventures (other than hotels) with foreign exchange surpluses to make this provision meaningful at this time remains to be seen.

One approach suggested to resolve the problem is for foreign enterprises to set up holding companies in China to balance their foreign exchange. Cohen, *supra* note 80, at P-1, 2. A Chinese expert recently characterized this approach as "an issue worth studying," describing it as "a feasible way to speed up absorption of foreign capital and to maintain the State's balance of foreign exchange." Dong, *supra* note 78, at 54. Yet another recent suggestion would involve allowing foreign businessmen to use their RMB earnings to buy Chinese goods and then sell the goods overseas to generate foreign exchange earnings. Wang Yake, *How to Tackle Foreign Imbalances of Foreign-Financed Companies*, INTERTRADE, Sept. 1985, at 57,

of China Concerning Joint Ventures with Chinese and Foreign Investment (the Joint Venture Income Tax Law);¹⁰⁸ 2) The Consolidated Industrial and Commercial Tax (the Consolidated Tax);¹⁰⁹ and 3) The Provisional Urban and Real Estate Tax.¹¹⁰ In addition, the October 1986 Provisions for the Encouragement of Foreign Investment have reduced taxes in a number of respects for the targeted export-oriented companies and enterprises possessing advanced technology.

Under the Joint Venture Income Tax Law, a joint venture is taxed on its annual net income, after deductions for costs, expenses, and losses, at a rate of thirty percent *plus* a ten percent local surtax. The government levies an additional ten percent tax on the remittance abroad of income by the foreign side.¹¹¹ A variety of opportunities

61. This concept was recently embodied in the Provisions on the Purchase and Export of Domestic Products by Foreign Investment Enterprises to Balance Foreign Exchange Accounts, promulgated by MOFERT on January 20, 1987. For a text of the provisions, see INTERTRADE, Mar. 1987, at 53.

It is true that China has, to some extent, reformed and relaxed its policies on foreign currency exchange in an effort to smooth the way for increasing its international trade. See China Daily Bus. Weekly, July 3, 1985, at 2, col. 2. An official of the State Administration of Exchange Control, however, indicated recently that the relaxed policies do not mean that China will abrogate actual control over foreign currency use. "This policy will not change as the country adopts an opening up policy and bids to relax its economy. . . . China is not economically strong and with only limited foreign currency reserves, we must adhere to policies tailored to China's specific needs and circumstances." *Id.* at col. 4. Indeed, certain of the 1986 Provisions appear to be *more* restrictive than past guidelines. Gelatt, *supra* note 107. A 30% drop in China's foreign currency reserve during a recent six-month period (from \$16.3 billion at the beginning of the fourth quarter of 1984 to \$11.3 billion on March 31, 1985) promises future Chinese caution in this area. China Daily, July 9, 1985, at 2, col. 6; see Wall St. J., July 9, 1985, at 32, col. 1. By the end of the first quarter of 1986, reserves had shrunk further, to \$10.35 billion, Wall St. J., June 6, 1986, at 28, col. 2, and have remained at about that level into the Fall of 1986. Asian Wall St. J., Dec. 5-6, 1986, at 5, col. 1. Thus, although the Chinese have acknowledged the need for urgent reform, and have experts considering the problem and alternative approaches to its resolution, see, e.g., China Daily, Aug. 23, 1985, at 1, cols. 1-2; there appears to be no ready solution at hand.

¹⁰⁸ The text of this Law, as amended in 1983, and its Implementing Regulations may be found in the CHINA INVESTMENT GUIDE, *supra* note 72, at 427-32.

¹⁰⁹ The text of this Law and its Implementing Regulations may be found in the CHINA INVESTMENT GUIDE, *supra* note 72, at 415-27.

¹¹⁰ For a general discussion and explanation of the tax consequences of joint ventures, see CHINA INVESTMENT GUIDE, *supra* note 72, at 329-38; Chang and Pow, *supra* note 81, at 34-37; Cohen, *supra* note 72, at 113-17; Cohen and Horsley, *supra* note 75, at 47-48; Dong, *Potential Investors' Queries Answered - Part 3*, INTERTRADE, Apr. 1985, at 31-32, 49; Duan, *Taxes and Preferential Treatment for Foreign Enterprises*, INTERTRADE, Oct. 1984, at 61-62; Horsley, *supra* note 72, at 168-77; Moser, *supra* note 72, at 132-33.

¹¹¹ Joint Venture Income Tax Law, art. 4.

exist for preferential treatment, often keyed to either the geographic location of the joint venture or the nature of its business.¹¹²

¹¹² Some of the more significant preferential arrangements may be summarized as follows:

(1) The tax rate in the SEZs and some of the open coastal city economic development zones is reduced to 15%. Article 8 of the October 1986 Provisions for the Encouragement of Foreign Investment reduces the rate to 10% for export enterprises whose value of export products amounts to 70% or more of the value of their products;

(2) The local government unit may exempt or reduce the local income tax;

(3) Joint ventures contracted to operate for a period of 10 years or more may, upon approval of the tax authorities, be exempted from income tax in the first profit-making year, and be allowed a 50% reduction in the subsequent two years. Article 8 of the October 1986 Provisions for the Encouragement of Foreign Investment provides that after the expiration of the period for the reduction or exemption of enterprise income tax, export enterprises whose value of export products in that year amounts to 70% or more of the value of their products for that year may pay enterprise income tax at one half the rate of the present tax. China Daily, Oct. 14, 1986, at 2. Article 9 provides that after the expiration of the period of reduction or exemption of enterprise income tax, technologically advanced enterprises may extend for three years the payment of enterprise income tax at a rate reduced by one half.

