Business Organizations

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1. Introduction

Since the late 1970s, China has been engaged in the transformation of its economy from a "planned economy" to a "socialist market economy with Chinese characteristics". Before the adoption of the policies of internal economic reform and opening up internationally, its economy was generally characterized by central planning in which the central government under the direction of the Communist Party allocated key resources and supplied commodities on the basis of administrative orders through State monopolies. In other words, the allocation of resources and distribution of wealth were determined by the State rather than market forces, and social stratification was determined by political status rather than by income or other criteria.

1.1. Evolution of Chinese economic organizations since 1949

From the founding of the Communist regime in 1949 until the reform and opening-up movement, State-owned enterprises (SOEs) were positioned at the centre of the State's economy and all production and supply activities of SOEs were carried out in accordance with government instructions. Thus, SOEs essentially served as administrative arms of the government to manage and control the State's economy. Under this system, SOEs were not independent and lacked, for example, their own accounting systems for profits and losses. This hampered the development of China's economy because of the absence of a mechanism to encourage SOEs and other business organizations to maximize profits by improving productivity and reducing expenses.

Under the planned economy, business organizations were generally classified into four categories in accordance with their respective ownership forms: State-owned (nominally owned by the whole people), collectively-owned (owned by smaller groups such as all members of a village or township), privately-owned and individually-owned enterprises. While the State encouraged the development of the first two categories, the third and fourth categories were simply deemed as unintended by-products of the planned economy and mere accompaniments to the publicly owned economy, and were at times banned outright. The growth of individual or household enterprises was legally constrained by capping the number of their employees at seven.

In 1978, following the Cultural Revolution, the Communist Party led by Deng Xiaoping convened the Third Plenary Session of its Eleventh Central Committee. At this meeting, the Central Committee approved the shift of the focus of the Party's work from "political struggle" to "building China's economic system" and decided to launch a campaign to reform China's economic system to realize the objective of building a socialist market economy. To establish a market economy, a modern enterprise system first had to be established with the features of "clear property rights, clear rights and obligations, separation of government administrative functions from enterprise operations and adoption of scientific management systems."

To this end, the government has gradually promulgated a series of laws and regulations since the late 1970s, including the Company Law, several laws and regulations governing foreign-invested enterprises (FIEs), the Wholly Individual-owned Enterprise Law, the Partnership Enterprise Law, and others, for the purpose of creating a variety of forms of business organization to promote the development of the socialist market economy in accordance with international standards with the aim of facilitating China's integration into the global economy. Under these laws and regulations, business organizations may be constituted and operated as sole proprietorships, partnerships, private limited liability companies, or joint stock companies.

Since the reform, business organizations are less restricted by their respective forms and increasingly subject to modern corporate standards including independence in the ownership of their assets and in the assumption of the risks and rewards of their activities, and protection for the rights of shareholders and creditors. The modern enterprise system encourages business organizations to pursue and maximize their economic returns by improving productivity and reducing costs, a vision that conforms to the political and economic requirements for establishing a market economy in China, the nominally 'socialist' nature of which has faded over time.

1.2. Legal framework

As stated above, under the planned economy, business organizations generally included State-owned (owned by the whole people), collectively-owned (owned by smaller groups such as all members of a village), privately-owned and individually-owned enterprises.

The reformed normative framework governing business organizations included:

- the Law of Industrial Enterprises Owned by the Whole People[1] which governs SOEs (the SOE Law);
- the Rural Collectively-owned Enterprise Regulations;[2]
- the Urban Collectively-owned Enterprise (COE) Regulations;[3]
- the Urban and Rural Individual Industrial and Commercial Households (IICHs) Provisional Regulations;[4]
- the Rural Land Contract Operations (RLCOs) Law,[5] which governs rural land contract operation households; and
- the Township and Village Enterprise Law.[6]

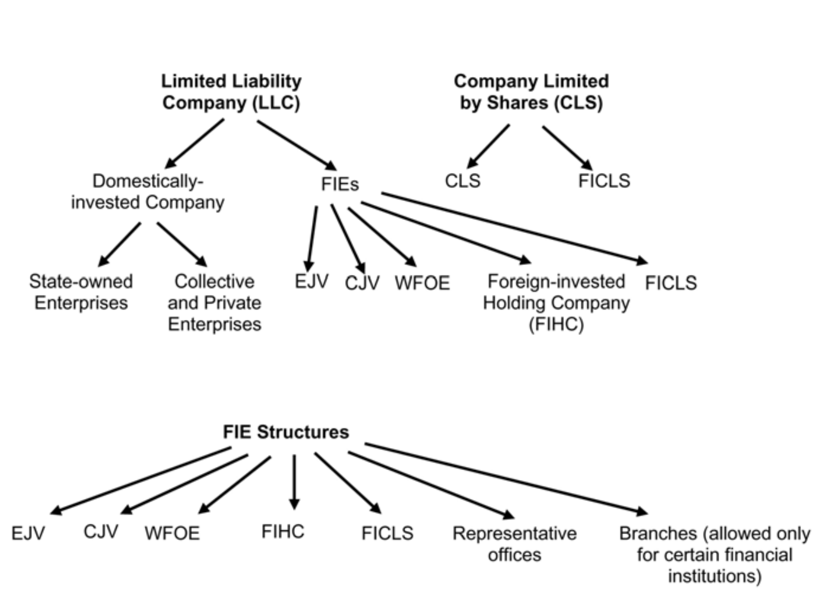
To establish a modern enterprise system to facilitate the transformation from the planned economy to a market economy, the government has since promulgated the following important laws and regulations to oversee the creation and operation of modern business organizations:

- the Company Law that was originally adopted on December 29, 1993 with effect on July 1, 1994 governs all types of limited liability companies, wholly State-owned SOEs and companies limited by shares (except for certain special industries); it was substantially amended on October 27, 2005 with effect from January 1, 2006 (the Company Law of 2005);[7]
- the Partnership Enterprise Law[8] which governs partnership enterprises;
- the Wholly Individual-owned Enterprise Law,[9] which governs wholly individually-owned enterprises; and
- the Sino-foreign Equity Joint Venture Law,[10] Sino-foreign Cooperative Joint Venture Law,[11] Wholly Foreign-owned Enterprise Law[12] and the Regulations on Foreign-Invested Holding Companies,[13] which govern foreign-invested holding companies.

Most recently, a consortium of ministries adopted the Provisional Measures on the Administration of Venture Capital Enterprises.[14]

We discuss these laws and regulations and the business organizations to which they apply in greater detail later in this chapter. It should be stressed, however, that China is still in a transitional period during which business organizations under the planned economy system and the new market system continue to co-exist, although the general trend is in favour of the market and the recognition of private equity interests. The State plan now serves mainly to guide rather than to command. The theoretically distinctive features of a socialist market economy with Chinese characteristics appear to be rooted in these transitional features of the transformation toward a market economy, coupled with continuing State control of key industries and Communist Party control of labour organizations.

Legal Structures under the Company Law and FIE Laws and Regulations



2. Business organizations prior to the reform

2.1. State-owned enterprises (SOEs)

China law does not have a precise definition of SOE, although it generally refers to enterprises funded, established and owned by a government or government-authorized investment institutions or departments. An SOE may be referred to as an "enterprise owned by the whole people" (quanmin suoyouzhi qiye) which is a defined term under the SOE Law. Article 2 of the SOE Law defines an enterprise owned by the whole people as "a socialist commodity production and operation unit established in accordance with law which conducts business operations independently, enjoys profits and assumes losses independently and maintains independent books." All the assets of an SOE belong to the whole people, but the State may authorize an SOE to operate and manage such assets in accordance with the principle of "separation of ownership rights and operating rights" (suoyouquan he jingyingquan fengli). Upon authorization by the State, an SOE may have the right to possess, use and/or dispose of assets, which the SOE is authorized to operate.

The SOE Law retains strong elements of the planned economy. For example, article 3 provides that the fundamental tasks of an SOE are to improve commodity production, and to create and accumulate value in accordance with the State plan as well as market conditions. Article 23 further provides that an SOE may independently produce commodities and provide services needed by society while respecting and following the instructions of the State plan. The first priority for SOEs is still to follow the State's instructions to fulfil the needs of a planned economy.

Article 7 provides that the factory director (changzhang) is designated to be responsible for an SOE's management and operations. Factory directors have customarily been appointed and removed by the competent government authorities more on the basis of political criteria (the nomenklatura in Soviet parlance) than competence. Moreover, the SOE Law does not provide for a board of directors, board of supervisors or shareholders' meeting, which are essential elements for governance of a modern enterprise. However, as economic reforms have been implemented, an increasing number of SOEs have acquired such features of a modern enterprise and in many instances State ownership has been diluted without negating fundamental State control.

The SOE law requires that SOEs must be registered with the competent company registration authority, the State Administration for Industry and Commerce (SAIC) or local administration for industry and commence (AIC), before they begin to conduct business.

From the above provisions of the SOE Law, we can see that traditional SOEs have the following basic features.

An SOE does not have full ownership of its assets but instead has only a usufructuary right to manage, operate and dispose of such assets upon authorization by the State.

The management of an SOE is neither independent nor composed of experienced professional managers, rather, the government retains the right to appoint and remove management on the basis of loyalty and political performance. Senior management of SOEs often comes from relevant government departments and consists generally of quasi-government officials.

The objective of SOEs is not to maximize profit but rather to fulfil the State plan and to follow the State's instructions.

As such, SOEs generally serve as arms of the government to attain the goals of the planned economy, and the government's administrative functions are intertwined with the operations of SOEs in almost all respects.

Since 1992, China has been progressively restructuring SOEs into limited liability companies (LLCs) and companies limited by shares (CLSs). The reform began with the promulgation of the Share System Experimental Enterprise Procedures, the Opinion Concerning Standardization of a Company Limited by Shares and the Opinion on Standards for Limited Liability Companies.[15] The goal of the reform is to create a "Modern Enterprise System" (xiandai qiye zhidu) in China. These pioneer regulations and rules enabled the government to accumulate essential experience with respect to reform of traditional SOEs and paved the way for enactment of the Company Law in 1993. The enactment of the Company Law was a milestone that greatly facilitated the reform process by recognizing SOEs' independent property rights with respect to their assets, creating a comprehensive corporate governance system and separating the government's administrative functions from the ordinary business operations of SOEs.

2.2. Collectively-owned enterprises (COEs)

SOEs and COEs were the two most important types of business organizations in China under the planned economy. Unlike SOEs, which are nominally owned by the whole people, COEs are nominally owned by smaller groups, such as all people in a village, township or larger county or municipal jurisdiction. Because both SOEs and COEs are owned by the people, not by particular individuals, they are together referred to as publicly owned enterprises (gongyouzhi qiye).

2.2.1. Urban COEs

Article 4 of the Urban COE Regulations defines urban COEs as "socialist economic organizations collectively owned by working people in which people work together and receive economic interests in accordance with their work performance," i.e., "to each according to his labour." Article 4 further provides that enterprises "collectively owned by working people" include the following three situations:

- those collectively owned by all working people in an enterprise;
- those collectively owned by all working people of an economic unit with which a COE is associated (e.g., municipality or other territorial jurisdiction) and
- those owned by two or more COEs.

Collective ownership must amount to 50% or more for an enterprise to qualify as a COE. The Urban COE Regulations apply to all urban COEs regardless of industry or organizational form.[16] The fundamental tasks and basic purposes of urban COEs are the same as those of SOEs, i.e., to improve commodity production, expand commodity operations and provide services to society to accumulate assets in accordance with the State plan and the needs of the market and society.

