law. Company law in other jurisdictions such as the United Kingdom, Germany, France, Japan and other countries will also be mentioned from time to time in order to interpret particular provisions of the Chinese company law. In this regard, it is necessary to give a brief introduction of company law in the United States, Hong Kong and Taiwan.

IV. THE EVOLUTION OF CHINESE COMPANY LAW

From a legal perspective, China did not have a concept of "company" or "corporation" until the end of the Qing Dynasty, when the government promulgated the first Chinese corporation law, the *Da Qing Gong Si Lu*, in 1904.[15] Although many scholars have argued that before 1904, China only existed family businesses,[16] a few have argued that many traditional families were really "corporations" in an economic sense: the members of large clans worked together not merely out of affection for their kin, but also to accumulate capital and to pursue profit more effectively.[17] Even if this argument is persuasive, it is important to note that so called "modern" business enterprises[18] only came into existence in China after 1840, the year the British government launched the Opium War against China and forced the Qing Dynasty to open China's doors to foreign investment and businesses. As data indicated, in 1913, there were 136 enterprises invested in by western businessmen; each enterprise having more than US$100,000 invested in it and the total investment of these enterprises amounted to US$103 million. Among those enterprises, 96 were solely invested in by western businessmen, and 40 were invested

15. The contents of *Da Qing Gong Si Lu* could be found in Wang Baoshu and Cui Qingzhi, the *Principles of the Chinese Company Law* (*Zhongguo Gongsi Fa Yuanli*), the Social Science Documents Press (Beijing), 1998, pp. 7–8.
16. Max Weber said that in the absence of a law governing voluntary associations, most businesses were "merely" family businesses. Teemu Ruskola, Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective, *Stanford Law Review*, Vol. 52, No. 1599, 2000, p. 1605.
17. Hill Gates, China's Motor: A Thousand Years of Petty Capitalism, citing Teemu Ruskola, Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective, *Stanford Law Review*, Vol. 52, No. 1599, 2000, p. 1605, fn. 15.
18. "Modern business enterprises" were created in western jurisdictions in the form of companies, partnerships and sole proprietorships with notions of separate legal entity and limited liability of shareholders.

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in through the form of joint ventures.[19] From the very beginning, foreign companies in China were translated into the Chinese word "Yang Hang", such as Jardine, Matheson & Co. (Yi He Yang Hang), which was used in Hong Kong and Macao. This word can even be seen today.

As mentioned above, the term "company" became a formal legal term in China in 1903 when the Qing Dynasty published its *Da Qing Gong Si Lu*. The purposes for publishing this law were bifurcate. One was to use this law as a tool to promote China's industrial development. At that time, it was recognized that the establishment of a modern business structure was the only way to compete with foreign counterparts. On the other hand, the Qing Government had no other choice in order to get rid of extraterritorial legal systems. During that time, many western "big powers (*Lie Qiang*)" had imposed their various influences on China. England, Japan, America and other countries promised the Qing Government to give up their "consular jurisdictional power" (*Lingshi Caipanquan*) if it abolished its cruel punishments and would establish another legal system. In order to maintain its political control, the Qing Government started reforming its legal system by taking into consideration the legal systems of European countries, the United States, Japan and other countries. For this reason, the *Da Qing Gong Si Lu* was drafted based on the British Joint Stock Company Act (1856) and the British Company Act (1862), as well as the Japanese Commercial Code (1899). Thus, the *Da Qing Gongsi Lu* was the combination of traditions of both common law jurisdictions and continental law jurisdictions.[20] Comparatively modern Chinese company law was created by the Guomingdang Government in 1929, which was under the influence of the German Commercial Code and the Japanese Commercial Code. The relevant law has been amended many times and is still applied in Taiwan today.[21]

After the People's Republic of China was established in 1949, the development of company law could be divided into three periods:

19. Liu Fengming, Joint Stock Company and Joint Venture Enterprise Laws (*Gufen Gongsi yu Zezi Qiye Fa*), the China University of Politics and Law Press (Beijing), 1998, p. 1.
20. Common law is a case law (or judge-made law) system and the two major represented countries are the United Kingdom and the United States, while Continental Law is a *Written Law* system and the two major represented countries are Germany and France. Before World War II, Japanese law was heavily influenced by continental law traditions
21. Jiang Ping, ed., *New Company Law Textbook* (*Xin Gongsi Fa Jiaocheng*), the Law Press (Beijing), 1997, p. 16 (hereinafter referred to as "Jiang Ping").

- It is a non-profit corporation, which is formed in order to engage in a charity, education or scientific research; and
- It is a business corporation, which is formed with the goal of making profit.

Today, people use these two words ("company" or "corporation") interchangeably. For example, the Delaware General Corporation Law provides for the name of the corporation, which shall contain one of the words "association, company, corporation, club, foundation, fund, incorporated, institute, society, union, syndicate, or limited". Nevertheless, it is necessary to bear in mind that only a business corporation or a business company is the research target of this book.

2. The Legal Meanings of Companies

By reading the Chinese company law, one cannot possibly find out the specific definition of a company. Article 2 of the 2005 Chinese Company Law only provides the following description:

> "For the purpose of this Law, the term 'company' means a limited liability company or a joint stock company established within the territory of China in accordance with this Law."

Interestingly, the Hong Kong Companies Ordinance adopts the same approach by not defining the meaning of a company. Section 2(1) of the Companies Ordinance states that the term "companies" shall mean companies formed and registered under the Ordinance or existing companies. In the United States, the Revised Modern Business Corporation Act states that a corporation means a corporation for profit, which is not a foreign corporation, incorporated under or subject to the provisions of this Act [Sec. 1.40(1)]. This simple definition is not helpful for the purpose of theoretic research. One could say that this is a rare situation when a written law fails to define the concept of companies. The only possible reason is that the legislators want to leave more room for defining various business associations. Under company law, duties will be imposed on a business association if it is deemed to be a company.

However, the silence of both the Chinese company law and the Hong Kong company law on the concept of a company does not mean that it is impossible to obtain a definition of a company. For example, Article 2 of the Provisional Regulations on Management of Company

Registration[2] (hereinafter referred to as the "Registration Regulations") defines a company as an economic entity which is formed in accordance with the Registration Regulations to engage in production and services. Furthermore, it has an independent property right and autonomy in management, and shall take full responsibility for its profits and losses. However, one problem remains. It is evident that, under Article 2 of the Law of the PRC on Industrial Enterprises Owned by the Whole People, that the definition of a wholly State-owned enterprise is almost the same as the definition of a company. In other words, the definition provided by the Registration Regulations does not necessarily reflect the exact meaning of a company.