(4) Joint ventures engaged in low-profit operations, such as farming and forestry, or located in remote, economically underdeveloped areas may, in addition to the income tax concessions for the first three profit-making years, be allowed a 15-30% reduction in income tax for a further period of 10 years, upon approval from the Ministry of Finance;

(5) A foreign partner who reinvests its share of the profits in China for a period of not less than five years in a joint venture may, after producing the necessary documentation and reporting to the tax authorities, obtain a refund of 40% of the income tax paid on the reinvested amount. If a foreign participant in a joint venture then remits money so refunded out of China, no tax shall be liable. Article 10 of the October 1986 Provisions for the Encouragement of Foreign Investment provides for a refund of the total amount of enterprise income tax already paid on profits reinvested to establish or expand export enterprises or technologically advanced enterprises for a period of operation of not less than five years. China Daily, Oct. 14, 1986, at 2;

(6) Any losses incurred by a joint venture in a tax year may be carried over to the next tax year and made up with a matching amount drawn from that year's income, but such deductions shall not exceed a period of five years; and,

(7) Joint ventures may, in certain circumstances, file an application for changing the duration or method of depreciation of fixed assets and may, after obtaining approval, adopt the method of accelerating depreciation.

Chang and Pow, *supra* note 81, at 34-37; Hu, *PRC's Income Tax Laws on Foreign-Financed Enterprises*, INTERTRADE, Nov. 1985, at 54-55, 57; see Wang, *Preferential Taxation Manipulation*, INTERTRADE, May 1986, at 27. Finally, Article 7 of the Provisions for the Encouragement of Foreign Investment states that when foreign investors in export enterprises and technologically advanced enterprises remit abroad profits distributed to them by such enterprises, the amount remitted shall be exempt from income tax. China Daily, Oct. 14, 1986, at 2.

The Industrial and Commercial Consolidated Tax applies to sales of manufacturing, trade, transport, catering, and other services. The tax is calculated on the basis of gross receipts, and the rates are categorized according to product or transaction. There are 104 separate categories encompassing forty-two tax rates, ranging from 1.5 percent to sixty-nine percent. Exemption from the Consolidated Tax and customs duty is available for equipment imported under the joint venture contract. To qualify for the exemption, the equipment must be purchased either with funds within the total investment of the joint venture or with additional capital, subject to the approval of government authorities. The exemption from the Consolidated Tax and customs duty also extends to imported raw materials, component parts, and other items necessary for the production of products manufactured by the joint venture.¹¹³ Although the Consolidated Tax applies in principle to all the export sales of the venture, the Ministry of Finance may exempt the venture from export tax.¹¹⁴ Generally, joint ventures suffering financial difficulties are encouraged to apply for an exemption from the tax.

Moreover, the joint venture also is subject to the Provisional Urban Real Estate Tax. This tax applies only to the buildings of the venture contributed by the Chinese party as part of its equity in the venture.¹¹⁵ The tax is 1.2 percent annually on the assessed value of the buildings.¹¹⁶

H. Relevant Contract Law Principles

1. Choice of Law

The Implementing Regulations make reference to both a "joint venture agreement" and a "joint venture contract." The Regulations define the former as an agreement "on some main points and principles governing the establishment of a joint venture." The latter constitutes the parties' agreement "on their rights and obligations."

¹¹³ Gelatt and Theroux, *supra* note 111, at 26-27; Huang, *Foreign-Financed Ventures Enjoy Import Tax Exemptions*, INTERTRADE, Nov. 1985, at 16.

¹¹⁴ Gelatt and Theroux, *supra* note 111, at 26. Article 11 of the October 1986 Provisions for the Encouragement of Foreign Investment exempts from the consolidated industrial and commercial tax export products of enterprises with foreign investment, except crude oil, finished oil, and other products subject to special state provisions. *China Daily*, Oct. 14, 1986, at 2.

¹¹⁵ Gelatt and Theroux, *supra* note 111, at 26.

¹¹⁶ *Id.* at 27.

The contract prevails over the agreement in the event of conflict between the two, and the parties can agree to omit the agreement altogether.¹¹⁷ Although the Foreign Economic Contract Law generally contains relatively flexible choice of law provisions,¹¹⁸ it expressly provides that “contracts for joint ventures . . . operating within the boundary of the PRC are subject to the law of the PRC.”¹¹⁹ This language corresponds to the Implementing Regulations’ provision that Chinese law governs “the formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it.”¹²⁰

¹¹⁷ Implementing Regulations, *supra* note 76, at ch. 2., art. 13. Article 14 further identifies 14 categories of information the contract must contain.