To establish an urban COE, the approval of the competent government authority must be obtained, and the COE must then be registered with the competent company registration authority. The person designated as factory director is the head of an urban COE and is responsible for its daily management and operation. In contrast to the rules governing SOEs, the Urban COE Regulations provide that the employee representatives' meeting is the highest authority and has the right to appoint or dismiss the factory director or equivalent and decide on all important matters of the COE. By contrast, factory directors in SOEs are directly appointed by the government. Thus, urban COEs and their workers enjoy somewhat more autonomy than SOEs with respect to management, although in practice the enterprise Party Committee exercises leadership.

2.2.2. Rural COEs

Rural COEs are similar to urban COEs in terms of their establishment procedures, organizational structure and management processes, among other features. The major difference lies in ownership.

Article 2 defines rural COEs as "enterprises established by peasants and residents of counties, towns and villages in rural areas". Article 18 provides that a rural COE is collectively owned by all peasants or villagers of a county or village that sponsors the establishment of such COE. Article 19 further provides that the peasant representatives' meeting is the highest authority of the enterprise with the right to appoint and dismiss the factory director or equivalent and decide all important matters of the enterprise, although here as well the enterprise Party Committee exercises leadership.

2.3. Individual industrial and commercial households (IICHs)

Different from SOEs and COEs which are components of the public ownership system (gongyouzhi), IICHs constitute the earliest rudiments of privately owned enterprises. Unlike SOEs and COEs, which are encouraged and supported by the government, IICHs are deemed a by-product which can exist and operate only within the scope and to the extent permitted by government.

The IICH Regulations generally define IICHs as "individual operators who use individual or family assets as working capital to conduct non-agricultural operating activities within their approved scope of business after completion of registration with the enterprise registration authority."[17] IICHs have the following features:

- the working capital of an IICH comes from individual or family assets;
- the owner and operator of an IICH are not separate parties and the owner of an IICH assumes unlimited liability for the debts of an IICH through his assets or the assets of his family;
- an IICH may be composed of an individual or a family and is operated in the name of a household;
- an IICH may engage in such activities as production, sale, transportation, food services, repair and other industrial and commercial activities, provided that the scope of activities is first approved by the government;
- an IICH may conduct business only after due registration with the government authority; and
- the maximum number of employees of an IICH is seven and, if the number of employees is more than seven, the business must be registered as another form of business organization.

The IICH Regulations do not distinguish between rural IICHs and urban IICHs and thus rural IICHs are subject to the same requirements and conditions as urban IICHs.

2.4. Rural land contract operation households (RLCOHs)

The rights and obligations of RLCOHs are stipulated in the RLCOH Law and the General Principles of Civil Law,[18] which provides for "members of a rural collective economic organization to conduct operations through contract."

Article 1 provides that the legislative purpose of the RLCOH Law is "to stabilize and improve the two-level operating system on the basis of contractual arrangements with families, to grant peasants long-term land use rights and to protect the lawful rights of peasants." The State implements a "rural land contract operation system" (nongcun tudi chengbao jingyingzhi) under which members of rural collective economic organizations have the rights to use and operate the land offered by the collective economic organization through contractual arrangements.[19] The land must generally be used for agricultural purposes.

RLCOHs generally refer to families in rural areas that obtain rights to use land for production in accordance with applicable contractual arrangements with competent village, township and county governments. Through such contractual arrangements, RLCOHs' rights to use the land are protected and RLCOHs can operate the land on an independent basis and independently enjoy profits and assume losses derived from the land. The RLCOH system constituted a significant reform of China's traditional agricultural industry and greatly promoted the development of the rural economy by recognizing peasants' independent land-use rights and the rights to receive profits from the land that they operate. RLCOHs do not, however, have the right to transfer land and hence do not have the right to monetize the value of the land. Transfers of land by village governments for less than full value and without the consent of RLCOHs, often followed by transfers at higher value to the benefit of officials and insiders, are a major source of discontent in rural areas.

2.5. Township and Village Enterprises (TVEs)

The TVE is a unique type of enterprise which can be either collectively owned or privately owned.

Article 2 of the Township and Village Enterprise Law defines TVEs as all types of enterprises established in towns and villages by either rural collective economic organizations or peasants or farmers, the purpose of which is to support agricultural production obligations. Article 10 further clarifies that the ownership of a TVE can be either “collectively owned” if the enterprise is established by an urban collective economic organization or “privately owned” if established by an individual peasant or farmer or by a partnership composed of several peasants or farmers.

Regardless of ownership, TVEs still have a substantial planned-economy element because they are established for the purpose of supporting fulfilment of agricultural production obligations, including related industries, albeit at the micro level, rather than realizing and maximizing profits of the individual enterprise.

TVEs are required to be registered with the relevant registration authority at the town or village level.

3. Business organizations since the reform

The Company Law provides for two basic forms of business organizations: limited liability companies (LLCs) and companies limited by shares (essentially joint stock companies, CLSs). A Wholly State-owned Company is a special form of LLC.

3.1. Business associations under the Company Law

3.1.1. Limited liability companies (LLCs)

An LLC refers to a company in which the liability of shareholders to creditors of the company is limited to the contributions by the shareholders to the registered capital of the company. In other words, shareholders of an LLC only assume limited liability with respect to the company's debts and the company is responsible for its debts with its own assets. The ceiling on the number of shareholders of an LLC is 50.[20]

3.1.2. Companies limited by shares or joint stock companies (CLSs)

A CLS refers to a company in which total capital is divided into shares of equal value, i.e., a single class of common stock, and its shareholders are liable for the company's debts to the extent of their respective shares. A CLS also enjoys limited liability, but the number of shareholders is not subject to a ceiling such as that applicable to an LLC. A company must first be established or reorganized as a CLS before it can list shares on a domestic or overseas stock exchange.[21]

3.1.3. Wholly State-owned Companies (WSOCs)

One important legislative purpose of the Company Law is to facilitate reform of traditional SOEs by reorganizing them into companies in accordance with standards and conditions provided in the Company Law. The Company Law thus created a special form of company, the WSOC, to meet such need. A WSOC is defined in article 64 of the Company Law as "a limited liability company invested and established solely by investment institutions or departments authorized by government".

Unlike LLCs for which the establishment required at least two shareholders until the Company Law of 2005 took effect on January 1, 2006, a WSOC has only one shareholder, a government-authorized investment institution or department. In practice, the State-owned Assets Supervision and Administration Commission (SASAC) or its local counterpart, rather than a functional government department, now usually serves as the sole owner of WSOCs following SASAC's establishment in 2003 under the State Council Institution Reform Plan,[22] which was intended to divest State ownership of non-critical SOEs and partial State ownership of others as part of an effort to make all SOEs more commercially oriented and self-supporting. WSOCs do not have a shareholders' meeting and government-authorized investment institutions or departments delegate most management authority to the WSOC's board of directors (except for the authority to approve mergers, divisions, dissolution, increases and decreases of capital and issues of debentures, which is retained by government-authorized investment institutions or departments). Decision-making power with respect to the appointment and removal of senior management also typically remains with the government-authorized bodies.

The Company Law provides unique rules with respect to the composition of the board of directors and transfer of assets in a WSOC.

In summary, the WSOC is a business organization with Chinese characteristics, the creation of which is tailored to the task of restructuring SOEs into modern enterprises to meet the requirements of transforming the planned economy into a market economy.

3.1.4. LLCs governed by specific laws and regulations

The Company Law sets out general conditions, requirements and procedures governing the establishment, management and operation of LLCs in China. However, LLCs engaged in certain industries may also be subject to specific regulation.

3.1.4.1. Commercial banks

The commercial banking industry is a special industry subject to the supervision and regulation of China's bank regulatory authority, and therefore the establishment and operation of commercial banks in China is governed by industry-specific laws and regulations in addition to the Company Law. The People's Bank of China (PBOC), China's central bank, exercises authority over monetary policy under the State Council. However, after its establishment on April 23, 2003, the China Banking Regulatory Commission (CBRC) assumed most supervisory roles from the PBOC including, "the regulation and supervision of banks, asset management companies, trust and investment companies as well as other deposit-taking financial institutions."

In addition to the Company Law, the establishment and operation of commercial banks in China must also comply with the Commercial Bank Law[23] and relevant regulations. Article 2 of the Commercial Bank Law defines commercial banks as enterprise legal persons established in accordance with such Law and the Company Law and that are permitted to conduct such businesses as taking public deposits, granting loans and settling debts. Article 13 provides that the minimum registered capital requirements for national, city and rural commercial banks are RMB 1 billion, RMB 100 million and RMB 50 million, respectively. Articles 12, 14 and 15 set out detailed conditions and procedures for the establishment of commercial banks in China. Article 16 requires CBRC approval before a commercial bank can be registered at the company registration authority. Article 39 requires commercial banks to maintain a sufficient capital adequacy ratio. These requirements, as well as regulatory requirements for other financial institutions such as financial leasing companies, urban credit cooperatives and rural credit cooperatives, are covered in the relevant regulations.

3.1.4.2. Securities companies

Articles 117 and 118 of the Securities Law[24] define securities companies as LLCs or CLSs duly established in accordance with the Company Law and approved by the State Council's securities regulatory authority, i.e., the China Securities Regulatory Commission (CSRC), to engage in the securities business in China. Thus, companies engaged in securities businesses are subject not only to the Company Law, but also to CSRC requirements.

There are two categories of securities companies under the Securities Law:

- securities companies engaging in comprehensive business (zonghelei zhengquan gongsi); and
- securities companies engaging in broker-dealer business (jingjilei zhengquan gongsi).

The minimum registered capital for establishment of a securities company engaging in comprehensive business and a securities company engaging in broker-dealer business are RMB 500 million and RMB 50 million, respectively.

A securities company engaging in comprehensive business may conduct the following business activities:

- securities brokerage business;
- securities business for its own account;
- securities underwriting business; and
- other securities business approved by the CSRC.

A securities company engaging in broker-dealer business may only conduct securities brokerage business.

The establishment of a securities company must obtain approval from the CSRC before registration with the SAIC or competent AIC.

3.1.4.3. Securities investment fund management companies

The CSRC on October 1, 2004 promulgated the Regulations on Securities Investment Fund Management Companies. Securities investment fund management companies are defined as LLCs approved by the State Council's securities regulatory authority to manage securities investment funds. Thus, fund management companies must first be "companies" satisfying relevant conditions under the Company Law and then obtain approval from the CSRC as the industry regulator to conduct fund management business in China.

These regulations set out requirements relating to the establishment of fund management companies, and the procedural and documentary requirements with respect to applications to the CSRC for approval to conduct fund management business. They also include requirements for applications to the CSRC for the establishment of foreign-invested fund management companies. The regulations provide that a shareholder may not have a controlling interest in more than two fund management companies. The shareholding structure of a fund management company must satisfy CSRC requirements and shareholders of fund management companies must have relevant prior experience in fund management.

3.1.4.4. Insurance companies

The establishment, management and operation of insurance companies are subject to the Regulations Concerning the Administration of Insurance Companies (the Insurance Company Regulations) promulgated on May 13, 2004 by the China Insurance Regulatory Commission (CIRC), China's insurance regulatory authority.