The comparative law approach could help to understand the true meaning of a company. Firstly, the Taiwanese Company Law provides a clear definition of a company. Article 1 of the Taiwanese Company Law states that a company is an organization with legal person status (*She Tuan Fa Ren*) organized, registered and established in accordance with this Law for the purpose of profit. Other western countries, especially continental countries, treat a company as a corporation for profit formed under national company law. For example, the French Civil Code states that a company is an enterprise formed by more than two persons through an agreement under which all the parties of the agreement are required to make their investments in the form of property or skills, and all the parties share the profits and interests generated by the operation.[3]

Based on the above descriptions, it is possible to conclude that a company should contain at least four elements:

(1) Domestic Company Law Is the Controlling Law

A company is formed under a particular national company law. All companies must be established in accordance with relevant national company law because companies are traditionally subject to control by a national sovereignty. Furthermore, the establishment of a company must go through a registration process. For example, Article 3 of the Administrative Rules of the People's Republic of China Governing the

2. This law was issued by the State Council in 1985.
3. Article 1832. The translation was carried out in accordance with the Chinese version of the French Civil Code. See Bian Yaowu, ed., Dangdai Waiguo Gongsifa ("*Contemporary Foreign Company Law*"), the Law Press (Beijing), 1996, p. 367.

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(a) Shares have already been issued to the public with the approval of the China's Securities Regulatory Commission (hereinafter referred to as the "CSRC");
(b) The total amount of the company's share capital shall not be less than Y30,000,000;[15]
(c) The amount of shares issued to the public shall be more than 25 per cent of the total amount of the company's shares. For a company whose share capital exceeds Y400,000,000, the shares issued to the public shall be more than 10 per cent of the total shares of the company; and
(d) The company has not committed any significant illegal acts and there are no false records in the financial accounting statements for the previous three years.[16]

Apparently those are minimum requirements because the 2005 Chinese Securities Law allows Stock Exchanges to issue requirements, which could be more restrictive if they are approved by the CSRC.[17]

2. Companies in Hong Kong

Under Section 4(2) of the Hong Kong Companies Ordinance, there are three types of company that are classified in accordance with the extent of the liability of members, i.e. companies limited by shares, companies limited by guarantee, and unlimited companies.

(1) A Company Limited by Shares

This is a company formed on the principle of having the liability of its members limited by the amount of shares for which they promised to pay. Because the members of a company limited by shares have limited liability, creditors of such a company do not have access to the personal property of the members in order to satisfy their debts. Therefore, Section 5(1)(a) requires a limited company to have the word "limited" as part of it and at the end of its name. This provides a warning to

15. Under the 1993 Company Law, the total amount of share capital should be no less than Y50,000,000.
16. The 2006 Securities Law, Article 50.
17. The 2006 Securities Law, Article 5(2).

potential creditors that the liability of each member of the company is limited and debts of the company can only be satisfied from the assets of the company.[18]

(2) A Company Limited by Guarantee

In Hong Kong, a company limited by guarantee refers to a company whose shareholders guarantee their contribution but are only required to make such a contribution upon the request of the company. It can be further divided into the following companies.

(a) A Company with No Share Capital

This company is formed based on the principle of having the liability of its members limited by the memorandum to the respective amounts that the members undertake to contribute to the property of the company in the event of it being wound up. Members are not required to contribute capital while the company is operating. However, in the event of the company being wound up and its assets being insufficient to meet its liabilities, its members are liable to pay up to the amount specified in the memorandum as the members guaranteed. Such companies are very rarely used for the purposes of trading, because these companies do not raise initial or working capital from its members. However, this type of company may be convenient for clubs and other non-trading companies (charities and quasi-charitable organizations such as schools and hospitals) whose capital needs can be met from outside courses, subscriptions and social activities. Because this type of company is usually engaged in nonprofit activities, it usually does not require a large amount of money. Thus, by soliciting the promise or guarantee from a member, the company can acquire sufficient credibility to engage in its relevant activities.

(b) A Company with Share Capital

A member of such a company is liable to pay the amount, if any, unpaid on any shares held by him or her, in addition to meeting his or her guarantee undertaking to contribute a specified amount in the event

18. K Arjunan & C K Low, *Lipton & Herzberg's Understanding Company Law in Hong Kong*, the LBC Information Service, 1996, pp. 30–31.

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However, both in practice and in theory, the word "Ying Dang" has been interpreted differently. Firstly, it is said that some items listed in Article 25 or Article 82 must be included in the articles of association. Those items include company name, domicile, scope of business, registered capital, names of shareholders, forms and amount of contribution, internal organizations and the methods of establishment. Secondly, it is said that some items are relatively important but are not listed in Articles 25 and 82, such as the rights and duties of shareholders, functions and powers of a company, legal representative of a company, dissolution and liquidation of a company. Although these items are not listed under Articles 25 and 82, it does not mean that they are not important. In fact, the 2005 Company Law separately deals with these issues. For example, Articles 21 and 34 deal with the obligations and rights of shareholders; Articles 37, 41, and 52 deal with three important organizations (the shareholders' meeting, the board of directors and the board of supervisors); and Article 13 deals with the legal representative. Thus, it is necessary to clear the confusion that the items listed in Articles 25 or 82 are not exclusive and the items not mentioned by the two provisions are still somewhat important under the Chinese company law. Thirdly, it is said that some items not listed by Articles 25 and 82 are discretionary and could be included in the articles of association by shareholders.[5] These interpretations make some sense but are not consistent with the meaning of "Ying Dang". In any event, this may reflect the fact that the Chinese company law needs to reconcile these different interpretations in the near future. On the other hand, it is necessary to observe that the 2005 Company Law gives more freedoms to companies. So far it is observed that more than 20 provisions grant the right to shareholders to freely incorporate in their special desires in the articles of association so long as those desires do not contradict to relevant laws and regulations. Therefore, they can: (1) decide the scope of business (Art. 12); (2) decide the ceiling of providing guarantee (Art. 16); (3) decide notice period (Art. 42); (4) decide how to exercise voting right (Art. 43); (4) decide deliberation and voting procedures of annual shareholders' meeting (Art. 44); (5) decide the term of directorship (Art. 46); (6) decide powers and functions of board of directors (Art. 47); (7) decide deliberation and voting procedures of board of directors (Art. 49); (8) decide powers and functions of supervisory board (Art. 54); (9) decide deliberation and voting procedures of supervisory board (Art. 56); (10) decide procedures for transferring stock ownership (Art. 72); (11) decide term of operating the company (Art. 75); (12) decide matter of succession (Art. 76); (13) decide subscription of shares by promoters (Art. 84); (14) decide situations for holding an interim shareholders' meeting (Art. 101); (15) decide major assets transition (Art. 105); (16) decide limits of transferring shares by directors, supervisors and senior executives (142); (17) decide specific duties of directors, supervisors and senior executives (Art. 148); (18) decide time limit to submit financial statements to shareholders (Art. 166); (19) decide distribution of profits (Art. 167) and (20) decide the meaning of "senior executives" (Art. 217). Many of these freedoms were not available under the 1993 Company Law.