¹¹⁸ The Law was adopted at the Tenth Session of the Standing Committee of the Sixth National People’s Congress on March 12, 1985, and became effective on July 1, 1985. For a text of the Law and a general discussion of its content, see Cohen, *The New Foreign Contract Law*, 12 CHINA BUS. REV., July-Aug. 1985, at 52-55; see also Shao, *Legal Guidelines for Investors*, INTERTRADE (Supp.), May 1986, at 16-17; Wei, *Law on Economic Contracts Involving Foreign Interests*, 3 CHINA LAW. REP. 166-69 (1986). The Contract Law requires the parties to observe the laws of China in making contracts, but allows the parties to seek settlement to disputes “in accordance with laws of their choosing applicable to such disputes.” Foreign Economic Contract Law, art. 5. “If the parties make no such choice, the law of the country most closely related to the contract shall apply.” *Id.* A representative of MOFERT’s Treaty and Law Department has pointed out that this conforms to the general principles of private international law. Zhang, *Law to Guarantee Reliability of Foreign Economic Contracts*, INTERTRADE, July 1985, at 65. In their contracting practice the Chinese generally have tended not to include any choice of law clause or other language allowing a third party to determine what law should be used to govern the contract. Torbert, *Contracting Law in the People’s Republic of China*, in FOREIGN TRADE, INVESTMENT AND THE LAW IN THE PEOPLE’S REPUBLIC OF CHINA 214, 223 (M. Moser ed. 1984). It has been pointed out, however, that because the Chinese are now signing contracts which often contain arbitration clauses providing for arbitration in third countries, the absence of a governing law clause has added to uncertainty of contract interpretation. *Id.* Not surprisingly, governing law clauses are beginning to appear in some contracts. *Id.* With respect to joint venture contracts specifically, one commentator summarized the situation as follows:

Disputes arising from the operation of joint ventures should in general be resolved as stipulated in the contract. With joint venture contracts, if clauses from specific laws are to be quoted, these can only be from relevant Chinese laws and not imported from any other state. If the foreign partner objects to these clauses they can be dropped as China to date has not legislated that joint venture contracts should specify legal clauses. In the case of a dispute, the two partners can appoint an arbitrator who may then make reference to the appropriate law justified by the nature of the dispute.

Dong, *Potential Investors’ Queries Answered - Part II*, INTERTRADE, Feb. 1985, at 23.

¹¹⁹ Foreign Economic Contract Law, ch. 1, art. 5.

¹²⁰ Implementing Regulations, *supra* note 76, at ch. 2, art. 15.

2. *Dispute Resolution*

The Implementing Regulations require that contract disputes be settled “in accordance with relevant law and the contract concluded between both parties.”¹²¹ Both the Implementing Regulations¹²² and the Foreign Economic Contract Law¹²³ provide for similar dispute resolution procedures. Friendly consultation and mediation are the preferred form of solution. If the parties cannot settle their dispute through these means, they may seek settlement through arbitration or courts of justice.¹²⁴ Arbitration may proceed before Chinese or other arbitration bodies, depending on the parties’ agreement. If no written arbitration agreement exists either party may bring suit in the Chinese courts.

3. *Liabilities and Remedies*

It is with respect to remedies for breach of contract that the Foreign Economic Contract Law most significantly supplements the Implementing Regulations. The Regulations require the parties to include in the joint venture contract “the liabilities for breach of contract.”¹²⁵ The only other significant liability provision in the Implementing Regulations is that which applies when the joint venture is dissolved as a result of “inability to continue operations due to the failure of one of the contracting parties to fulfill the obligations prescribed by the agreement, contract and articles of association.”¹²⁶ In such a situation the breaching party is liable for the losses thus caused.¹²⁷ The Foreign Economic Contract Law’s further clarification of liability issues may be summarized as follows:

[A] party who fails to perform the contract or has failed to fulfill obligations as agreed shall be considered as having breached the contract. Under such circumstances, the other party shall have the

¹²¹ *Id.* at ch. 8, art. 67.

¹²² *Id.* at ch. 15, arts. 109-12.

¹²³ Foreign Economic Contract Law, ch. 6, arts. 37-38.

¹²⁴ Implementing Regulations, *supra* note 76, at ch. 15, art. 109. These are exclusive alternatives. When a dispute is submitted for international arbitration, the courts have no jurisdiction. Moreover, article 193 of China’s Civil Procedure Law provides that once a Chinese organ of arbitration dealing with foreign affairs has settled a case, the party concerned may no longer bring the case to court. Zhang, *supra* note 118, at 64.

¹²⁵ Implementing Regulations, *supra* note 76, at ch. 15, arts. 110-11. *Id.* at ch. 2, art. 14(12).

¹²⁶ *Id.* ch. 14, art. 102(3).