Under the Insurance Company Regulations, "insurance companies" are defined as commercial insurance companies established upon approval by the insurance regulatory authority and registered in accordance with law.[25] The Insurance Company Regulations apply not only to domestic insurance companies but also foreign-invested insurance companies and to both primary insurers and reinsurers. To establish an insurance company, certain criteria and procedures must be followed. The minimum registered capital for an insurance company is RMB 200 million and the competent management personnel of the company must satisfy the qualification requirements imposed by the CIRC. To open a branch, an insurance company must satisfy the solvency requirements of the CIRC, have a sound internal control system and have a clean regulatory record.[26]

Under the Insurance Company Regulations, a property insurance company may engage in such insurance businesses as property and casualty insurance, liability insurance, credit insurance and bond insurance, agricultural insurance, other property insurance, short-term health insurance and accidental injury insurance, and reinsurance of the above insurance businesses.[27] A life insurance company may engage in such insurance businesses as accidental injury insurance, health insurance, traditional life insurance, new life insurance products, traditional annuity insurance, new annuity insurance products, other personal insurance businesses and reinsurance of the above insurance businesses.[28]

3.2. Partnerships

China also permits the establishment of business organizations in the form of partnerships in which investors, more recently confined to general partners, assume unlimited liability for the debts of such organizations.

3.2.1. Partnership Enterprise Law

The Partnership Enterprise Law governs the establishment and operation of partnership enterprises in China. The Partnership Enterprise Law was originally enacted in 1997 and was amended in August 2006.

A partnership is defined under article 2 of the amended Partnership Enterprise Law as "a general partnership or limited partnership established in China by individuals, legal persons or other organizations in accordance with this Law". Article 2 further defines "general partnership" as "a partnership formed by general partners who assume risks and bear unlimited liability for the debts of the partnership", and "limited partnership" as "a partnership formed by general partner(s) and limited partner(s) where general partners assume unlimited liability and limited partners assume limited liability to the extent of their respective capital contributions to the partnership." Compared to its 1997 edition, the amended Partnership Enterprise Law expressly allows the establishment of limited partnerships. Because a limited partnership is the most common legal structure used by venture capital and private equity investment funds, this change constitutes substantial progress and paves the way for the expansion of venture capital, private equity management and real estate investment trusts as investment vehicles in China. Income tax is imposed on partners on a pass-through basis.

A partnership enterprise must have at least two partners. A limited partnership enterprise must have no more than fifty partners including at least one general partner.

General partners assume unlimited liability while limited partners assume limited liability to the extent of their respective capital contributions.

Unless the partnership agreement otherwise provides, all partners in a partnership enjoy the same rights and obligations.

For general partnership enterprises, all partnership decisions on important matters are subject to unanimous approval of all partners. With respect to limited partnership enterprises, limited partners usually do not have the right to represent the partnership enterprise or conduct business for the partnership enterprise.

Unless the partnership agreement otherwise provides, limited partners in limited partnership enterprises may engage in businesses which compete with the limited partnership enterprise.

A limited partnership enterprise may be converted to a general partnership enterprise if all limited partners in such enterprise leave the enterprise or convert to general partners.

3.2.2. Applicability of the Partnership Enterprise Law

Because the 1997 version of the Partnership Enterprise Law only provided that investors of a partnership shall assume "unlimited liability" and did not allow limited liability partnerships, partnerships organized under the 1997 version of the Law in practice were only used in such professional service entities as law firms and accounting firms, as well as in close knit family businesses.

Since the late 1990s, the government has encouraged the establishment of domestic and foreign venture capital investment funds to invest in China's high-technology industries. Having realized the shortcomings of the 1997 edition of the Partnership Enterprise Law, the central government decided to amend the Law to provide for limited partnerships to develop venture capital and private equity financing with particular benefit to China's high-tech and life sciences industries. In addition to the legislation at the central level, different localities also adopted their own local regulations to allow for limited liability partnerships (LLPs). For example, the Beijing Municipal Government promulgated the Zhongguancun Park Measures on the Administration of Limited Liability Partnerships on February 21, 2001. These Measures became one of the most important sets of local regulations allowing LLP venture capital funds. They provide that an LLP must have at least one general partner and one limited partner, with general partner(s) assuming unlimited liability and limited partner(s) assuming limited liability to the extent of their respective capital contributions. Limited partners may transfer their interests in the partnership upon the approval of partners constituting 2/3 or more of the entire equity of the fund, including that of all the general partners. Management of the limited partnership consists only of general partners, and limited partners are generally not permitted to participate in management (limited partners who actually participate in management will be deemed "general partners" for liability purposes). Partners in a limited partnership fund pay tax directly as the limited partnership is deemed a "pass-through" or fiscally transparent entity for tax purposes.

3.3. Wholly individual-owned enterprises (WIOEs)

The WIOEs discussed here differ from the one-person limited liability company (OPLLC) included in the Company Law as amended in 2005, discussed below in Section 7.1. The major differences between the two are that:

- the former refers to enterprises established in accordance with the Wholly Individual-owned Enterprise Law and the latter refers to companies established in accordance with the Company Law;
- although both are invested in and owned by a single investor, the investor in the former assumes unlimited liability with respect to the debts of the enterprise while the investor in the latter assumes only limited liability for the debts of the company to the extent of his/its capital contributions; and
- the investor in the former can only be a natural person while the investor in the latter may be either a natural person or an enterprise legal person.

3.3.1. Wholly Individual-owned Enterprise Law

Article 2 of the Wholly Individual-owned Enterprise Law defines a WIOE as "a business organization established in China in accordance with this Law, funded by a natural person and all assets of which are owned by the investor for which the natural person assumes unlimited liability."

The concept of "registered capital" is absent from the Wholly Individual-owned Enterprise Law because the natural person investor assumes unlimited liability for the debts of the enterprise, i.e., it is an extension of the investor.

Article 8 requires that the establishment of a WIOE satisfy the following conditions:

- the investor is a natural person;
- it has a legitimate enterprise name;
- it is funded by an investment from the investor;
- it has a fixed place of business and necessary operating and production conditions; and
- it has sufficient employees.

To establish a WIOE, an application must be submitted to the SAIC or the competent AIC. Once approved, a business licence will be issued and the enterprise will be established on the date of issuance.

3.3.2. Distinctions between WIOEs and IICHs

Although both WIOEs and IICHs are appropriate business organizations for small and close-knit family businesses, they are governed by different laws and manifest significant differences.

WIOEs take the formal legal form of an "enterprise", while IICHs are not deemed to be formal enterprises.

The investor in a WIOE must be a natural person while the investor in an IICH can be a natural person or several family members.

The investor in a WIOE is liable for the debts of the enterprise to the full extent of all of his personal assets, while in an IICH the assets available for the debts of the IICH may extend to those of other family members if they also engage in the IICH business.

Employment in an IICH is capped at seven while there is no limit on the number of employees in a WIOE.

The WIOE is commonly used as a business vehicle by small private business persons. In fact, after the promulgation of the WIOE Law, a significant number of IICHs were converted into WIOEs, in part to expand their business by increasing the number of employees. However, because the investor bears unlimited liability, the WIOE is not suitable for medium- or large-sized businesses and presents financial risks even for small businesses.

4. Enactment of the Company Law

4.1. Basic legal terminology

To understand business organizations under Chinese law, familiarity with fundamental legal terms with respect to business organizations in China is essential.

4.1.1. Enterprises and companies

In Chinese legislation, the term "enterprise" (qiye) has a much broader meaning than the term "company" (gongsi). "Company" generally refers to business organizations established in accordance with the Company Law, including LLCs and CLSs and WSOCs. "Enterprise" includes not only companies but also other forms of economic undertakings such as partnership enterprises, WIOEs, SOEs, COEs and FIEs (including EJVs, CJVs, WFOEs and FIHCs).

Enterprises are profit-oriented economic organizations established to engage in business activities, unlike organizations which are not intended to carry on business or generate profits. For example, government and private charity funds and social welfare funds are not enterprises or companies because they are not intended to engage in business activities, although they may make certain investments for investment purposes. In practice, however, some entities that wish to operate on a non-profit basis are established as enterprises because of political barriers to the approval of non-profit entities and the reluctance of tax authorities to grant tax-exempt status.

Representative offices are not considered to be enterprises. Under Chinese law, a representative office of an enterprise may only conduct liaison activities for its parent and may not engage in concrete business activities, e.g., it may not execute contracts in its own name, place orders, or receive payments from customers. However, the tax authorities often seek to impose enterprise income tax on representative offices even though they are prohibited from doing business.[29]

Enterprises must be registered with the SAIC or the competent AIC. To carry on business, they are required to obtain business licences with specific scopes of business. To maintain their existence, they must pass annual inspections and audits under the auspices of the SAIC or competent AIC and other competent government authorities. To dissolve, they must complete a voluntary or involuntary dissolution process and settle debts with their creditors prior to dissolution.

With a few exceptions (such as partnerships, which may be deemed as "pass-through" entities for tax purposes, and IICHs in which individuals are liable for taxes), the entity itself is generally subject to enterprise income tax.

"Enterprises" and "companies" differ in the following respects.

A company is organized under the Company Law whereas other forms of enterprise are governed by special laws.

A company always enjoys legal personality, it owns its assets and assumes civil liability. By contrast, not all enterprises necessarily have legal personality. For example, partnerships and some CJVs are usually not deemed to be legal persons. Thus, companies obtain "Legal Person Business Licences (faren yingye zhizhao)" whereas enterprises without legal personality are issued "Business Licences (yingye zhizhao)".

Even in its earliest versions, the Company Law contained more comprehensive and sophisticated provisions concerning corporate governance, management structure, shareholder rights and obligations, self-dealing and disclosure than those required for other types of enterprises. Under Chinese law, the company is a modern business vehicle modelled on international standards.

4.1.2. Legal personality

Legal personality is an essential feature of the company. Legal person refers to an entity or organization that enjoys civil rights, assumes civil obligations and conducts civil acts. Article 37 of the General Principles of Civil Law[30] provides that a legal person must satisfy the following requirements:

- its establishment must comply with the law;
- it must possess necessary assets or funds;
- it must possess its own name, organization and premises; and
- it must have the capacity to bear civil liability independently.

Legal personality is intertwined with the doctrine of limited liability. Legal persons are entities with limited liability because their legal personality endows them with an independent right to their assets separate from those of their investors. Once an investor contributes certain assets to a legal person, such assets constitute assets of the legal person and the investor may not later claim title thereto but will instead have a right to a share of profits distributed by the legal person as dividends, as well as a pro rata right to its residual assets. Thus, legal personality, together with the limited liability doctrine, enables individuals and entities to invest their assets and energies without risking their uninvested and uncommitted assets, a concept that has played a central role in the rise of capitalism.

A legal person's domicile is the place where it is registered, which should in principle be where its principal business office is located. In practice, tax and investment preferences, among other factors, may result in a spatial separation between domicile or legal address and principal place of business. A legal person's civil capacity begins when it is established and ends when its existence is terminated. All companies, but not all enterprises, are registered as legal persons. Companies established in accordance with the Company Law and EJVs, CJVs, WFOEs and FIHCs established in accordance with FIE laws and regulations usually enjoy legal person status, although some CJVs may not.

4.1.3. Legal representatives

Legal representative (fading daibiaoren) in contrast to legal person (faren) refers to the responsible person of a legal person (whether a company or an enterprise) who acts on behalf of such legal person in exercising powers and performing functions. Legal persons are entities (fictions) whereas their legal representatives are actually individuals. Because the legal representative has the authority to represent a legal person in dealing with third parties, any civil liability or other consequences arising from such representation will ultimately be borne by the legal person. In this regard, the relationship between legal representative and legal person resembles that between agent and principal. The functions and powers of the legal representative of a legal person are usually defined by law and by the articles of association of the legal person.