5. By reading both Kong Xiangjun and others, *New Interpretation of Company Law and Relevant Regulations* (Gongsi Fa ji Peitao Guiding Xin Shi Xin Jie) (First Part), the People's Court Press (Beijing), 1997, p. 291 and Jiang Daxing, the *Intensive Studies on Company Law* (Gongsi Fa de Zhankai yu Pingpan), the Law Press (Beijing), 2001, p. 337 (hereinafter referred to as "Jiang Daxing"), one could conclude that there is no uniform interpretation of word "Ying Dang". Furthermore, this issue has not been resolved by the 2005 Company Law either.

II. THE NATURE OF THE ARTICLES OF ASSOCIATION

In accordance with Article 11, the articles of association must be formulated in accordance with the Chinese company law when a company is being incorporated. A company's articles of association shall have a binding force over the company, its shareholders, directors, supervisors and managers. Therefore, it may be concluded that the articles of association in China also serve as a "contract" amongst the company, its shareholders, directors, supervisors and managers. People from common law jurisdictions may not fully understand this provision because the articles of association are usually considered a contract between a company and its members or between members in their jurisdictions. In order to explain this confusion, it is necessary to examine the nature of the articles of association in common law jurisdictions, taking the Hong Kong Companies Ordinance as one example.

In Hong Kong, the effect of the memorandum or the articles of association is different. Section 23 of the Companies Ordinance states that after the memorandum and the articles of association have been registered, they shall bind the company and its members to the

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and trust. This part will be discussed in detail when discussing the shareholders' meeting.

6. Method and Amount of Capital Contribution

Capital contribution usually means the payment in the form of money or in the form of material objects, intellectual property rights, and land-use rights at their appraised value. In accordance with Article 27(3) of the 2005 Company Law, the amount of cash contribution must be no less than 30% of the total registered capital. This means that China no longer limits percentage of other forms of capital contribution. On 25 December 1999, the National People's Congress Standing Committee decided to amend the Company Law and to add one provision to Article 229. Thus, Article 229(2) provides that the State Council shall promulgate separate rules concerning the percentage of the capital contribution in the form of industrial property rights or technology with non-patent rights by the promoters of a high-tech joint stock company, as well as the conditions of issuing new shares or listing shares. However, the 2005 Company Law simply removes this provision and presumably the 30% cash rule could sufficiently solve this issue.

As for the liability towards capital contribution is concerned, differences exist between a limited liability company and a joint stock company as seen in Article 3(2) of the 2005 Company Law. Article 3(2) provides the definition of these two companies. Shareholders in a limited liability company assume liability that is equivalent to the "amount of capital contribution" while shareholders in a joint stock company assume liability that is equivalent to the number of shares held and each share has equal value. The question is whether the capital contribution in a limited liability company can be divided into equal amounts.

So far, there are three methods around the world when dealing with the amount of capital contribution in a limited liability company. (1) The total capital is divided into equal portions and each shareholder can subscribe one or more portions. For example, Article 10 of the Japanese Limited Liability Company Law states that each share should be equal in amount and shall be at least 1,000 Japanese yen. (2) The total capital is divided into unequal portions and each shareholder subscribes one portion. The Taiwanese Company Law provides this method. (3) The compromised approach. Article 5 of the German GmbH Act provides

that the minimum capital of a company shall be 50,000 marks (about 25,000 Euro). The basic contribution of each shareholder shall be 500 marks (about 250 Euro). Each shareholder can only get one basic contribution, but the company can provide different amounts of the basic contribution which will be multiples of 100 marks (about 50 Euro).

The Chinese company law does not state the method of capital contribution. It is assumed that a limited liability company can choose any method it thinks fit.[44] But in any event, the shareholders in a limited liability company can only hold a proof of contribution that is not tradable like share certificates (Gu Piao).

7. Conditions for Transferring Capital Contributions

According to Article 36 of the 2005 Company Law, once a company is registered, its shareholders cannot withdraw their capital contributions. Furthermore, in comparison with a joint stock company, the transfer of capital contributions is more limited for the shareholders in a limited liability company. Article 72(2) of the 2005 Company Law states that if a shareholder intends to assign its capital contribution to persons who are not shareholders, the consent of over half of all the shareholders must be secured. Those shareholders who disapprove of the assignment shall purchase the capital contribution to be assigned. If such shareholders do not make the purchase, they shall be deemed to have consented to the assignment.

According to this provision, one shareholder can freely transfer his capital contribution to other shareholders, but cannot freely transfer his capital contribution to persons who are not shareholders. If a shareholder wants to transfer his or her capital contribution to outsiders, he or she must get the consent (regardless of whether it is express consent or implied consent) from other shareholders. Furthermore, the consent must be given from more than half of the shareholders instead of shareholders who hold more than half of the votes. However, if more than half of shareholders reject the transfer of capital contribution to persons who are not shareholders, they should purchase that capital

44. Kong Junxiang and others, ed., the *Company Law and the Relevant Set of Rules, New Interpretations (First Part)*, the People's Court Press (Beijing), pp. 307–308.

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(b) If Zhang Yu and Zhang Chi could not fully pay back the debts, Y Bank Branch should bear 70 per cent liability within the limit of Y480,000 and Z Accounting Firm should bear 30 per cent liability within the limit of Y480,000.

The court of second instance upheld the judgment and held that in this case, Y Bank Branch had committed a greater civil wrong than that of Z Accounting Firm.[28]

Obviously in this case, the valuer, Z Accounting Firm, was ordered to bear a percentage of liability. Percentage liability is a better approach. However, different outcomes of similar cases reflect the problem that the same court cannot make consistent judgments.

(c) Valuer Shall Take Joint Liability

In June 1995, the Jianglong Company borrowed Y500,000 from the Tiandi Company to purchase rabbit furs. However, due to its unsuccessful business operation, the Jianglong Company could only return Y100,000 to the Tiandi Company. The Tiandi Company asked the Jianglong Company to return Y400,000 several times without success and had to sue Jianglong in October 1997. The court discovered that the Jianglong Company had no cash in its account. The court further discovered that at the time of incorporation, the investor, the Jianglong Group did not make an actual capital contribution. In this situation, the court decided to add the Jianglong Group, A Bank that issued the deposit certificate for the Jianglong Company and FZ Accounting Firm that issued the capital evaluation report for the Jianglong Company as joint defendants.

The Jianglong Group argued that when Jianglong was incorporated in August 1994, even though the Jianglong Group did not invest Y400,000 in accordance with the articles of association, it had invested in the Jianglong Company's house, tower crane and one car, which were worth Y400,000. Those assets were evaluated and confirmed by FZ Accounting Firm. For this reason, it should not bear any civil liability.

A Bank argued that when the Jianglong Company was established, even though it issued a certificate of deposit, the certificate was not fully false and it should be further examined by FZ Accounting Firm. For this reason, it should not bear any civil liability.