¹²⁷ *Id.* ch. 14, art. 102.

right to demand compensation for losses incurred or to adopt other remedies. The law also stipulates that the liabilities for the compensation of one party shall be the same as the losses incurred to the other party and shall not exceed any possible losses anticipated by this party at the signing of the contract. This reflects solemnity in identifying the liabilities of those who breach contracts to protect the rights of possible victims, while at the same time, an upper limit is set so that those who breach a contract are not subject to unlimited liabilities. The United Nations Convention on Contracts for the International Sale of Goods contains similar provisions.

[I]f the compensation for a breach of contract as agreed upon and written into the contract is unduly higher or lower than the losses incurred, the relevant party may request an organ of arbitration or a court to order an appropriate reduction or increase in the said compensation. This demonstrates that provisions for justified liability are provided by the law.¹²⁸

4. *Relationship Between Contract, Law, and Policy*

Acts of government can have two types of impact on executed contracts. The first involves the relationship between the joint venture and China's planned economy. The second involves changes in economic policy or law which might be inconsistent with provisions of the joint venture contract.

With respect to the role of joint ventures in China's planned economy, the Implementing Regulations seek to ensure a certain degree of autonomy for joint ventures while at the same time guaranteeing their priority access to centrally-located resources. In addition, the Regulations govern the prices of materials and services purchased and products sold domestically.¹²⁹ Foreign companies dealing with China should be aware of the potential problems of changes in the state economic plan affecting their contracts in China.¹³⁰ On the other hand, the liberalization of China's economy has had its own pitfalls for foreign investors.¹³¹

Although it is less of a problem now than it was several years ago, the relationship between existing contracts and subsequently enacted

¹²⁸ Zhang, *supra* note 118, at 66; *see generally* Foreign Economic Contract Law, ch. 3, arts. 16-25.

¹²⁹ Implementing Regulations, *supra* note 76, at ch. 1, art. 7; *id.* at ch. 8, arts. 54-68.

¹³⁰ *See* Torbert, *supra* note 118, at 220-22.

¹³¹ Recent complaints have included shortages and price increases for goods no longer controlled by the government. Wall St. J., Mar. 18, 1985, at 38, col. 1.

laws and regulations has created an atmosphere of uncertainty for foreign investors in China. MOFERT expressed the following position on the matter in 1982: "In accordance with generally accepted international practice, a contract signed before a new law is enacted should be bound by the new law. Nevertheless, execution of some provisions in the contract may continue even though these provisions run counter to the newly promulgated laws or Regulations."¹³² The lack of assurance in such a position has led foreign negotiators to seek to write into investment contracts provisions that would insulate them against the adverse effects of subsequent legislation.¹³³ The pragmatic approach which the Chinese usually have taken in approaching such matters, however, often has avoided serious problems.¹³⁴ In addition, the Foreign Economic Contract Law has given additional assistance to foreign investors by providing that joint venture contracts "which are executed in the PRC and approved by state organs may continue to be fulfilled according to the contract terms *in spite of new legal provisions*."¹³⁵

IV. A COMPARISON OF THE TAIWAN AND PRC JOINT VENTURE AND CONTRACT LAWS

A. Corporate Control

1. Chairman and Board of Directors

Under Taiwan law the chairman has specific statutorily-defined powers which may not be altered by the articles of association.¹³⁶ He

¹³² Cohen, *supra* note 72, at 83. Compare Gu Ming's comments on this point:

Now, even before the promulgation of some of these laws and Regulations, Chinese and foreign investors may establish their rights and obligations in contract form through equitable negotiations. Once the contract signed between the Chinese and foreign parties is approved by the relevant department of the Chinese government, it is legally effective and binding upon both parties.

Gu, *supra* note 71, at 58.

¹³³ For an analysis of such provisions, see Cohen, *supra* note 72, at 81-83.

¹³⁴ See Torbert, *supra* note 118, at 220.

¹³⁵ Foreign Economic Contract Law, ch. 7, art. 40 (emphasis added). How this provision will be applied in practice remains to be seen. See Wei, *supra* note 118, at 168.

¹³⁶ Hsu, Li, and Wang, *supra* note 8, at 568. The directors or managing directors will elect a chairman of the board. The Company Law provides that the chairman will represent the company. In addition, the chairman will be authorized to take charge of all important affairs of the company, his authority being subject only to

may be either Chinese or a foreigner, and with regard to the actual running of the enterprise, he is a relatively important player, although some management authority may be delegated to a general manager whose functions should be stipulated in the articles of association.¹³⁷ Moreover, the chairman is elected from the board of directors by a two-thirds majority.

Conversely, under PRC law the chairman is appointed by the Chinese party, and the vice chairman by the foreign participant. The duties of the chairman are not statutorily defined. The statute states, however, that the "highest authority" of the venture is its board of directors, which is "empowered to decide all major issues concerning the venture."¹³⁸ The directors are appointed in proportion to investment contribution, but certain important decisions require unanimous agreement among the directors.¹³⁹ The general manager of the enterprise, appointed by the board of directors, has considerable authority over day-to-day operations.