Normally, the legal representative of a company is the chairman of its board of directors. Under the Company Law of 2005, legal representatives need no longer be the chairman, and now the managing director (if there is no board of directors) or general manager may also serve as legal representative. This change does not apply to FIEs, however. Because the legal representative bears great responsibility, Chinese law generally requires that individuals who serve as legal representatives be honest and reputable persons with no record of misbehaviour. The selection of the legal representative and the specification of his or her authority to bind the company or enterprise are critical decisions.

An enterprise legal person usually has three official "chops" (stamps or seals) which are used in its daily operations, including the legal person chop (faren zhang), the financial chop (caiwu zhang) and the contract chop (hetong zhang). The legal person chop is the most important of the three and usually remains in the custody of the legal representative. Endorsement of a contract with the contract chop constitutes execution thereof. The legal representative's signature is usually recorded on the bank specimen card of a company and such card is used by the bank to examine the authenticity of signatures on company cheques before the bank begins to process a banking transaction.

4.1.4. Scope of business

China applies a strong *ultra vires* rule that limits a company's business activities to those which have been approved by and registered with the government. The Contract Law, among other laws and regulations, provides that a contract may be held void if a party has acted beyond its scope of business.

The Company Law provides that a company must specify its scope of business in its articles of association and register it with the competent company registration authority.[31] In sectors subject to State control, approval of a company's scope of business by the competent authorities is a prerequisite to its registration. Once approved and registered, a company must conduct its activities within its registered scope of business unless it is modified by amending the company's articles of association and business licence.

In addition to the general rule requiring registration or approval of a company's scope of business, the SAIC has issued specific rules to standardize the wording of scopes of business. In other words, a company only has limited latitude with respect to the detailed description of its business activities. For example, some localities have specific rules which require that the description of a company's scope of business shall not exceed 46 Chinese characters. Companies, based on the nature of their business activities, are usually classified as manufacturing entities, service entities or investment entities and a set of standardized wording applies to the scope of business of each type of enterprise. For example, the scope of business for a manufacturing enterprise usually reads "manufacture and sale of XYZ products and provision of after-sale services..." or the scope of business for a trading company established inside a free trade (bonded) zone in China usually reads "engage in international trade and transit trade, trade inside the zone and between zones and trade with companies outside the zone through import and export agent…".

The purpose of standardizing the wording of the scope of business is to facilitate government supervision and regulation of different types of enterprises; and to clarify which types of activities lie within the scope of approved businesses. It may, however, be possible to include different activities within a scope of business, e.g., manufacturing and services, which are subject to different turnover taxes.

In practice, Beijing and Shenzhen in particular have authorized less restrictive wording under Certain Opinions of Beijing Municipality Concerning Reform of the Market Entry System and Optimization of Economic Development Environment,[32] and Certain Opinions of Guangdong Province Concerning Enterprise Registration Reform.[33] Such terminology authorizes the company to engage in any activity subject to the provisions of required approvals, and thus constitutes a form of advance regulatory clearance.

4.2. Principal corporate forms

4.2.1. Limited liability companies (LLCs) and companies limited by shares (CLSs)

Both an LLC and a CLS are companies with legal person status which have independent rights with respect to their assets and are liable for their debts to the extent of their assets. An LLC refers to a company in which the liability of shareholders is limited to their capital contributions to the company and the company itself is responsible for its liabilities with all of its assets.[34] In the past, LLCs comprised two to 50 shareholders and one-person companies were not allowed, except for WSOCs and WFOEs. Under the Company Law of 2005, one-person limited liability companies are permitted subject to certain restrictions, especially registered capital requirements that are higher than for limited liability companies with multiple shareholders, and limitations on reinvestment. A CLS refers to a company whose total capital is divided into shares of equal value and whose shareholders are liable for the company's debts to the extent of the payments for their respective subscribed shares and the company is responsible for its debts with its own assets.

4.2.2. Applicability of the Company Law to foreign direct investment

Prior to the original enactment of the Company Law in 1993, there were three laws and relevant implementing regulations with respect to the establishment, operation and management of FIEs: the EJV Law, CJV Law and WFOE Law, which collectively allow foreign investors to establish joint ventures or WFOEs in the form of a limited liability company.

By virtue of Article 18, the Company Law governs LLCs with foreign investment. Where the laws with respect to EJVs, CJVs and WFOEs contain provisions different from those of the Company Law, the former prevail[35] in accordance with the general principle of "special law prevails" set out in Article 83 of the Legislation Law.[36] Matters that are not expressly covered under the laws with respect to EJVs, CJVs and WFOEs will be governed by the Company Law because the Company Law as a law of general application prevails in the absence of variant provisions in special laws concerning EJVs, CJVs and WFOEs.

Comparison of Principal Company Structures

Type / Issue	LLC	CLS	One Person Limited Liability Company (OPLLC)	Wholly State-Owned Company (WSOC)	EJV	CJV	WFOE
Minimum registered capital	RMB30,000	RMB5 million (RMB30 million for IPO)	RMB100,000	RMB30,000	• Varies by industry, in no event less than RMB30,000 • foreign investor must hold no less than 25% ownership	• Varies by industry, but in no event less than RMB30,000 • foreign investor must hold no less than 25% ownership	• Varies by industry, but in no event less than RMB30,000 • foreign investor holds 100% ownership
Number of shareholders	1-50	2–200 promoters for establishment (unlimited number of shareholders upon listing)	N/A	1	at least 2 investors (one Chinese and one foreign)	at least 2 investors (one Chinese and one foreign)	1 or more foreign investors
Board of directors	3–13; 1 managing director permissible in lieu of board of directors for small LLCs	5–19	N/A	3-13	no less than 3; 1 managing director permissible in lieu of board of directors for small EJVs	no less than 3; 1 managing director permissible in lieu of board of directors for small CJVs	no less than 3; 1 managing director permissible in lieu of board of directors for small WFOEs
Board of supervisors	at least 3 members; for smaller LLCs, 1-2 supervisors permissible in lieu of board	at least 3 members	N/A	at least 5 members	at lease 3 members, 1-2 supervisors permissible in lieu of board for small EJVs	at lease 3 members, 1-2 supervisors permissible in lieu of board for small CJVs	at lease 3 members, 1-2 supervisors permissible in lieu of board for small WFOEs
Approval authority	N/A	Provincial government (CSRC and Shanghai or Shenzhen Stock Exchanges for listing)	N/A	SASAC or its local office	MOFCOM or its local office	MOFCOM or its local office	MOFCOM or its local office
Registration	competent AIC						
Registration fees	• 0.08% to 0.1% of capital up to RMB 10 million • 0.04% to 0.05% of the excess up to RMB 100 million	• 0.08% to 0.1% of capital up to RMB 10 million • 0.04% to 0.05% of the excess up to RMB 100 million	• 0.08% to 0.1% of capital up to RMB 10 million	• 0.08% to 0.1% of capital up to RMB 10 million • 0.04% to 0.05% of the excess up to RMB 100 million		• 0.1% of capital up to RMB 10 million • 0.05% of the excess up to RMB 100 million	
Corporate income tax base rate (from January 1, 2008)	25%						
Legal person status	Legal person	Legal person	Unlimited personal liability (subject to rebuttal)	Legal person	Legal person	Legal person or (in rare cases) non-legal person	Legal person
Term	Not specified in law, usually 10-30 years in practice (renewable)	Not specified in law, 10 years to unlimited in practice	Not specified in law, usually 10-30 years in practice (renewable)	Not specified in law, usually 10-50 years in practice (renewable)	Not specified in law, usually 10-50 years in practice (renewable)	Not specified in law, usually 10-50 years in practice (renewable)	Not specified in law, usually 10-50 years in practice (renewable)

5. Overview of the Company Law

Prior to enactment of the Company Law, no unified rules governed the establishment and operation of companies in China, which was regarded as a hindrance to China's opening-up and economic development during the 1980s and early 1990s.

The former State Economic and Trade Commission and other State Council departments began to draft a unified company law in 1983. On May 15, 1992, the former State Commission for Economic Restructuring promulgated the Opinions on Regulating Limited Liability Companies and the Opinions on Regulating Companies Limited by Shares. At the same time, the State Council submitted a draft Law on Limited Liability Companies to the Standing Committee of the NPC for review. However, the NPC decided that instead of formulating a law governing LLCs only, it was opportune to enact a unified law governing all types of companies.

Based on its accumulated experience in the supervision and regulation of different types of business entities over the previous ten years, the Standing Committee of the NPC enacted the Company Law to serve the following legislative purposes:

- to introduce the modern enterprise system into China;
- to facilitate the reform of traditional SOEs by converting them into structures provided under the Company Law in accordance with the principle of "separation of government administrative functions from enterprise operations" (zhengqi fenkai); and
- to attract foreign investment.

The Company Law provided for the two basic corporate forms, LLCs and CLSs. Since the enactment of the Company Law in 1993, 90% or more of all SOEs have been converted into or reorganized as LLCs enabling government to extricate itself from the general operations of the SOEs. The Company Law has thus played an important role in the modernization of the SOE sector.

The Company Law for the first time set down clear and detailed provisions with respect to the relationship between shareholders of a company and the company itself, corporate governance structure, and roles and responsibilities of shareholders' meetings, boards of directors, boards of supervisors and management. The Company Law also provided that, except for particular industries, once conditions required under the Company Law were satisfied, a company may be established by registration with the SAIC or competent AIC, thus eliminating the burdensome requirement of prior approval from the competent government authority and significantly reducing the time and costs for establishment of a business organization.

In short, enactment of the Company Law constituted a significant step towards the development of a market economy in China.

5.1. Establishment of companies

This section will discuss the relevant establishment procedures for LLCs and CLSs.

5.1.1. LLCs

The LLC is the equivalent in Chinese law of what is elsewhere frequently called the private limited company. The following conditions must be fulfilled in order to establish an LLC:

- the number of shareholders conforms to that specified under law;
- the capital contributions meet the minimum statutory requirement;
- the articles of association have been jointly adopted by the shareholders;
- the company has a name and organizational structure in compliance with regulatory requirements; and
- there are permanent business premises and the necessary conditions for production and operation.[37]

Article 22 of the Company Law requires that an LLC adopt articles of association which include the company's name and address, its scope of business, its registered capital, the names of the founding investor(s), their rights and obligations, the method and the amount of capital contributions, the conditions governing transfers of equity interests in the company, its organizational structure, a designation of its legal representative and procedures for its liquidation and dissolution.

After the contributions of shareholders to the registered capital of an LLC have been made and verified by a qualified capital verification institution, all shareholders must designate a representative or agent to file an application to establish the LLC with the SAIC or competent AIC.[38]

Before the application to establish an LLC is made, shareholders must first conduct a name search at the SAIC or competent AIC to ensure that the proposed name of the LLC is available and, if so, to pre-register it. The pre-registration of an enterprise name is valid for six months.[39]

In addition, for certain activities, the approval of specific government authorities must be obtained before an LLC can apply to the SAIC or the competent AIC.

The SAIC and its local offices will usually complete registration within 30 days after receipt of an application.

An LLC is established on the date on which the business licence is issued by SAIC or the competent AIC.[40] After obtaining its business licence, an LLC is required to complete other registrations with tax and, if applicable, customs and foreign exchange authorities within the next 30 days.