28. Citing Jiang Daxing, supra note 12, pp. 262–264.

FZ Accounting Firm argued that at the time the Jianglong Company was established, it strictly followed the legal procedures to evaluate the assets of the Jianglong Company. The articles of association stated that the registered capital was Y600,000, of which the Jianglong Group should invest Y400,000 and another 10 individuals should invest Y200,000. FZ Accounting Firm evaluated two pieces of important evidence. One was 11 invoices issued by the Jianglong Company to the Jianglong Group and 10 individuals, which indicated that investors had made capital contributions in July 1994. Even though these invoices had no financial chop of the Jianglong Company (because the company had not been officially established), they were signed by the relevant persons. Furthermore, the investment amount complied with the articles of association. The second piece of evidence was 2 certificates issued by A Bank in order to prove that both the Jianglong Group and 10 individuals had deposited Y400,000 and Y200,000 respectively. FZ Accounting Firm, based on the evidence, issued a capital evaluation report. Even though those documents were proved to be falsified, FZ Accounting Firm could not discover these falsified documents at that time. Thus, it should not bear any civil liability.

The court ruled as follows:

(a) The loan contract between the Tiandi Company and the Jianglong Company was an illegal private loan and the contract should be invalid. Since both parties were at fault, the Jianglong Company should pay back the principal debt to the Tiandi Company but the interest should be confiscated.
(b) The Defendant, the Jianglong Group, did not actually make capital contribution when the Jianglong Company was established, and thus, it should bear joint liability. However, considering that it had made up all the capital contribution, its liability could be excused.
(c) The Defendant, A Bank, did issue a false certificate of creditworthiness, and thus it should bear joint liability.
(d) The Defendant, FZ Accounting Firm, failed to carefully examine the certificate of creditworthiness and caused the Jianglong Company to be registered, and thus it should bear joint liability.[29]

29. Citing Jiang Daxing, supra note 12, pp. 267–269.

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from Hong Kong or Macau can, from 1 January 2004, establish the FTCs in the form of equity joint ventures, contractual joint ventures and sole ownership ventures. In addition, investors of Hong Kong or Macau are only required to have engaged in trade with China in the average amount of more than US$10 million within three years prior to the application (Art. 2). Finally, the registered capital of the FTCs established by investors from Hong Kong or Macau should be no less than Y20 million (Art. 3).

4. Foreign-Funded Commercial Enterprises

On 25 June 1999, both the then MOFTEC and the State Economic and Trade Commission jointly issued the Regulations on Establishment of Pilot Projects of Foreign-Funded Commercial Enterprises. The Regulations were replaced by the Administrative Measures on Foreign Investment in the Commercial Areas (hereinafter referred to as the "Administrative Measures") issued by the Ministry of Commerce on 9 April 2004.

Under the Administrative Measures, a foreign-funded commercial enterprise (hereinafter referred to as the "FFCE") is allowed to be established between foreign companies and enterprises (foreign partner) and Chinese companies and enterprises (Chinese partner). The establishment of wholly foreign-funded commercial enterprises in China will be permissible in the near future (five years after China's entry into the World Trade Organization).

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(1) *Form of cooperation*

Every FFCE can be formed by way of either an equity joint venture or contractual joint venture. After 11 December 2004, wholly foreign-owned commercial enterprises have been permitted to be established (Art. 21).

(2) *Financial condition of investors*

This is also relevant to the registered capital. Any FFCE shall satisfy the minimum registered capital in accordance with the Chinese company law. For example, the minimum registered capital for retail commercial enterprises shall be not less than Y50 million; the minimum registered capital for wholesale commercial enterprises shall be bigger even though the Chinese Company Law is silent on this matter (Art. 7.1). Presumably, in the situation of a joint venture, foreign investors shall contribute at least 25 per cent of the total registered capital.

(3) *Fixed duration*

The period of operation of an FFEC shall not exceed 30 years (40 years for those based in central and western parts of China).

(4) *Scope of business*

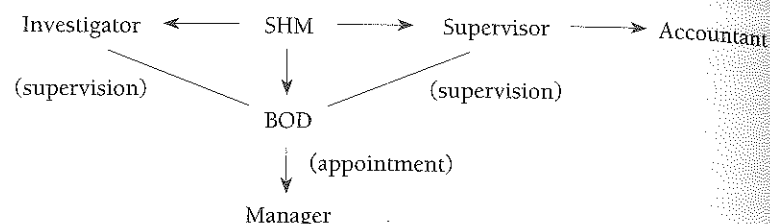
For an FFCE doing retail commercial business, it can engage in retail (including the retail of goods on commission basis and consignment of goods for sale on commission), organize the export of Chinese goods, the import and export of goods for their own operation and operate auxiliary services concerned. For an FFCE doing wholesale commercial business, it can engage in the wholesale in China of Chinese goods and imported goods for their own commercial operation and organize the export of Chinese goods.

The FFCEs are no longer subject to the limitation of the location. Furthermore, investors from Hong Kong or Macau may enjoy preferential treatment in accordance with the CEPA arrangement. One of the noticeable benefits is that Chinese citizens who are permanent residents of Hong Kong or Macau are allowed to engage in commercial retail businesses by forming an individual household for commerce and industry (Art. 25.4).

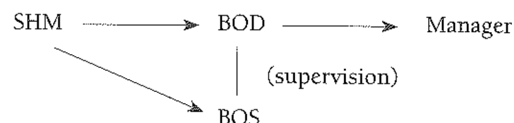
5. Foreign Resident Representative Offices of Foreign Companies

On 30 October 1980, the State Council issued the Interim Regulations of the State Council of the PRC concerning the Control of Resident Representative Offices of Foreign Enterprises. Then the National Administration for Commerce and Industry issued the Measures for Managing the Registration of Resident Representative Office of Foreign Enterprises (1983) and the MOFTEC issued the Detailed Implementation Rules for Examination and Management of Resident Representative Offices of Foreign Enterprises in the same year. Under

established a compromised model which has been followed by Taiwan's company law until today.



In comparison, China's internal structure of companies has been built up differently. On the face of it, the internal structure is similar to the pattern of the continental law jurisdictions. In reality, the internal structure is problematic which will be discussed thoroughly in the following subchapters.



II. SHAREHOLDERS' MEETING

1. The Nature of the Shareholders' Meeting

The SHM is formed by all shareholders of a company. It is recognized as the most powerful authority of a company because shareholders are the capital contributors and without their capital contribution the company cannot be effectively formed or operated.[10] Thus, the SHM must represent the interests of the majority shareholders. The interests of the majority shareholders represent the company's interest while one shareholder's interest usually cannot be said to reflect the interests of the company. This is so called "shareholders' democracy". However, in

10. Some scholars even believe that the SHM is not the highest authority but just an indispensable organ. See Shi Zhimou, the *Company Law* (Gongsi Fa), (1991 Taiwan), p. 142.

the situation of modern companies, which refers to the large-sized JSCs with very many shareholders, The democracy of shareholders would not be easy to be realized when the shareholders are located disperedly. For those shareholders who own only small amount of shares, the internal governance will almost be unachievable. In reality, most shareholders of JSCs have only a loose expectation of profit return and management power is entirely controlled by internal management personnel.