2. *Voting Rights*

Under Taiwan law gaining shares in the venture is the most effective means of gaining corporate control, and usually voting is on the basis of one share-one vote. Shareholders may vote the board of directors in or out, and thus maintain control over the appointment of the chairman.

law, ordinances, the articles of incorporation, the resolutions of the shareholders meetings, and the resolutions of the board of directors. He also will preside at shareholders' meetings, board of directors' meetings, and, if there are managing directors, at their meetings. *Id.*

In an election of directors, each share will have a number of votes equal to the number of directors to be elected. These votes may be concentrated on one candidate or divided among several candidates. Those who receive the highest number of votes will be elected directors. Company Law, art. 198.

¹³⁷ Hsu, Li, and Wang, *supra* note 8, at 568-69. Articles 29-34 of the Company Law describe the role of the manager. His duties and powers, if not fixed by the articles of incorporation, may be stipulated in a contract. As regards third persons, a manager is presumed to have authority to do whatever is necessary for the management of the company or the accomplishment of the line of business entrusted him. Therefore, no limitation on the power of the manager may be set up as a defense against a bona fide third party, except a limitation of authority to a particular line of business or branch, to the purchase or sale of real estate, or to the incumbrance of immovable property without express written authority. Wang, *supra* note 25, at 544.

¹³⁸ Implementing Regulations, *supra* note 76, at ch. 5, art. 33.

¹³⁹ *Id.* arts. 34, 36.

The PRC joint venture law is silent on the subject of voting rights.¹⁴⁰ The foreign party apparently is expected to reach decisions through consensus rather than voting, and is, therefore, never sure about the degree of its control. Thus, even where the Chinese participant is a minority shareholder, major decisions may require its consent.¹⁴¹

B. Capital Contribution

The joint venture laws of both the PRC and Taiwan permit capital contribution in the form of intangible assets. In Taiwan government authorities assess the valuation of the intangible assets. In the PRC, however, valuation of non-cash contributions (except for the site) are determined by agreement between the parties, or by a mutually acceptable third party. Taiwan restricts the percentage of patent rights and know-how capitalized into the venture to an established minimum percentage. In contrast, the PRC does not specify a percentage of minimum contribution, although the law does provide guidelines as to the *type* of non-cash assets which can be capitalized.¹⁴²

C. Repatriation and Taxation

In Taiwan the joint venture statutes (particularly the SIFN and the SEI) provide a package of investment incentives which include repatriation of profits, repatriation in the event of transfer of shares, and a twenty-year guarantee against government expropriation where foreign participation exceeds forty-five percent. Qualified joint ventures are eligible for a five-year income tax holiday, and certain technology intensive enterprises may qualify for an additional one to four-year income tax exemption. Other incentives include accelerated depreciation and import duty exemptions.

The PRC statutes authorize repatriation in foreign exchange for specified funds of the foreign participant, although at present, foreign investors are experiencing serious problems with foreign exchange restrictions in the PRC. Thus, many investors are concentrating on investments which promise returns in United States dollars (such as hotels).¹⁴³ The law provides a two-year income tax holiday for approved ventures and an additional two-year reduction of fifty percent

¹⁴⁰ *Id.* arts. 38-40. Presumably, a majority could rule on a contested issue. Article 36 of the Implementing Regulations defers to "rules of procedure stipulated in the articles of association." *Id.* art. 36.

¹⁴¹ Wan, *supra* note 4, at 267.

¹⁴² Implementing Regulations, *supra* note 76, ch. 4, art. 27.

¹⁴³ Wall. St. J., Mar. 18, 1985 at 38, col. 1.

after the venture begins showing a profit. Other exemptions exist for imported materials and from the consolidated tax.

In both Taiwan and the PRC, the investment incentive programs are export oriented. In Taiwan the investment incentive package is shifting its focus to high technology and service industries.¹⁴⁴

D. Relevant Contract Law

1. Choice of Law

Subject to considerations of public policy, parties to joint ventures in Taiwan may freely stipulate the law applicable to the contract. Taiwan courts will apply foreign law and, with a few limited exceptions,¹⁴⁵ will recognize the decisions of international arbitral bodies and the judgments of foreign courts. In the PRC, however, both the Foreign Economic Contract Law and The Joint Venture Implementing Regulations provide that PRC law is to govern the joint venture contract and disputes arising thereunder.

Authorities in the PRC have indicated that with respect to joint venture contracts, the parties to a dispute can appoint an arbitrator to resolve disputes with reference to whatever law seems appropriate. In a recent directive concerning choice of law clauses in foreign economic contracts, the standing committee of the National People's Congress declared that, effective July, 1985, parties to joint ventures may seek to settle disputes in accordance with the law of their own choosing.