After establishment, an LLC issues capital contribution certificates to its shareholders[41] and prepares a shareholders list containing information on the name, domicile and amount of capital contribution of each shareholder. Shareholders are entitled to inspect the shareholders' meeting records and the financial accounts of the company.[42]

The establishment of a branch of an LLC generally follows the same procedures as those for an LLC.

5.1.2. CLSs

A CLS is essentially a joint stock company in which the entire capital is divided into equal shares and shareholders' liability is limited to payments for their respective subscribed shares.[43] Although the former Company Law did not allow a CLS to issue different classes of shares, the 2005 amendments to the Company Law allowed a CLS to issue different classes of shares subject to the approval of the competent departments of the State Council, which would likely require a regulatory change.

Article 77 of the Company Law imposes the following requirements for the establishment of a CLS:

- the number of promoters satisfies the legal requirements;
- the capital shares subscribed by the promoters or by the public satisfy minimum capital requirements;
- the preparation of the CLS and the issue of its shares satisfy legal requirements;
- the articles of association have been adopted by the shareholders' founding general meeting;
- the company has a name and suitable organizational structure; and
- it has a fixed place of business and necessary production and operating facilities.

In addition to the above requirements, article 78 of the Company Law provides that a CLS must be sponsored by at least two and not more than 200 promoters, at least half of whom must maintain a domicile in Mainland China, i.e., excluding Hong Kong, Macao and Taiwan. Furthermore, more than half of the promoters must be domiciled in Mainland China.

Compared with LLCs, CLSs are much more complicated to establish and involve longer approval and registration times. The establishment of a CLS must first be approved by the government authority at the provincial level or above. A CLS may be established by either the "promotion method" or "public issue" method.[44]

The promotion method requires that all promoters of a CLS subscribe for all shares of a CLS while the public issue method requires that promoters of a CLS subscribe for no less than 35% of the total capital shares of a CLS with the remaining shares to be subscribed by the public. The registration procedure is similar to that for LLCs once approval for establishment is obtained.

Establishment of a CLS through the public issue method is more complex in that it involves approval of the CSRC. To establish a CLS through the public issue method, the promoters have to submit underwriting agreements and other documentation to the CSRC for approval. It usually takes the CSRC at least three months to process an application.

The promoters must convene a founding meeting within 30 days after all shares have been subscribed and the share capital has been verified by a capital verification institution.[45] At the founding meeting, board members are designated and, within 30 days after the founding meeting, the board applies to the SAIC or competent AIC for registration.[46] The SAIC and competent AIC have 30 days to register the CLS. As with LLCs, a CLS is officially established on the date on which the business licence is issued by the SAIC or competent AIC.

5.2. Capital requirements and contributions

5.2.1. Share capital of LLCs

Unlike most advanced industrialized countries in which the concept of "authorized capital" applies to the incorporation of companies, China requires that each company established under the Company Law have "registered capital", which must be fully contributed by the company's investors. The former Company Law provided minimum standards of registered capital for companies engaging in different business activities.[47] However, varying minimum registered capital requirements for companies engaging in different activities has been replaced by a lower unified minimum registered capital requirement of RMB 30,000 for LLCs, with the exception of OPLLCs for which the minimum registered capital is RMB 100,000. Companies that engage in regulated industries, such as telecommunications, real property development and automobile manufacturing as well as financial services, are subject to higher minimum registered capital requirements. Registered capital requirements may also vary by locality.

Under the former Company Law, shareholders of an LLC were required to make their contributions in full to the registered capital of the LLC, verified by an accounting firm, before applying for establishment.[48] However, the Company Law of 2005 amended the definition of "registered capital" from "capital contributions actually made by shareholders of an LLC" to "capital contributions subscribed by shareholders of an LLC"[49] and does not require full contributions by shareholders before the establishment of an LLC.

With respect to capital contributions, both the former Company Law and the most recently amended version allow capital contributions to be made in cash, in kind, or in the form of land use rights or intellectual property rights. Under the former Company Law, capital contributions made in the form of intellectual property rights were capped at 20 per cent of the total registered capital of the company.[50] This restriction was to prevent thin capitalization by limiting contributions of such subjectively valued intangible assets as IP rights. To encourage the development of high-tech enterprises and to demonstrate government recognition of the value of intangible assets such as intellectual property rights, article 27 of the Company Law of 2005 abolished the 20% cap and replaced it with a new requirement that cash contributions be not less than 30% of total registered capital. Licenced rights may not constitute contributions to registered capital. In-kind contributions are generally required to be appraised before they are contributed to the company to ensure that capital contributions to the company are not false or inflated.

Once made, a shareholder's capital contribution may not be withdrawn after formation of the company. Withdrawal of capital contributions without government approval is a violation of the Company Law and other relevant laws and regulations and, if sufficiently grave, may incur criminal liability.

5.2.2. Share capital of CLSs

The Company Law provides that the minimum registered capital of a CLS is RMB 5 million, reduced from the RMB 10 million requirement under the former Company Law. As stated above, a CLS may be established by either the promotion method or the public issue method. When established by the public issue method, a CLS is not allowed to issue shares for less than their nominal value.[51] A CLS does not mean that the company is already publicly listed. By contrast, a publicly listed company must first be organized as a CLS in order to issue shares on public stock exchanges.

The "issue of new shares" and the "issue of shares on stock exchanges" are not the same. The former can be a private placement targeted at specific legal persons or institutional investors while the latter refers to a public offering on a stock exchange. Before the stock reform launched in 2005, which we will discuss in greater detail later, the shares initially subscribed by promoters of a CLS and by legal persons or institutional investors through subsequent private placements constituted "legal person shares" (or "State-owned shares") of a CLS. These shares are not tradeable and do not circulate on stock exchanges while shares subscribed by the general public through a public offering on open stock exchanges are tradeable and circulate on the exchange where they are listed. By the same token, shares acquired by foreign investors in a CLS through private contract are also "legal person" shares and accordingly they may not be traded on stock exchanges. Thus, although the Company Law does not presently allow a CLS to have different classes of shares, legal person shares and shares owned by the public in a CLS essentially constitute two categories of shares, the shareholders of which do not necessarily enjoy the same rights or assume the same liabilities. In the past, legal person shares used to account on average for about 60% to 70% of the total share capital of a CLS while the remainder was held in public hands. Unlike public shares, legal person shares may only be transferred through private agreement but not through trading on open stock exchanges. This restriction greatly reduced their liquidity and therefore their value.

The Company Law requires that a CLS obtain prior approval from the CSRC and comply with relevant security laws and regulations to issue stock on public stock exchanges, including both domestic and overseas exchanges. However, the Company Law deleted the detailed conditions for issuance of new shares and conditions for listing shares provided in the former Company Law[52] that are separately provided in the Securities Law and securities regulations.

Transformation of legal person shares into "circulating" or publicly tradeable shares has been a major concern of policy makers since at least 2000. The government in 2005 finally launched a reform to consolidate legal person shares and public shares in a CLS into one single category of circulating shares.[53] Such consolidation is achieved by conversion of legal person shares (or State-owned shares) into public shares through specially designed compensation programmes approved by the shareholders' meeting in a CLS. Because the legal person shares and State-owned shares only have limited liquidity, their value is normally below that of public shares, which may be tradeable on open stock exchanges. Thus, to convert legal person shares to public shares, the government decided that a premium was due to the holders of public shares to prevent dilution, although investors were arguably aware of such risk. To ensure that relevant stock reform programmes also protect the interests of minority shareholders, the government requires that any such programme must be approved by the shareholders' meeting of a CLS before being implemented. By December 2006, the total value of public companies in China (A share companies) which had already commenced or completed such stock reform (by converting all or a portion of their legal person shares to circulating public shares through compensating holders of public shares) accounted for about 96% of the total value of all public companies in China. Therefore, the stock reform was almost complete, and in the future, all public companies are likely to have only one category of stock, all shares of which will be circulating and tradeable on stock exchanges.

Despite the above reform, however, foreign-invested CLSs are still confronted with many restrictions and thus only a few have been permitted to go public on China's domestic stock exchanges.

5.3. Shareholder rights

5.3.1. Rights of shareholders of LLCs

Each shareholder in an LLC is entitled to dividends. Under the former Company Law, dividends were distributed in strict proportion to the capital contribution of each shareholder to the registered capital of the company. Under the Company Law of 2005, however, the "proportionality" rule is no longer mandatory, rather; shareholders may agree on specific distribution percentages.[54] This amendment grants shareholders more flexibility with respect to capital structure when establishing an LLC if and when different classes of shares are permitted. Shareholders to an LLC also have the right to examine their company's financial statements as well as the minutes of shareholders' meetings. In the event of capital increases, shareholders have priority rights to subscribe for new shares in accordance with their respective equity interests in the company. Absent approval, a shareholder may not withdraw its capital contribution after registration of the company.

Shareholders of an LLC may freely transfer their equity interests among themselves. If a transfer is to be made to a third party, the consent of at least one-half of the remaining shareholders by voting rights is required. If a shareholder does not consent to an external transfer, it must purchase shares in question at the price offered by the transferring shareholder to the third party. A shareholder who declines to purchase will be deemed to approve the proposed transfer.

5.3.2. Rights of shareholders of CLSs

In CLSs, capital is divided into equal shares. Each share entitles its holder to one vote at the shareholders' meeting. Decisions on mergers, divisions or dissolution as well as amendments to the articles of association require approval by two-thirds or more of the voting rights present at the meeting. A shareholder has the right to appoint a proxy to attend the shareholders' meeting to discuss and vote on relevant matters.

If the lawful rights of a shareholder are infringed, such shareholder may file suit in a people's court for an injunction and compensation.

Shareholders of a CLS receive dividends in proportion to their percentage ownership of shares.

In the event of a capital increase, shareholders have priority to purchase new shares.

Compared with the company laws of most developed countries, China's Company Law prior to amendment in 2005 did not have comprehensive provisions to prohibit controlling shareholders from conflicts of interest, self-dealing or other activities that may negatively or unfairly impact the rights of minority shareholders.

5.4. Transfers of shares

5.4.1. Transfers of shares in LLCs

A shareholder may transfer its equity interest in the company to a third party or to other shareholders. The Company Law requires that other shareholders approve any transfer of equity interests in their company to a third party. If the other shareholders do not approve the proposed transfer, they must purchase the equity interest to be transferred. A shareholder who declines to purchase will be deemed to approve the transfer. Other shareholders have a right of first refusal on equal terms and conditions.[55] The former Company Law did not specify the time period during which other shareholders must approve or purchase the equity interests to be transferred should they disapprove of the proposed transfer. The lack of a clear time period for action gave rise to situations where the other shareholders could delay a proposed third party transfer indefinitely. This shortcoming was remedied by the Company Law of 2005, which requires that shareholders decide whether to approve or purchase the equity interest to be transferred within 30 days after receipt of notice from the transferring shareholder.

5.4.2. Transfers of shares in CLSs

As stated above, shares of a CLS can be separated into two categories: legal person shares and public shares. The former may not be traded on stock exchanges and may only be transferred through private agreements while the latter can be freely traded on a stock exchange subject to the following restrictions.