Even though the SHM is the most powerful authority of companies, it should not be treated as a standing authority because it usually holds a meeting once a year to decide the most important matters of the company. Furthermore, even though it is regarded as the most powerful authority, it does not representing the company because the SHM only decides a company's internal matters and it cannot directly deal with a third party. Also, in line with the general theory, the BOD has already been entrusted to represent the company despite the fact that in reality different jurisdictions may provide different answers.

In accordance with Article 82 of Table A of the Hong Kong Companies Ordinance, directors shall manage a company's business. This provision indicates clearly that directors are authorized to represent the company to engage in business with any third party. Although the Chinese company law provides a similar idea, it gives too many powers to the SHM as explained below.

2. Shareholders' Rights and Powers of the SHM

(1) *Shareholders' Rights*

Shareholders' rights can be summarized into three major rights, i.e. the voting right, the right to sue and the right to information. The voting right is to ensure a shareholder can vote on the important matters of a company, especially to vote for their favored directors. The right to sue is important in the sense a shareholder can seek legal remedies in order to protect him/her and his/her company's legal interests. The right to information is equally important because it will enable a shareholder to make informed decisions. Shareholders' other rights are basically developed from these three rights. The Chinese company law also provides these three rights to shareholders. In summary, the shareholders' rights, in either an LLC situation or a JSC situation, can be listed as follows:

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shares are considered as one unit) is not enough.[35] The US laws dealing with derivative action require the plaintiff to have been a shareholder when the cause of action arose and continuously since that time. Furthermore, it is noted that many States permit a shareholder to serve as a plaintiff even though he or she is not a shareholder when the cause of action arose if the shareholder acquired the shares in ignorance of the existence of the claim. In this situation, it is possible for a person to "buy a lawsuit". From a positive aspect, the derivative action is a good device to monitor the behaviour of the management board and majority shareholders. Thus, if a person wants to "buy a lawsuit", he or she should be encouraged because he or she is still subject to other preconditions.

In China, there is a view that the qualification requirement should be relaxing and a shareholder shall be allowed to sue so long as he/she is the member of the company when the wrongs have been done and regardless the quantity of his/her share amount.[36] This book supports this view based on the lesson learned from Taiwan, where the system of derivative action is hardly used because there are too many restrictions.[37] That is one of the reasons why starting from 2003, Taiwan has been considering to adopt "the class action for securities cases",[38] even though the two systems are different in nature. In China, the structure of shareholding is relatively simple and too harsh requirements may not be encouraging. More sophisticate rules could be developed when the company system is matured enough.

In China, the research on derivative action is just started. In the USA, the technical discussion about the qualifications of a plaintiff is going on. For example, due to the reason of merger (use shares of one

35. Qiao Xin and others, Gongsi Jiufen de Sifa Jiuji ("Judicial Remedies for Company's Disputes"), the Law Press (Beijing), 2007, p. 52.
36. Shu Xuxia, Shenli Gudong Piasheng Susong Anjian de Jige Wenti ("Several Issues concerning the Adjudication of Shareholder's Derivative Action"), retrieved from http://www.chinacourt.org/public/detail.php?id=59176 on 8 August 2009.
37. Taiwan imported in the derivative action in 1929 and there was no such an action being taken. In 1983, its company law was amended again in order to lower the threshold. From 2001 to today, there were in total 7 derivative actions. See Lai Yuanhe, Taiwan de Gudong Daibiao Zhi Su Zhidu ("the System of Shareholder's Derivative Action in Taiwan"), in the thesis collection for the 4th Legal Forum for Asian Enterprises held in the East China University for Politics and Law (Shanghai) on 8 June 2007.
38. The Speech made by Zhu Defang at the 4th Legal Forum for Asian Enterprises held in the East China University for Politics and Law (Shanghai) on 8 June 2007.

company to change for shares of another company) or other reasons, the plaintiff may lose his/her shareholder status and cannot continue the derivative action.[39] A person who purchases shares in the Initial Share Offering cannot take derivative action against the directors who have decided the offering conditions because the plaintiff must prove that at the time the offering conditions were made he/she was the shareholder of the new company.[40] In another case, the court concludes: if a plaintiff (1) simultaneously holds the shares of both parent company and wholly-owned subsidiary company; (2) sues directors of the subsidiary company in the capacity as the shareholder of the parent company (Double Derivative Action); or (3) has lost a plaintiff qualification when the parent company has taken back all shares of the subsidiary company, but is still considered as plaintiff, as a matter of equity, he/she is allow to take derivative action on behalf of former subsidiary company even if the wrongs were committed before the plaintiff had become the shareholder to the subsidiary company.[41]

(C) The Preconditions of a Derivative Action

Before a derivative action is taken, the plaintiff must do something. Firstly, if the wrong is committed by directors or senior management personnel, the plaintiff should send a written demand to the Supervisory Board asking it to sue those wrongdoers. Secondly, if the wrong is committed by supervisors, the plaintiff should send a written demand to the Board of Directors asking it to sue the wrongdoers (Art. 152.1). This provision may create a false image to potential plaintiffs because it allows the plaintiff to make a written demand automatically. Contrarily, in the case where the wrong is done by the directors, the plaintiff should ask the directors concerned or the Board of Directors to correct the relevant wrong in the first place. If they refuse to correct their wrong, then the written demand could be sent to the Supervisor Board. This is the same situation where the wrong is committed by the supervisors. This arrangement is more logical because the demand to correct a wrong is more positive than the demand to sue and less litigation is good for the normal operation of a company.

39. The relevant cases are *Lewis*, 477 A.2d at 1049; *Heit v. Tenneco, Inc.*, 319 F. Supp. 884, 886 (D. Del. 1970).
40. *7547 Partners v. Beck*, 682 A.2d 160, 162-63 (Del. 1996).
41. *Shaev v. Wyly*, 1998 Del. Ch. LEXIS 2, 1998 WL 13858 (Del. Ch. Jan. 6, 1998).

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control the election, because each director will be elected by them by 51 votes. However, under the accumulative election, each share equals 3 votes, so the total votes of a company shall be 300. Among 300 votes, the majority shareholder holds 51 x 3 = 153 votes, and the other shareholders hold 49 x 3 = 147 votes. By utilizing this election method, the minority shareholders can at least elect one director to represent their interests. In China, because the biggest shareholder is the State, it is logical to provide accumulative election so that minority shareholders have a hope to protect their interests.

3. Term of Office for Directors

Article 46 of the 2005 Company Law requires that the articles of association shall state the term of office of directors and the term shall not exceed three years. A director may, if re-elected upon the expiration of the term of office, serve consecutive terms. However, in China, it is very possible for a director to remain in office as long as possible even though it is illegal to provide a life term for a director in the articles of association, because he or she can always manage to be re-elected by using his or her powerful influence. Contrarily, according to the Hong Kong Companies Ordinance, the articles of association may allow directors to be appointed for life, for an indefinite term or a certain prescribed term.[8] Apparently, the decision to adopt a particular term is in the hands of shareholders. Thus, comparatively speaking, the approach adopted by the Chinese company law is less significant.