2. Dispute Resolution

Dispute resolution in Taiwan may take the form of litigation in the civil courts, reconciliation or compromise under the auspices of

¹⁴⁴ Under the present spirit of the investment incentives program, any foreign investment which offers to contribute to the increase in export volume of locally-manufactured projects, creates new job opportunities, and brings in fresh capital and advanced technology, will be qualified to enjoy the benefits provided by the program. In other words, the focus of Taiwan's foreign investment incentives program is primarily manufacture and export-oriented, although in recent years emphasis also has gradually been placed on high-technology service industries and manufacturing industries contributing to the domestic consumer market. According to article 5 of the statute for Investment by Foreign Nationals, and article 3 of the Statute for Encouragement of Investment, any operation engaging in only the sale of products, such as a trading company, is not eligible to enjoy the benefits of the investment incentives program. Moreover, it is doubtful whether an operation rendering ordinary technical and professional services will meet these standards and monetary benefit from the program. Hsu, *supra* note 15, at 84.

¹⁴⁵ See *supra* note 58.

the court, formal arbitration, or informal mediation by the Board of Foreign Trade. Of these four methods, informal mediation, reconciliation, and compromise are the preferred alternatives. Very few disputes reach the courts or international arbitral bodies.

In the PRC "friendly negotiation" is the preferred method of dispute resolution. When friendly, informal negotiation either fails to resolve the dispute or results in an adjustment which affects the state plan, the next bureaucratic level will attempt informal administrative mediation. Should this fail, the parties may, by mutual agreement, submit the dispute to the relevant Industrial and Commercial Management Office¹⁴⁶ or other Chinese arbitration body, or to an international arbitral tribunal. If one party refuses to submit the dispute to arbitration, the other party may pursue litigation in the civil courts of China.¹⁴⁷

¹⁴⁶ The PRC's traditional practice of dispute settlement . . . has begun to give way to acceptance of arbitration in third countries under the provisions of such arbitration rules as those of the United Nations Commission on International Trade Law (UNCITRAL). The acceptance of UNCITRAL procedures over those set forth [in the rules of Chinese arbitral bodies] raises the possibility of resort to law of third countries in the settlement of trade disputes with China. . . . [T]he Chinese have expressed their willingness to execute foreign arbitral awards so long as they are fair and not in violation of Chinese laws and policies. Thus, in the area of trade disputes, the Chinese have begun to accept dispute settlement provisions that are at variance with traditional PRC practice.

Potter, *Resolving Contract Disputes*, 11 CHINA BUS. REV., Sept.-Oct. 1984, at 22.

¹⁴⁷ The procedure for adjudication of contract disputes [in the Peoples Court of the PRC] is set forth in the Draft Civil Procedure Law of the PRC issued on October 1, 1982. Even in a judicial proceeding, as a first step the court will attempt to mediate the dispute. While judicial mediation is similar in many respects to administrative mediation, judicial mediation is legally binding on the parties whereas compliance with administrative mediation is voluntary.

If the parties insist on formal adjudication of a dispute, the court will take evidence, examine witnesses, and listen to the arguments of parties either speaking on their own or represented by counsel. The court's decision must be reduced to a written opinion delivered to the parties, usually within 10 days of the decision. If dissatisfied with the decision of the trial court, either party may lodge an appeal with the court at the next highest level. [I]t is unlikely that many foreign firms will avail themselves of this option should a dispute arise. For not only are the Chinese courts extremely vulnerable to political pressure, but many of the regulations and procedures pertinent to judicial proceedings are state secrets. . . . Moreover, the PRC still lacks a comprehensive statute regulating foreign contracts. Thus most disputes in China's foreign economic relations are resolved through non-judicial methods.

Id. at 21.

3. *Liabilities and Remedies*

In both the PRC and Taiwan, a breach of contract by one party gives rise to a right to sue for money damages in the injured party. In the PRC the parties must include liabilities for breach in the joint venture contract. In both countries the measure of damages equals losses actually suffered, including foreseeable lost profits; moreover, the law of both countries provides that courts as arbitral bodies may adjust damage awards according to the special circumstances of each case. In Taiwan the Code specifically provides for the remedy of specific performance or rescission as appropriate.

4. *The Relationship between Contract, Law, and Policy*

Confucian ethics in Taiwan are an important factor in legal and business relationships. The Western businessman or lawyer may find that his Chinese counterpart has a completely different attitude toward the nature and purpose of a contract, with contract interpretation being influenced by notions of morality and good faith rather than by the literal language of the contract. The Chinese businessman may consider a highly detailed and sophisticated contract an inauspicious beginning to the business relationship, even an article of bad faith. Although Chinese businessmen in Taiwan increasingly have adopted the legal formalities which often attend business relationships among Westerners, one may expect to find a certain distrust of a writing which attempts to anticipate and resolve all problems in advance.

Westerners engaged in business in the PRC must comprehend the role of contracts in a socialist, centrally-planned economy. Changes in state economic plans and new legislation may alter the legal relations established by contract, creating an atmosphere of uncertainty for the foreign investor. In the PRC the joint venture contract is a means of implementing state plans, and a contract at variance with state plans, especially a contract involving the production of goods within mandatory state plans, either must change as the plan changes, or be held invalid.