Promoters are prohibited from transferring their shares during the lock-up period. The amendment of the Company Law of 2005 reduced the lock-up period from three years to one year.[56]

Directors, supervisors, and managers must disclose their shareholdings to the company and are subject to certain restrictions on the number of shares to be transferred during their term of office. The amendment of the Company Law in 2005 abolished the absolute prohibition on transfers of shares by directors, supervisors and senior officers during their term of office, and replaced it with a one-year lockup period after public listing subject to a maximum transfer of 25% of shareholdings in any subsequent year.[57]

A company may not purchase its own shares, except where they are to be granted to employees as stock incentives or cancelled for the purpose of reducing the company's capital, or where the company is merged with and into another company.

The initial public offering of shares of a CLS and any subsequent new issue are subject to approval by the CSRC and the relevant stock exchange and must comply with the exchange's listing and issue rules. Secondary trading of publicly traded shares does not require prior approval but registration is required at the China Securities Registration and Settlement Centre.

5.5. Corporate governance

5.5.1. Shareholders' meeting

The shareholders' meeting of an LLC is comprised of all its shareholders.[58] Shareholders exercise their voting rights in proportion to their respective percentage ownership of registered capital. The shareholders' meeting has the following powers:

- to approve the company's business principles and investment plans;
- to amend its articles of association;
- to appoint and dismiss directors and decide their remuneration;
- to appoint and dismiss supervisors and determine their remuneration;
- to review and approve reports submitted by the board of directors and the board of supervisors;
- to review and approve the annual budget and settlement plans;
- to examine and approve the company's profit distribution plans;
- to approve changes to the company's registered capital;
- to approve the issue of corporate bonds;
- to approve transfers of equity interests in the company to third parties;
- to approve increases and decreases of the company's registered capital; and
- to approve mergers, divisions, termination and liquidation of the company.[59]

Resolutions with respect to capital increases or decreases, mergers or divisions of the company, its dissolution or changes of its corporate form and amendments to its articles of association must be approved by at least two-thirds of the shareholders present or represented at the meeting. Other matters may be adopted by a simple majority of votes present or represented at the meeting.

While shareholders' meetings of both an LLC and a CLS may exercise the above powers, there are differences between the requirements of the shareholders' meetings of an LLC and a CLS. In a CLS, a shareholders' meeting must be held at least once a year, whereas no statutory frequency rule applies to shareholders' meetings in an LLC.

Within two months after the occurrence of any of the following events, an interim shareholders' meeting must be convened:

- the number of directors falls below the legal requirement or below two-thirds of the minimum number of directors provided in the company's articles of association;
- the company's net accumulated losses falls below one-third of its registered capital;
- shareholders holding more than 10% of the total shares so request; or
- the board of directors or the board of supervisors so requests.[60]

5.5.2. Board of directors

The powers of the board of directors of an LLC are the same as those of the board of a CLS:

- convening shareholders' meetings;
- implementing resolutions of shareholders' meetings;
- deciding the company's operational and investment plans;
- adopting the company's financial plans, including increases or decreases of registered capital;
- formulating plans for distributing profits and making up losses;
- formulating plans for mergers, divisions, transformations or dissolution;
- deciding the internal management structure and appointing officers; and
- adopting internal regulations.[61]

Where an LLC has a small number of shareholders and is comparatively small in scale, it may substitute an executive director for the board of directors. The executive director may also serve as manager of the company. The executive director in such an LLC is its legal representative. The detailed responsibilities of the executive director must be set out in the company's articles of association. A director may be re-elected and dismissed by the appointing shareholder.[62]

The Company Law also provides that the chairman of the board has the right to convene and organize meetings of the board of directors.

Detailed rules concerning the convening of board meetings and relevant voting procedures are usually provided in a company's articles of association.

Note that under the former Company Law, the chairman of the board, once elected, would serve as the legal representative of the company. Now any director or senior officer may act as legal representative. Legal representatives of companies have broad powers and assume significant responsibilities.

Article 45 of the Company Law provides that the board of directors of an LLC is composed of at least three and no more than 13 members whose term of office generally lasts three years.[63] The Company Law as amended in 2005 provides that the board of directors of a joint stock company must be composed of five to 19 members.[64]

The term of a board member is usually three years. The chairman of the board is elected by simple majority vote of all directors.[65] The chairman presides over both shareholders' meetings and board meetings, reviews the implementation of the board's resolutions, and signs the company's shares and bonds. The board may have vice chairmen, who perform the chairman's duties in the event of his incapacity.[66]

The Company Law requires that meetings of the board be convened at least twice a year with half of all board members constituting a quorum.[67] Article 116 further provides that notice must be sent to all directors and supervisors of a CLS at least ten days prior to the board meeting and, upon the request of shareholders with 10% or more of the voting rights and one-third or more of the directors or supervisors, an interim board meeting must be convened. A director may appoint a proxy to attend board meetings if he/she is unable to attend in person.[68] A director may concurrently serve as officer of the company. However, directors and senior officers may not concurrently serve as supervisors of a CLS.

The Company Law entitles directors participating in a board meeting to have their dissenting opinions recorded in the minutes. Directors who have their dissenting votes on any resolution recorded are exempt from liability for the consequences of an illegal resolution.

The following persons are disqualified to be members of either the board of directors or the board of supervisors and they may not serve as senior managers of companies:

- those who do not have full civil capacity;
- those who have served a sentence for serious economic or other serious crimes where the period of deprivation of their political rights has yet to expire and for a period of five years;
- those who have, within the previous five years, completed a criminal sentence for corruption, bribery, encroachment of property, misappropriation of property or disrupting the economic order of the socialist market; as well as those who, within the previous three years, have completed a period of deprivation of political rights;
- those who have served as directors or officers or have been personally responsible for the management of any company that has gone bankrupt within the previous three years;
- those who have served as legal representative of a company or have been personally responsible for the violation by a company, the business licence of which has been withdrawn during the previous three years; and
- those who have failed to repay a large amount of personal debt when due.

5.5.3. Management

Article 50 of the Company Law provides that an LLC has a general manager[69] who is appointed and dismissed by the board of directors. General managers are responsible for the daily management and operation of the company and report to the board of directors. They may attend board meetings but without voting rights. The regulations relevant to managers in LLCs under the Company Law also apply to CLSs.[70]

General managers are authorized to exercise the following authority:

- direct production and operations of the company and implement resolutions of the board of directors;
- implement the company's annual operations and investment plans;
- formulate plans with respect to the company's internal organizational structure;
- formulate the company's basic management system;
- formulate the company's detailed rules;
- propose the appointment or dismissal of the deputy general manager and financial controller;
- appoint or dismiss other senior officers whose appointments and dismissals do not require approval of the board of directors; and
- exercise other powers assigned to them in the company's articles of association.

Articles 148 and 149 of the Company Law provide that directors, supervisors and senior officers of a CLS must act in the company's best interests and that they may not accept bribes, embezzle company assets, misappropriate its funds or engage in self-dealing or activities in competition with the company.

To encourage the development of high-tech enterprises, the government in 1999 adopted new measures to permit the grant of stock options by such enterprises to their management and employees.[71]

5.5.4. Board of supervisors

The Company Law requires that both LLCs and CLSs establish a board of supervisors comprised of at least three members. Small companies may instead appoint one or two supervisors.

The term of office of supervisors is three years, subject to renewal. Supervisors may attend board meetings but, like managers, they do not have voting rights.

The board of supervisors is comprised of representatives of the shareholders and employees in the proportions stipulated in the company's articles of association.[72]

Directors, managers and financial officers may not serve as supervisors. A chairman is elected by majority vote of the members of the board.

The board of supervisors has the following authority:

- to monitor the financial condition of the company;
- to supervise the directors' and managers' performance of their duties;
- to request that directors or managers rectify conduct that impairs the company's interests;
- to propose the convening of interim shareholders' meetings; and
- to exercise other powers stipulated by the articles of association.

Despite the above authority provided under the Company Law, boards of supervisors have played only a limited rule in corporate governance in practice. The Company Law does not specify a channel for the board of supervisors to report violations and the only measures that the board of supervisors can take are to request convening of an interim shareholders' meeting or board of directors meeting to report and discuss violations by directors or managers. When the challenged directors or managers are representatives of controlling shareholders, the board of supervisors does not have an effective method to request rectification of the violations except by filing suit in the competent people's court. However, because the board of supervisors is not an independent legal entity, such lawsuit may only be filed in the name of individual members of the board of supervisors and will impose substantial monetary and other burdens on such individuals.

The board of supervisors moreover arguably constitutes a redundant base of power alongside the board of directors. For these reasons, if the board of supervisors of a public company discovers a violation and intends to initiate a lawsuit against directors or officers representing controlling shareholders, it usually seeks assistance from minority shareholders of the company and files the lawsuit jointly with the minority shareholders. Chinese courts have become more aware of the importance of protecting the interests of minority shareholders and have issued several decisions favoring minority shareholders.

Although the functions of the board of supervisors in public companies have been strengthened under relevant securities laws and CSRC regulations, the Company Law has yet to impose such provisions on application to all types of enterprises in China.

5.6. Accounting principles

5.6.1. Financial and accounting reports and information disclosure

Chapter 8 of the Company Law requires that all companies establish financial and accounting systems in accordance with law, State regulations and relevant ministerial decrees. In the past, separate accounting and financial regulations and standards applied to domestic companies and FIEs. Such separate systems were replaced by the promulgation of a set of unified enterprise accounting and financial standards that applies to all types of companies in China.[73]

Companies must prepare financial statements at the end of each fiscal year, which must be audited by public accountants in China.[74] The financial statements usually include the following:

- a balance sheet;
- a profit and loss statement;
- a statement of sources and uses of funds;
- an explanation of financial conditions; and
- a proposal for distribution of dividends.

Companies must send their financial statements to their shareholders within the time stipulated in the company's articles of association.[75] No assets of a company may be deposited in a bank account held by an individual.[76]

In addition to the Company Law, the Accounting Law[77] provides more detailed accounting rules, standards and a framework for companies to handle their accounting matters. The CSRC has also issued specific accounting rules for public companies.[78]

5.6.2. Statutory reserve fund and statutory public welfare fund

Under the former Company Law,[79] a company was required to allocate at least 10% of its annual after-tax profits to the company's statutory reserve fund, and 5–10% to the company's staff benefits and welfare fund. The 2005 amendments abolished the requirement to allocate a specific percentage of after-tax profits to the company's staff benefits and welfare fund. A company is not required to make additional allocations to its statutory reserve fund when its amount equals 50% of its registered capital. The statutory reserve fund may be used to absorb losses or it may be converted to registered capital. The statutory reserve fund may be so converted provided that the amount remaining in the reserve fund is not less than 25% of the registered capital. Where the statutory reserve fund is not sufficient to make up losses from previous years, the company must use the new year's profits to make up the losses before any allocation is made to the statutory reserve fund.

Thus, only after a company makes up losses from previous years, pays enterprise income tax and makes required allocations to the statutory reserve fund, can it distribute profits to its shareholders in accordance with their respective equity interests in the company.[80]

The "capital reserve fund" (ziben gongjijin) and statutory reserve fund are different funds. Where shares are issued at a price above their nominal value, the difference between the issue price and the nominal value of shares must be imputed to the capital reserve fund. The capital reserve fund may be converted to registered capital but may not be used to make up losses carried over from prior years.[81]

5.7. Bankruptcy, dissolution and liquidation

Article 181 of the Company Law provides that a company may be dissolved upon the occurrence of any of the following events:

- its term expires or there occurs an event of dissolution stipulated in the company's articles of association;
- the shareholders' meeting decides to dissolve the company;
- a merger or division leads to its dissolution;
- its business licence is revoked or cancelled by government or the government orders the company's closure; or
- the people's court orders the company to be dissolved.[82]

The Company Law thus covers voluntary dissolutions and dissolutions upon government or court order (usually due to the company's serious violations of law).