4. Qualification for Appointment

Generally, most jurisdictions provide positive qualifications of a candidate (a person must meet these conditions in order to be a director) and passive qualifications of a director (in case something happens, a director shall be dismissed immediately).

8. K. Arjunan and C. K. Low, *Understanding Company Law in Hong Kong*, the LBC Information Services, 1996, p. 205 (hereinafter referred to as "K. Arjunan and C. K. Low").

(1) *Positive Qualifications*

(a) Nationality

Very few countries have set out their positive qualifications. Nevertheless in Switzerland, if there is only one director, that director must be a citizen of Switzerland and must live in the territory; if there are several directors, the majority must be citizens of Switzerland and must live therein. The Chinese company law does not provide this kind of limitation and it is particularly easy for foreign investors to take the position as directors. Following the trend of globalization it is foreseeable that nationality as a qualification will be ignored.

(b) Requirement of Shareholding Status

Around the world, there are three types of legislation concerning whether directors shall concurrently be the shareholders of a company. Firstly, directors do not have to be shareholders (examples may be seen in Japan, Italy, Australia and Germany). Secondly, whether a director should concurrently be a shareholder is not required by law, but the byelaw of a company can provide such a limitation (see the example in the USA). Thirdly, shareholders must be shareholders concurrently (examples can be seen in Switzerland, Belgium and France). In Hong Kong, if a director does not obtain the share qualification within the prescribed period, or ceases to hold this qualification, he or she must vacate the office of director (Section 155/3); he or she is then incapable of being re-appointed as a director until the qualification has been obtained (Section 155/4). A person who purports to act as a director in contravention of Section 155/3 is guilty of an offence (Section 155/5). The Chinese company law takes the same approach as that of Japan and Germany. Furthermore, the Chinese company law does not require the qualifying shares to be held by directors. It is difficult to determine which approach is better. Obviously, a director being required to be a shareholder concurrently is based on the theory that directors will tie their personal interests with the interests of the company closely. However, there is no persuasive evidence to show that other approaches are not good.

The next issue is whether, despite the silence of the 2005 Company Law on the matter of share qualification, companies in China can require directors to be shareholders through their articles of association. There are two arguments to support an affirmative answer. Firstly, in line

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Some States in the USA have eliminated the "reasonably believes" standard and substituted a standard of decisions "in accordance with his or her good faith business judgment of the best interests of the corporation" (Va. Code Ann. S13.1-690). Another test that is often quoted is that a degree of diligence, care, and skill "which ordinarily prudent men or women would exercise under similar circumstances in their personal business affairs." This language is taken from a leading Pennsylvania case, *Selheimer v. Manganess Corp. of American* (1966). In comparison, the latter is better because it is a reasonable person test, which would enable courts to decide relevant cases concerned.

Usually, if the duty of care is breached, the director(s) involved will be ordered to pay damages. In *Dorchester Finance Co. Ltd. v. Stebbing* (1989) BCLC 498, the company was in the money lending business and had three directors. No board meeting had ever been held. Two of the directors left all the affairs of the company to a third one, and would sign blank cheques on the company's account. The third director lent the company's money to companies controlled by himself or herself, his or her clients or his or her brother but without complying with the statutory controls on money lending then in force. As a result the loans were all unenforceable. The court held that all three directors should be liable to the company for their negligence.

Traditionally in common law jurisdictions, the standard for the duty of care is relatively lower. However, the law in this area has been changed. Given the recent development of the profession of directors, the standard of care expected for a director will be much higher than before. Hoffmann J in two recent English cases put forward an objective standard for the duty of care. In *Norman v. Theodore Goddard* (1992) 10 ACLC 2016, Hoffmann J introduced an objective requirement that a director must possess the skill "that may reasonably be expected from a person undertaking those duties." He gave an example that "a director who undertakes the management of the company's properties is expected to have a reasonable skill in property management, but not offshore tax avoidance." Hoffmann J held the view that the appropriate test of the common law duty to exercise care and skill is set out in s. 214(4) of the UK Insolvency Act 1986. This provision lays down an objective test for directors' standards for a duty in the context of wrongful trading. An assessment of what a director would have done or would have known is to be based on what "a reasonably diligent person having both (a) the general knowledge, skill and experience that may reasonably be expected of a person carrying out the same functions as are carried out by that director in relation to the company and (b) the general knowledge, skill and experience that the director has." The same idea was stated in the case of *Re D'Jan of London Ltd*, (1993) BCC 646; (1994) 1 BCLC 561. In that case, Mr D'Jan was held to have acted negligently having regard only to his own knowledge and experience. He was liable for negligence to the company at common law for a failure of reading an insurance policy before signing it. It is very clear that a director may not need to have a high level of skill to satisfy the duty of care. He or she nevertheless needs to have the necessary skill to exercise his or her duty of care. Furthermore, he or she should try to learn as many as possible skills in order to be capable for his or her position as a director.

The 2005 Company Law does not provide this type of duty specifically even though the term "duty of care" has been mentioned in Article 148. However, as a general law, the General Principle of Civil Law could be used to solve the problem in case where the duty of care is breached. Furthermore, Article 150 provides that directors shall be liable to pay compensation, if they violate laws, administrative rules and regulations or the articles of association in performance of their duties and thus cause damage to the company. It may be inferred from this provision that breach of duty of care is closely related to the rules and articles of association. However, many cases have revealed that in the case where directors violate rules and articles of association the imposition of a personal liability will hardly ever be the case. A traditional breach of duty of care is usually subject to administrative or criminal liability in China. For example, Article 63 of the Law of Wholly State-Owned Enterprises states that a leading cadre of an enterprise or relevant government department who causes relatively heavy losses to the enterprise and the State due to errors in his or her work shall be subject to administrative penalties imposed by the government department in charge of the relevant higher level organ. The criminal liability of a leading cadre of an enterprise or relevant government department who, through neglect of duty, causes serious losses to enterprise property and the interests of the State and the people shall be investigated.

Furthermore, a director may be free from any personal liability for the loss to his or her company caused by his or her negligence, as long as he or she does not breach the duties imposed by the Chinese company law, administrative law and the articles of association. The case of the Jin Hua Department Store Joint Stock Company

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The second model (the German model) is that both the BOS and BOD are created by the SHM, but the BOS is in charge of the BOD; it supervises the company's business and financial situation, as well as the activities of the BOD. The typical example can be seen from German company law. In Germany, to establish the BOS is a mandatory requirement for joint stock companies under the German Stock Corporation Act. The BOS is elected by the shareholders' meeting and has broad powers. It then elects or dismisses the members of the BOD. In other words, the BOD is somewhat responsible to the BOS.