Finally, Westerners doing business in China, whether in Taiwan or in the PRC, should remember that the spirit of compromise is a fundamental trait of the Chinese character which operates as a powerful deterrent to the institution of formal legal proceedings. In Taiwan decades of practice have demonstrated that very few cases involving contract disputes are formally resolved in court or by arbitral bodies. It is not unlikely that the Chinese in the PRC will be similarly disinclined to resort to formal legal process in resolving contract disputes.

V. CONCLUSION

Foreign investment, particularly in the form of a joint venture, can play an important role in the development of a modern, industrialized economy. Joint ventures speed the acquisition of new technology and equipment, help develop a skilled domestic workforce, and operate as an important source of foreign exchange earnings for the capital or technology importing country.

Joint ventures in Taiwan have contributed to the development of a sophisticated industrial structure and have facilitated the entry of goods "made in Taiwan" into markets around the world. Joint ventures in Taiwan enjoy considerable autonomy and can take advantage of a highly-skilled labor force. Huge stocks of foreign exchange ease the repatriation of the foreign investor's earnings. This is not to say, however, that Taiwan and its foreign investors confront no problems. Although the past three decades have seen miraculous economic gains, the island's international status has waned in some respects.¹⁴⁸ Political succession issues loom on the horizon.¹⁴⁹ Nor can the premises underlying Taiwan's economic success be expected to continue unchanged.¹⁵⁰ Nonetheless, Taiwan is continuing to take the necessary steps to encourage foreign investment.¹⁵¹

¹⁴⁸ See, e.g., Weng, *Taiwan's International Status Today*, 99 CHINA Q. 462 (Sept. 1984). As Lucian Pye has pointed out, it is essential to temper even the conventional view that Taiwan is an economic miracle. "Taiwan may be an economic success in Third World terms, but it is still a lower-middle class society when compared with Japan or the United States. The island's population is still striving for prosperity. Consequently, the relationship between actual achievement and self-congratulation is somewhat out of joint." Pye, *Taiwan's Development and Its Implications for Beijing and Washington*, 26 ASIAN SURVEY 11, 626 (June 1986).

¹⁴⁹ This is a much more complicated question than simply determining who the number one political leader will be after Chiang Ching-Kuo passes from the scene. At the same time that political divisions between mainlanders and local Taiwanese have receded, see Warner, *Taiwan's Trade Flows*, 25 ASIAN SURVEY 1096, 1107-111, (Nov. 1985), political participation has increased significantly, *id.* at 1110, and "divisive and not easily controllable opinion groups" have developed to "limit the freedom of choice of the leaders." Pye, *supra* note 148, at 615. Pye describes Taiwan's increasingly diversified and pluralistic political order as follows: "Contemporary Taiwan has a political and social system that is as 'advanced' over that on the mainland as are its economic accomplishments. Indeed, it has surprisingly complex political relationships and, compared with most Asian societies, its people are accustomed to dealing with a relatively wide range of opinions." *Id.* at 612.

¹⁵⁰ Problems pointed out by commentators include the following: Taiwan's world-wide dependency (over half of its gross national product is derived from foreign exports); protectionist pressures which might result from serious trade imbalances with certain of its trading partners (particularly the United States); the difficulty

As present PRC laws regulating joint ventures have taken shape, foreign investors have faced numerous difficulties. Potential lack of control over the venture's operations, a relatively unskilled labor force, and difficulties in repatriation of profits are just a few of the problems which counsel the foreign investor to exercise caution in the PRC.¹⁵² Differences of approach between foreign investors and

which the Taiwan economy might begin to experience in making the necessary, flexible adjustment to ever-changing international demands; population pressure; and, the future of Taiwan's relationship with Hong Kong and mainland China. Myers, *The Economic Transformation of the Republic of China on Taiwan*, 99 CHINA Q. 500 (Sept. 1984); Williams, *The Economies of Hong Kong and Taiwan and Their Future Relationship with the P.R.C.*, 4 J. NORTHEAST ASIAN STUD. 58, 70-78 (Spring 1985).

¹⁵¹ The government created an Economic Renovation Committee in 1985 in response to "perceived difficulties of a structural nature resulting from both internal pressures, such as the failure of the legal framework to keep pace with economic development, and external pressures, such as competition from lower cost countries." Hayden, *Legal Developments in the ROC - The ERC*, 24 F.T. L. REV. 34 (Dec. 1985). Noting the restrictions of permissible foreign investment to certain areas specified in the law,

The ERC recommended reversing this system to allow foreign investment (subject still to prior approval from the Investment Commission) in all areas unless specifically excluded by law. It suggested that exclusions should cover investments causing heavy pollution or damage to public security, or which for policy reasons are undesirable or unsuitable for foreign investment.

In addition, the ERC suggested:

(a) Abolition of requirements that foreign investors meet specified ratios for export sales, domestic sales and local participation.

(b) Abolition of quotas for import of raw materials.

(c) Allowing foreign investors to manufacture here through branch offices (rather than having to establish a subsidiary as is presently required), provided that such offices are subject to withholding tax of 20% on profits remitted to the head office (in the same way as for a subsidiary remitting profits to its parent company).