The 2005 amendments to the Company Law deleted bankruptcy as a cause for dissolution as detailed procedures with respect to bankruptcy are defined in the Civil Procedure Law[83] and other regulations. The Enterprise Bankruptcy Law was subsequently enacted in 2006. The Enterprise Bankruptcy Law for the first time unified bankruptcy procedures for SOEs, other domestic enterprises and FIEs which had previously been more cumbersome as well as uneven. It defines "bankrupt" as an enterprise legal person which cannot pay its debts when due and whose assets are not sufficient to pay all debts or which clearly lacks repayment capability. Bankruptcy cases are handled by the people's court in the locality where the debtor is domiciled in accordance with the procedures set out in the Enterprise Bankruptcy Law as well as in the Civil Procedure Law. Under the Enterprise Bankruptcy Law, either the debtor or the creditor can file a bankruptcy application in the court. The court will review and decide whether to accept the application. Once accepted, the court will nominate an "administrator" to take over the debtor's assets and books. The responsibilities of the administrator include investigation of the debtor's financial status, preparation of an investigation report, making decisions on the debtor's management affairs, management and disposition of the debtor's assets, representing the debtor in relevant lawsuits and other legal proceedings, and organization of the creditors' meeting. The court will also determine a period of 30 days to three months for creditors to declare and register their debts. The creditors' meeting, consisting of all known creditors, will be convened upon expiration of the above period. The creditors' meeting has the authority to replace the court-appointed administrator, inspect the administrator's expenses, approve or disapprove any restructuring plan or settlement plan, and elect and replace members of the standing committee of the creditors' meeting.

Bankruptcy applications can be classified in three categories: restructuring applications, settlement applications and bankruptcy applications. Under a restructuring application, the debtor will have an obligation to formulate a restructuring plan within six months after the court accepts the application. The creditors' meeting has the right to review and approve such plan. If approved, the debtor will implement the restructuring plan under the supervision of the administrator. After successful completion of the restructuring, the debtor will no longer be liable for debts waived or reduced under the restructuring plan. If the creditors' meeting refuses to approve the plan, the parties will have a second chance to negotiate and amend it. If the amended restructuring plan is again rejected by the creditors' meeting, the court will terminate the restructuring procedure and declare the debtor bankrupt. Under a settlement application, the debtor will formulate a settlement agreement for approval by the creditors' meeting. If approved, the debtor has the obligation to strictly implement the terms of the settlement agreement. If not approved, the court will declare the debtor bankrupt.

After the court announces the bankruptcy of the debtor, the administrator will formulate an assets disposal plan for approval by the creditors' meeting. Once approved, the debtor's assets will be disposed of and the proceeds received therefrom will be distributed to the creditors and other claimants in accordance with the priorities specified in the Enterprise Bankruptcy Law. It is illegal for the debtor to dispose of its assets during the bankruptcy process without the consent of the administrator, creditors' meeting and the court.

In a voluntary dissolution, a liquidation committee is constituted within 15 days after a resolution to dissolve is adopted by the shareholders' meeting or expiration of the company's term. In an LLC, the liquidation committee is composed of shareholders and, in a CLS, the liquidation committee is composed of members designated by the shareholders' meeting. If a liquidation committee is not established within the prescribed time, the creditors may apply to a people's court to order its formation.

The liquidation committee has the following functions and powers:

- to audit the company's assets and set its balance sheet and an inventory of its assets;
- to send notices to creditors or to inform them by public notice;
- to conduct unfinished business relating to the liquidation;
- to pay taxes when due;
- to clear debts and claim rights of the company;
- to dispose of its assets remaining after payment of its debts; and
- to represent the company in civil litigation.

The liquidation committee must send notices to creditors within ten days after its formation and must place a public announcement in a newspaper within 60 days.[84] The former Company Law required three public announcements within 60 days but the 2005 amendments reduced the number of announcements to one. Creditors must file their claims with the liquidation committee within 30 days from receipt of the notice or within 45 days following the public announcement. During the liquidation period, no business may be carried on by the company. The liquidation plan must be approved by the shareholders' meeting and by the competent authorities.

The proceeds from the liquidation are used in the following sequence: to settle the company's debts, to pay liquidation expenses, to pay employees' wages and insurance funds, to pay taxes when due, and to fulfil all other obligations.

After the above payments have been made, the residual assets of the company may be distributed among the shareholders in proportion to their holdings of registered capital.

Upon completion of the liquidation process, an application must be filed for cancellation of the company's registration. The company registration authority then revokes the company's business licence and gives public notice that the company has been closed.

5.8. Liability and sanctions

5.8.1. Liability under the Company Law

The Company Law defines principles for imposing liability on companies as well as on their directors, supervisors, executive personnel and professional advisors. Violations of laws and regulations may give rise to penalties.

Penalties are generally divided into three categories: administrative, civil and criminal.

Administrative penalties include fines, remedial orders, suspensions of business operations, confiscations of unlawful income, and revocations of business licences, as well as administrative penalties imposed on the individuals responsible for the violations.

Imputation of civil liability generally entails liability to pay damages to the victim.

If a violation is sufficiently serious, criminal liability may arise.

The Company Law prohibits a company's founding investors from providing false information during its establishment. If a company's investors provide false information or documentation or falsely report the registered capital of the company during registration, the company registration authority may order rectification, impose a fine or cancel the company's business licence.[85]

If promoters or investors of a company make disguised capital contributions to the registered capital, the company registration authority may order rectification and may impose fines of between 5% and 15% of the disguised capital contribution.[86]

Financial and accounting records must be accurate and truthful.[87]

Accounting firms and assets appraisal firms may not issue false or misleading capital verification reports and asset appraisal reports lest they incur administrative penalties of one to five times the illicit income. When the violations are serious, the business licences and relevant qualifications of the accounting firms or appraisal firms may be revoked.[88]

Other provisions apply to such illegal actions as concealing company assets or fraudulently transferring company assets during the liquidation process, conducting business without due registration and failure to amend the company's registration although required to do so.

If the company's assets prove insufficient to pay both civil and other liabilities, civil damages are paid first.[89]

The 2005 amendments to the Company Law deleted a number of liability provisions set out in the former Company Law, such as liability for fraudulent activities during the issue and trading of shares of CLSs, liability relating to the sale of State-owned assets at abnormally low prices, and liability of company directors and officers for accepting bribes, or embezzling or misappropriating company assets, because these are separately provided in such other laws and regulations as the Securities Law, the laws and regulations concerning disposal of State-owned assets, and the Criminal Law.

5.8.2. Corporate criminal liability

The Company Law only provides in general that if relevant violations are sufficiently serious, such activities may be subject to criminal liability. The Criminal Law sets out more detailed conditions and penalties in this regard. Provisions concerning criminal liability for serious violations of the Company Law are set out in the chapter entitled Crimes of Disrupting the Order of Administration of Companies and Enterprises.[90] The penalties include criminal fines, detention, confiscation of property and imprisonment.

In addition to the Criminal Law, on February 28, 1995, the Standing Committee of the NPC adopted the Decision concerning the Punishment of Crimes in Violation of the Company Law that also sets out conditions for constituting a criminal act in the management and operation of a company. Criminal liability may also be imposed on both the legal representative of the company and personnel directly responsible for the criminal activity.

Criminal liability may follow for responsible persons if a person applies for registration of a company by presenting falsified documents or by using other fraudulent means, thus causing serious consequences, or if a company makes false financial and accounting disclosures to the public, thus causing serious harm to the interests of shareholders or others. Criminal liability may also arise if a CLS issues a false prospectus, or investors to a company make false capital contributions or withdraw their capital contributions without permission thereby causing serious harm, or a company hides its assets or fraudulently transfers its assets during the liquidation process, or accounting firms or assets evaluation firms issue false capital verification reports or assets evaluation reports.

Directors, supervisors and employees may also be subject to criminal liability if they accept bribes or embezzle large amounts of company assets.

6. Corporate registration

Regardless of their form, all enterprises must be registered with the SAIC or competent AIC in order to obtain a business licence. Without registration and a business licence, no business activity may be conducted. The process of registration of an enterprise generally consists of pre-registration of its name, its registration as a legal entity, and the registration of its scope of business, its legal representative and its registered capital upon establishment. Once established, an enterprise is subject to ongoing registration requirements, such as filing of annual reports. Branches of enterprises must also be registered with the SAIC or the competent AIC before they engage in activities. The registration requirements applicable to branches, as well as for representative offices of foreign companies are generally the same as those for enterprises. Below we summarize the registration requirements and procedures for the registration of legal person enterprises.

6.1. Enterprise name registration

The registration of company names is governed by the Administrative Regulations concerning Registration of Enterprise Names[91] and its implementing regulations.[92]

Prior to the establishment of an enterprise, its shareholders or promoters must conduct a search of the available enterprise names at the local AIC to determine whether the proposed enterprise name is already in use by another enterprise. If the proposed enterprise name is available, the shareholders and promoters may file an application to pre-register the name prior to the enterprise's formal establishment. The reservation will become invalid if the enterprise is not established within six months. Once duly registered, the name is protected under law and no other enterprise in the same industry and in the same locality may use the same or a similar name.

6.2. Disclosure requirements in connection with enterprise registration

Following pre-registration of its name, the enterprise must be registered with the SAIC or competent AIC to obtain a business licence. Such registration is generally governed by the Administrative Rules with respect to the Registration of Companies (the "Company Registration Regulations")[93] and the Administrative Rules with respect to the Registration of Enterprises[94] for enterprises established under other laws and regulations without independent legal person status. The registration and disclosure standards under the two regulations are generally the same and can be summarized as requiring disclosure of:

- the enterprise's name and domicile;
- the name of its legal representative;
- the amount of its registered capital;
- its scope of business, legal form (LLC, CLS, WSOC, etc.) and operating term; and
- the names of its promoters or shareholders.

Registration of the scope of business of an enterprise is also subject to the Administrative Regulations on Registration of the Scope of Business of Enterprises.[95] Article 4 of these Regulations provides that the scope of business of an enterprise includes licenced business activities and general business activities. The former refer to business activities for which an enterprise is required by law, administrative regulation or government policy to apply to the competent government authority for approval prior to registration, while general business activities refer to business activities that do not require approval and for which an enterprise may directly apply for registration. Thus, enterprises engaging in specially regulated industries, such as banking, insurance, pharmaceuticals and telecommunications, must first apply for approval of their respective scopes of business by the competent government authority before they register as enterprises.

There are also special regulations.[96] Under these regulations, the following persons are prohibited from serving as the legal representative of an enterprise:

- persons without civil capacity or with limited capacity for civil acts;
- persons currently subject to criminal punishment or criminal enforcement measures;
- persons currently subject to an arrest warrant issued by a public security bureau or the state security authority; and
- persons subject to criminal punishment due to an offence involving corruption and bribery, property rights infringement or disrupting the order of the socialist market economy when less than five years have elapsed since the expiration of the sanction; persons subject to criminal punishment due to any other type of offence when less than three years have elapsed since the expiration of the sanction; and persons deprived of their political rights because of an offence when less than five years have elapsed since the expiration of the sanction.