At this stage, it is difficult to say which model is better. However, the 1993 Company Law followed the French model but failed to give sufficient powers to the BOS. Fortunately, the 2005 Company Law largely resolves this issue, which will be introduced subsequently.

Under the 2005 Company Law, the BOS shall exercise the following functions and powers:

(1) To examine the financial affairs of the company;
(2) To supervise whether the acts of directors and managers violate the laws, and the administrative rules and regulations or the articles of association of the company during the performance of their functions and to propose the dismissal of relevant directors;
(3) To demand directors or managers to make corrections if any of their acts are found to have damaged the interests of the company;
(4) To propose the convening of interim shareholders' general meetings and to convene and preside over the meetings if the BOD fails to convene and preside over the meeting;
(5) To put forward proposals to the meetings;
(6) To sue the directors or senior officers in accordance with Article 152; and
(7) To exercise other functions and powers provided for in the articles of association of the company.

In comparison with the 1993 Company Law, the 2005 Company Law gives several important powers to the BOS. One is to propose the convening of interim shareholder's general meetings and to convene and preside over the meetings if the BOD fails to convene and preside over the meeting (Art. 54.4). This power is so important because the shareholders will have a chance to re-consider whether relevant directors concerned should be replaced. Another one is to sue relevant directors and senior officers if the relevant directors or senior officers have breached their duties and the BOD is not going to take a legal action against them (Art. 54.6). The third one is to conduct investigation if in its view the business situation of the company is abnormal. Furthermore, if necessary, the BOS can engage any accountant's firm to assist its work at the expense of the company (Art. 55.2). The fourth one is that even though supervisors can only attend meetings of the BOD as non-voting participants, they are allowed to bring enquiries and suggestions on the matters decided by the BOD (Art. 55.1). Armed with those necessary teeth, one would believe that the main purpose of check and balance system between the BOS and the BOD could be largely achieved.

II. ESTABLISHMENT OF THE BOS

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1. Number of Members and Their Term

The number is usually stated in the articles of association. In JSCs, the BOS must have no less than 3 members while in LLCs, a BOS may not be required, and only one or two supervisors are required (Art. 52). The Chinese company law does not state the maximum number of supervisors for the BOS. Usually this is done according to the capital size of a company. In Germany, 9 supervisors are allowed if the capital is less than 3 million marks (about 1.5 million Euro); 15 supervisors are allowed if the capital is over 3 million marks (about 1.5 million Euro); and 21 supervisors are allowed if the capital is over 20 million marks (about 10 million Euro). The term of supervisors is usually for 3 years. In some jurisdictions, a supervisor cannot be re-elected. In China, however, the re-election is not a problem.

2. The Qualifications and Duties of a Supervisor

Generally speaking, the qualifications of a supervisor are similar to that of a director. But one interesting thing is that supervisors are assumed good people when directors and senior management personnel are not allow committing the acts listed in Article 149.

Chapter 6 of the 2005 Company Law provides conditions for disqualification. Furthermore, directors, managers and responsible

3. Paid-up Capital

It usually refers to the total amount of capital that has been actually paid up by the shareholders of a company. The minimum amount of capital is required by relevant law.

The 1993 Company Law adopted the system of statutory capital (it could also be called the statutory paid-up capital). This means in most situations, shareholders shall pay for all of their subscriptions before a company can be established. Because of this situation, the statutory capital is sometimes called the statutory registered capital, or the paid-up capital. On the other hand, because domestic companies and foreign invested companies are handled by the different Chinese laws and regulations, the requirements for the capital contribution were different. However, the 2005 Company Law significantly changes this unequal treatment, which will be discussed next.

4. Capital of Domestic Companies

As mentioned before, the 1993 Company Law requires that the total amount of capital provided by the articles of association shall be issued to all shareholders and be fully paid up by shareholders. If this condition is satisfied, the total amount of capital shall be examined by the relevant authorities. Among other items, the certificate of actually paid-in capital will be issued for the purpose of company registration.

5. Capital of Foreign Invested Companies

Foreign invested companies have been treated differently in China. One major difference is that the registered capital should be the total amount of capital subscribed by shareholders but it needs not be fully paid right way. In practice, the Chinese government allows foreign investors to pay their capital contributions by way of instalment. The instalment payment is made subject to several limitations. For example, Article 4 of the Certain Regulations on the Subscription of Capital by the Parties to Sino-foreign Joint Equity Enterprises[1] states that "if the joint equity venture stipulates that capital is to be fully subscribed in one payment

1. Zhongwai Hezi Jingyin Qiye Heying Shuangfang Chuzi de Ruogan Guiding, which was issued jointly by the Ministry of Foreign Economic Relations and Trade and the State Administration for Industry and Commerce on 1 January 1988.

only, the respective joint venture parties shall settle their contributions in full within six months of the day of issue of the Business Licence. If the joint venture contract stipulates that capital is to be paid up in instalments, the first payment by the respective joint venture parties shall be no less than 15 per cent of the respective capital contribution of each party and shall be paid within three months of the day of issue of the Business Licence." This different treatment should be removed if a unified company law can be adopted because different treatment has been applied to foreign and domestic investors. In comparison, the limited instalment system is better than the paid-up capital system because the former is more flexible and practicable.

Furthermore, in the case of a foreign invested enterprise, the total amount of investment is a special term that refers to capital necessary for a project. If the contribution by each partner cannot reach the total amount of investment, then more money may need to be borrowed. Therefore, the total amount of investment capital may include the registered capital plus debts. The more debts a company incurs the higher the risk the creditors take. In order to avoid this situation, the Chinese government issued the Interim Regulations on the Ratio between the Registered Capital and the Total Amount of Investment for an Equity Joint Venture issued in 1987 by the National Administration of Industry and Commerce.[2]

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2. Article 3 of the Provisional Regulations of the State Administration for Industry and Commerce on the Ratio between the Registered Capital and Total Investment of Sino-foreign Joint Equity Enterprises states the following:

The ratio between a Sino-foreign joint equity enterprise 's registered capital and its total investment shall comply with the following provisions:

(1) Where the total investment of a Sino-foreign joint equity enterprise is US$3 million or less, its registered capital shall be at least 70 per cent of its total investment.

(2) Where the total investment of a Sino-foreign joint equity enterprise is between US$3 million and US$10 million (US$10 million inclusive), its registered capital shall be at least half of its total investment. Where the total investment of such an enterprise is less than US$4.2 million, its registered capital may not be less than US$2.1 million.

(3) Where the total investment of a Sino-foreign joint equity enterprise is between US$10 million and US$30 million (US$30 million inclusive), its registered capital shall be at least 40 per cent of its total investment. Where the total investment of such an enterprise is less than US$12.5 million, its registered capital may not be less than US$5 million.