Another indication of Taiwan's flexible response to opportunities for increased investment is the recent announcement by the Ministry of Economic Affairs of its decision to set up additional export processing zones to facilitate the establishment of factories by Japanese inventors. China News, July 1, 1986, at 5, col. 6.

¹⁵² The titles of a number of articles in recent newspapers and journals reflect no shortage of coverage of the negative aspects of investing in China. *Problems at Two Joint Ventures*, 13 CHINA BUS. REV. 34 (July-Aug. 1986); *Sweet is Turning to Sour*, TIME, June 2, 1986, at 56; *Firms Doing Business in China are Stymied by Costs and Hassles*, Wall. St. J., July 17, 1986, at 1, col. 6; *Japan-China Oil Venture Beset by Woes*, Wall. St. J., June 13, 1986, at 26, col. 2; *Why Investors Are Sour on China*, N.Y. Times, June 8, 1986, § 3, at F7; *U.S. Firms Urge China to Make Changes or Risk the Loss of Foreign Investment*, Wall. St. J., June 6, 1986, at 28, col. 2; *AMC to Suspend Chinese Venture's Jeep Production*, Wall. St. J., Apr. 30, 1986, at 23, col. 2. The literature is largely anecdotal, and perceptions shift from hot to cold and back again with some ease. A recent preliminary empirical study

their Chinese partners can pose problems in both making the deal and making it work.¹⁵³ On the other hand, since the adoption of the Joint Venture Law, the PRC has made significant progress in developing a viable framework for encouragement of foreign investment. If the period of relative political stability, which has prevailed in the country since 1978, continues long enough for the economic reforms to mature and bear fruit on a continuing basis, future progress is probable, particularly for those investors who take part in the types of projects most sought by the Chinese Government.¹⁵⁴

focusing on joint ventures in Shenzhen suggests that while all of the problems noted are present, over half of the enterprises surveyed considered their business to be "very successful" or "basically successful." Nyaw and Lin, *An Empirical Study of the Organizational Attributes and Structure of Joint Ventures in Shenzhen, Mainland China*, PROC. OF THE ACAD. OF INT'L BUS. SOUTHEAST ASIA REGIONAL CONF. TAIPEI, JUNE 26-28, 1986, at 48-58. Much more empirical work needs to be done to reach sound conclusions. Perceptions, however, are not without their importance. The 20% decline of foreign investment in China during the first half of 1986 from a year earlier, see Wall St. J., July 31, 1986, at 25, may at least in part reflect some caution resulting from concerns about China's investment climate. At the same time it must be noted that the pace of investment during 1985 was unusually high and would have been difficult to maintain. *Id.*

¹⁵³ See, e.g., Hendryx, *supra* note 95; Pye, *The China Trade: Making the Deal*, 64 HARV. BUS. REV. 74, 76 (July-Aug. 1986).

¹⁵⁴ A recent statement of projects China will encourage includes the following:

Projects capable of importing advanced technology and producing new products, equipment and materials which are urgently needed in China and which will fill in China's void in these fields; e.g., certain mechanical and electronic products, a number of key components, spare parts and new building materials.

Productive projects which involve a large amount of investment and urgently require the imports of advanced technology for construction and for technically renovating the existing enterprises; e.g., projects for developing resources which are in short supply in the country and for the technological renovation of large key enterprises.

Projects for developing new export commodities and whose products are wholly and largely exported, and which are of great importance to diversifying international market bases and increasing the country's export earning capability.

Wu, *Absorbing Foreign Investment: Policies and Priorities*, INTERTRADE (Supp.), May 1986, at 10-11. For a period of time to come, China will restrict the establishment of the following types of projects:

Projects for which advanced technology has been imported, whose production capacity has been relatively excessive or has approached saturation point and whose products cannot be wholly exported, such as assembly lines for producing household electrical appliances like color TVs and refrigerators.

Projects which can neither import advanced production and management technology, nor earn foreign exchange through exports, such as projects

The rapid economic development of Taiwan since 1949 would be the envy of any developing nation. The success of a development plan, however, is contingent not only on the enactment of enlightened foreign investment statutes,¹⁵⁵ but also on a number of intangible political and economic factors. Important among these factors are the skill and motivation of the labor force, the stability of the government, and the confidence of the foreign investor that he can make a profit. Whether the success of Taiwan can be duplicated in the PRC under conditions of socialist central planning, or whether Taiwan can maintain the conditions responsible for its own past economic success, remains to be seen.

involving the enlargement of color photos and mini-taxis.

Projects whose products are subjected to fixed export quota, such as projects for the production of wool, cotton and linen fabrics and garment processing projects.

¹⁵⁵ One commentator has observed that “[c]omparatively, both the PRC and Taiwan offer the same tax holiday periods, but the PRC offers a lower corporate income tax (perhaps recognizing risk assessments and productivity factors in some sectors). The PRC’s wage rates are, of course, cheaper.” Werner, *supra* note 149, at 1105.