Where the total investment of s Sino-foreign joint Equity enterprise is more than US$30 million, its registered capital shall be at least one-third of its total investment. Where the total investment of such an enterprise is less than US$36 million, its registered capital may not be less than US$12 million.

form of open, centralized, competitive bidding. Furthermore, securities shall be traded in the form of spot securities. The 2005 Securities Law does not expressly address the issue of over-the-counter trading which emerged in 1986 and is popular in China today. In this case, it is reasonable to expect that other rules and regulations will govern the issue of over-the-counter trading.

8. Disclosure of Relevant Information

(1) Disclosure When Issuing Shares

All the issuers, promoters and directors must ensure that all the released information is authentic, accurate and complete, and it may not contain any false record, misleading statement or major omission. Securities institutions shall also guarantee the same matters. With regard to information involving accounting, legal evaluation or asset evaluation, all the relevant professionals should ensure that their documents are accurate and not misleading. According to Chinese regulations, lawyers who offer assistance to the issuing of shares must be specialized in securities and permitted to practice securities laws. The relevant securities authorities will examine all the documents to be released and allow those documents to be published in appointed publications.

Three types of information shall be disclosed, i.e. economic information (financial reports or auditing reports), non-economic information (name, age, gender, position, term of position, specialties, remuneration, bonus, welfare and benefits, securities amounts of all the current directors, supervisors and senior officers) and soft information (such as the operation of funds, foreseeable profits, the nearest development plan of the company and so on).

(2) Continued Disclosure of Information

The purpose of continued disclosure is to ensure that all investors have full knowledge of the listed companies to make good investment choices. Usually the relevant information should be submitted to the relevant securities authorities and to certain appointed media. The disclosure is usually done by way of mid-term reports, annual reports and publication of major events.

Within two months counted from the ending date of the first half of each fiscal year, the listed companies shall submit a mid-term report. Five items are required:

(a) The financial statement and operational situation of the company;
(b) Major lawsuits concerning the company;
(c) Changes in the shares and corporate bonds already issued;
(d) Major issues submitted to the general meeting of shareholders for examination and review; and
(e) Other matters defined by the securities regulatory authority.[27]

Within 4 months counted from the ending date of each fiscal year, the listed companies shall submit an annual report to the relevant securities authorities. The annual report is usually audited by a registered accountant. Five items are also required:

(a) The general situation of the company;
(b) The financial statement and operational situation of the company;
(c) A brief introduction of the directors, supervisors, managers and senior executives of the company, and information on their holding of shares;
(d) Information on the situation of the stocks or corporate bonds already issued, including a list of the top 10 shareholders holding the largest proportions of shares of the company and the quantities of shares held by them;
(e) The actual controllers of the company; and
(f) Other matters defined by the securities regulatory authority.[28]

Major events refer to all the events that will affect the market price of shares issued. As the 2005 Securities Law requires, if there occurs a major event which may have relatively great impacts on the trading price of shares of a listed company, but which has not been known by investors, the listed company concerned shall immediately submit an interim report of information relevant to the major event to the securities regulatory authority and the securities exchange, and shall proclaim the report as well.[29] According to Article 67 of the 2005 Securities Law, major events usually include the following items:

27. The 2005 Securities Law, Article 65.
28. The 2005 Securities Law, Article 66.
29. The 2005 Securities Law, Article 67.

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Foreign investors do not come to rescue Chinese enterprises, rather they intend to control certain enterprises through M&As, and further control the relevant markets. It should be noted that around the world, Chinese medium and large-sized enterprises are most attractive because (a) they can offer well established channels for purchase and sale of products, and (b) they can offer cheap but good labour. In this circumstance, it is suggested that the Chinese government should pay attention to enterprises that have close connections with the national economy and the people's livelihood, i.e. the government should use both the Rules on Foreign Investment Guidelines and the Guideline Catalogue for Foreign Investment Industrials as the lever to gradually open the door to foreign involved M&As, but on the other hand there is no violation of the WTO's obligations.

In addition, it is important to know that the recently promulgated Chinese Anti-monopoly Law shall be used as the controlling law to decide whether foreign involved M&A should be allowed. Under the Chinese Anti-monopoly Law, foreign involved M&As shall not create market concentration,[23] or affect the national security.[24]

In September 2008, the Ministry of Commerce of the People's Republic of China received the anti-monopoly declaration for concentration of business operators by the Coca-Cola Company of the United States (hereinafter referred to as the "Coca-Cola Company") and the China Huiyuan Juice Group Limited (hereinafter referred to as the "China Huiyuan Juice Company"). After a half year investigation and examination, the Ministry of Commerce confirmed that the Concentration of Business Operators would lead to the following adverse influence:

(1) After the completion of the Concentration, the Coca-Cola Company will gain the ability to leverage a dominant position in the carbonated beverage market over the fruit juice market, which causes the effect of eliminating or restricting competition on the existing fruit juice beverage producers and then will infringe upon the legitimate rights and interests of beverage consumers.

(2) After the completion of the Concentration, the controlling force of the Coca-Cola Company over the fruit juice market will

23. The Chinese Anti-monopoly Law, Article 20.
24. The Chinese Anti-monopoly Law, Article 31.

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be obviously increased through its control over the two well-known fruit juice brands "Minute Maid" and "Huiyuan", in addition to the dominant position of the Coca-Cola Company in the carbonated beverage market and corresponding influence-leveraging effect, the Concentration will obviously increase the barriers for potential competitors to enter the fruit juice beverage market.

(3) The Concentration has compressed the survival space for the domestic small and medium-sized fruit juice enterprises and restrained the domestic enterprises from participating in the competition in the fruit juice beverage market and their degree of autonomy and innovation, which will result in adverse influence to the effective competition situation of the fruit juice beverage market in China and unfavorable situation to the sustained and healthy development of the China fruit juice industry.

Based on the above findings, the merger between Coca-Cola Company and China Huiyuan Juice Company was refused.[25]

It should be noted that one of the consequences of foreign involved M&As is that wholly foreign-owned enterprises (hereinafter referred to as "WFOE") will be greatly increased. The WFOEs will be the predominant type of enterprise in China because they are suitable for foreign investors to have autonomous operations on the one hand, and to safely keep commercial secrets on the other hand. Because of this change, China's original intention to improve competition capacity of domestic enterprises through foreign involved M&As will totally disappear. Also, it should be noted that further development of the WFOEs will enable foreign investors to further control relevant Chinese markets. There will be a potential problem of transfer price. Thus, the Chinese government should further improve the supervision system through new legislation.

25. Public Announcement No. 22 of 2009 of the Ministry of Commerce — on Promulgating the Results of the Anti-monopoly Declaration for Concentration of Business Operators by the Coca-Cola Company of the United States and the China Huiyuan Juice Group Limited, retrieved from http://www.isinolaw.com/isinolaw/english/detail.jsp?iscatalog=0&statutes_id=10050718&skind=110&searchword=catalog%3D0+and+isenglish%3E%3D1&channelid=77205 on 17 September 2009.