The purpose of the above "disqualification" standards is to ensure that the legal representative of an enterprise who is granted extensive authority by such enterprise has a "clean" record and can give reasonable confidence and comfort to the business counterparts of such enterprise in their dealings.

6.3. Registration procedures

6.3.1. Registration of LLCs

To apply to establish an LLC, the following documents must be submitted to the SAIC or the competent AIC:

- application signed by the chairman of the board of directors or by the executive director;
- power of attorney authorizing an agent to handle the application;
- the company's articles of association;
- capital verification certificate issued by a qualified capital verification institution;[97]
- proof of legal person status for institutional shareholders and proof of identity for individual shareholders;
- names and addresses of the directors, supervisors and managers of the company, and documents with respect to their appointment, election or employment;
- identification document of the company's representative;
- enterprise name's pre-registration;
- documentation with respect to the company's domicile evidencing the company's right to use the domicile; and
- other documents required by the company registration authority.

Upon the receipt in proper form of all required documentation, the registration authority will accept the company's application. Within 30 calendar days, a decision is to be made whether or not to approve the registration. Upon approval, the authority notifies the applicant and issues a business licence.

Upon issue of the company's business licence, the company is duly established. The company may then, upon presentation of its business licence, have its chops carved, open a bank account and apply to register with the local tax, customs, financial, foreign exchange and other authorities. Business licences issued for enterprises with legal person status are indicated as such.

The enterprise registration authorities record the information disclosed in registries to which the public may have access and of which copies may be made.

After establishment, any subsequent changes to the enterprise (including, without limitation, changes of shareholders, increases and decreases of registered capital, changes to the legal representative and board membership, changes to the company's objects, name, or legal form, and openings and closures of branches and subsidiaries) must also be registered with the enterprise's original registration authority.

6.3.2. Registration of CLSs

To register a CLS, the following documentation is required in addition to that required for establishment of an LLC:

- appointment of representatives or agents by all shareholders;
- approval of the competent authority;
- minutes of the founding shareholders' meeting; and
- audited report with respect to the expenses incurred in connection with the preparation of the CLS.

The registration procedures with respect to a CLS are generally the same as those for an LLC.

6.4. Ongoing disclosure requirements

After registration upon its establishment, an enterprise must notify its original registration authority of any subsequent changes in the information previously registered and have its registration amended.

To amend its registration, an enterprise must submit the following documents:

- application signed by the legal representative of the enterprise;
- relevant resolutions or decisions authorizing registration of a change in the information provided in the previous registration; and
- other documents required by the registration authorities.

Applications to change the enterprise name must be filed within 30 calendar days after the resolution or decision to make such change.

Applications for changing an enterprise's domicile must be filed before the enterprise moves. A document proving the right to use the new domicile must also be submitted. If the new domicile is outside the jurisdiction of the original registration authority, the application must be filed with the registration authority where the new domicile is located. Changes of a company's management personnel (chairman and directors) must be filed within 30 calendar days of the relevant resolutions or decisions with respect to such changes.

Any change in an enterprise's shareholdings must be filed with the registration authority, including documentation with respect to a new institutional shareholder's legal person status or new individual shareholder's identification documents, together with the relevant equity transfer agreement and other relevant documents.

Increases in an enterprise's registered capital must be filed within 30 days after such increase. The period for registration of decreases in capital is 90 days, during which time at least three public notices are published in newspapers to notify creditors to report their debts. With respect to a capital increase application, a capital verification certificate issued by a qualified capital verification institution must be submitted together with the application.

Changes to the contents of an enterprise's scope of business must be filed within 30 days after adoption of the resolution approving such change. Where special approvals are required under law or regulation for business activities under the new scope of business, the application must be filed within 30 days from the date of approval by the competent authorities of the amended scope of business.

Changes of legal form (for example, from an LLC to a CLS) must be filed in accordance with the conditions applicable to the new legal form. For example, conversion of an LLC into a CLS is not a mere procedure to amend the enterprise's original registration, but rather a new registration in accordance with the procedures for establishing a CLS.

Changes to the articles of association of an enterprise must also be registered and the application must include the amended articles of association.

In the event of a merger or division, an application for registration must be filed within 90 days after the date on which the merger or division decision or resolution is made. Public notices must be published at least three times in newspapers to notify the enterprise's creditors. No merger or division can be carried out before the settlement of creditors' demands for the enterprise to provide additional guarantees or security to ensure the repayment of debts, even if the underlying contract did not provide a right to additional security. Interestingly, the sale of an enterprise's assets, even the sale of substantially all assets, is not required to be filed with the registration authority nor is such sale required to be announced in newspapers under current enterprise registration regulations.

In the event of dissolution, upon completion of the liquidation procedure, the liquidation committee of an enterprise must, within 30 days, apply for cancellation of the company's registration and business licence. To apply for such cancellation, the following documents must be submitted:

- application for liquidation signed by the responsible person;
- resolutions of the enterprise to dissolve (should the dissolution be on a voluntary basis) and the bankruptcy judgment or the administrative order to dissolve issued by the authority (should the dissolution be based on a bankruptcy petition or government order);
- liquidation report and the approval of such report by the shareholders' meeting of the enterprise or by the competent government authority; and
- business licence of the enterprise and other documents.

Within 30 days after cancellation of an its business licence, an enterprise must apply to the local tax, customs, finance, foreign exchange and other government authorities for cancellation of its registrations.

6.5. Registration fees

Registrations give rise to the collection of fees. Article 46 of the Company Registration Regulations provides detailed fee standards as follows:

- the registration fee for the establishment of an enterprise with registered capital of RMB 10 million or less is equal to 1/1000 of the total registered capital of such enterprise;
- for enterprises with registered capital of more than RMB 10 million, the registration fee is equal to RMB 10,000 (1/1000 of RMB 10 million) plus 0.5/1000 of the amount of registered capital from RMB 10 million to RMB 100 million;
- no registration fee is assessed on the portion of registered capital exceeding RMB 100 million.

6.6. Annual inspections and audits

To ensure that an enterprise engages in its business in a legitimate manner and on a continuous basis after its inception, the competent registration authorities conduct annual inspections and audits of enterprises. The Company Registration Regulations provide that the registration authorities conduct an annual inspection and audit of the enterprise's business operations between January 1 and April 30 of each year.[98] Enterprises must submit their annual inspection reports, balance sheets and income statements as well as copies of their business licences. Branches of an enterprise must also submit their annual reports, financial statements and copies of their business licences.

The purpose of the annual inspection and audit is to review the materials submitted by an enterprise to confirm the registered information, and to verify that the enterprise remains qualified to continue its business.

6.7. Violations and sanctions

The Company Registration Regulations include a chapter on legal liability to determine whether an enterprise's activity has violated laws and regulations and whether a penalty should be imposed on such enterprise. It is therefore important for all enterprises conducting business in China to gain an understanding of these liability provisions.

The most basic requirement is the truthfulness requirement with respect to all information disclosed by an enterprise during its initial establishment and annual inspection processes. All information communicated in connection with applications for registration and information communicated about business activities must be truthful and authentic. Enterprises and their responsible personnel are liable for fraudulent disclosures and intentional omissions. Civil and criminal liability may arise from fraudulent disclosures or intentional omissions.

Articles 58 and 59 provide that if the enterprise registration is obtained through a false declaration of registered capital, or through the presentation of false documents or through other fraudulent means, the registration authority may order remedial action and impose penalties equivalent to 5 percent to 10 percent of the falsely inflated registered capital, or between RMB 10,000 and RMB 100,000 for a bad faith presentation of registration documents. Criminal liability may be investigated if the violation is sufficiently grave, the registration may be cancelled and the business licence may be revoked.

Article 68 provides that if an enterprise conceals the truth and makes false statements during the annual inspection and audit, the registration authority may impose fines of RMB 10,000 to RMB 50,000 and may order the enterprise to remedy the situation.

Article 69 provides that where a business licence is forged, altered, leased, lent or transferred, the registration authority may impose fines ranging from RMB 10,000 to RMB 100,000. In serious cases, a company's business licence may be revoked and a criminal investigation may be initiated.

Article 60 provides that if promoters or shareholders of an enterprise fail to make their promised capital contributions, whether in cash or in kind, or if they make false capital contributions, the company registration authority may order remedial measures and impose fines of 5 percent to 10 percent of the amount of the false capital contribution. Criminal charges may be brought if the violation is sufficiently serious.

Article 61 provides that if promoters or shareholders of an enterprise withdraw the registered capital of such enterprise after its establishment, the company registration authority shall order remedial measures and impose a fine of 5 percent to 10 percent of the amount of the capital contribution so withdrawn. Criminal charges may be brought if the violation is sufficiently serious.

Enterprises in China are required to conduct business activities within their respective approved and registered objects.

Article 71 provides that if an enterprise carries on activities beyond its objects, the company registration authority may order rectification and impose fines ranging from RMB 10,000 to RMB 100,000, and in cases of serious violations, business licences may be revoked.

Article 68 requires that enterprises that fail to cooperate in the conduct of mandatory annual inspections may be fined by the registration authority in amounts ranging from RMB 10,000 to RMB 100,000 and, when enterprises fail to respond to orders of the registration authorities over extended periods, their business licences may be revoked.

To encourage duly registered and established enterprises to commence their business activities in a timely manner and to avoid the existence of "dormant" business vehicles, provisions penalize delay in commencing or conducting business. Article 62 provides that if an enterprise fails to conduct business without reason for a period of six consecutive months or fails to begin business operations within six months after its establishment, the enterprise registration authority may revoke the business licence of such enterprise.

If an enterprise conducts business under a name that it has not registered, the registration authority will order rectification and may impose fines of RMB 10,000 to RMB 100,000. In serious cases, a criminal investigation may also be initiated.

If an enterprise fails to amend its registration as required by law and regulation, the registration authority may order compliance within a specified period. If the enterprise fails to remedy the situation within the extended period, penalties of RMB 10,000 to RMB 100,000 may be imposed.

If a company fails to notify its creditors or give public notice of mergers, divisions, capital decreases or liquidation, the company registration authority will order rectification and may impose a fine of between RMB 10,000 and RMB 100,000.

7. Amendments to the Company Law in 2005

Since its enactment in 1993, the Company Law has been amended three times. The 1999 and 2004 amendments consisted of minor technical adjustments. The first amendment added limitations on the percentage of capital contributions paid by promoters of companies with intellectual property rights and non-patentable proprietary technologies, whereas the second amendment streamlined the approvals for issues of shares by public companies.

Compared to the first two amendments, the third amendment in 2005 contains more substantive changes and more important improvements. In the amended Company Law, about 40 articles were added and 180 articles were amended or deleted. The Company Law of 2005 constitutes a major step toward a comprehensive and sophisticated corporate regulatory system tailored to the needs of the socialist market economy.

The major changes under the Company Law of 2005 may be summarized as follows:

7.1. One Person Limited Liability Companies (OPLLCs)

The Company Law of 2005 abolished the requirement that an LLC must have at least two shareholders and allows a single natural person or legal person to establish an LLC with minimum registered capital of RMB 100,000.[99]

The registered capital of OPLLCs must be contributed in full in one lump sum payment.[100] A natural person may establish only one OPLLC. The Company Law of 2005 also provides that an OPLLC must prepare financial reports at the end of each fiscal year for audit by a certified public accountant. The investor/shareholder in an OPLLC assumes liability with respect to the debts of the OPLLC unless it can be proved that the OPLLC's assets are independent.[101] Although the Company Law as amended in 2005 allows the establishment of OPLLCs, they are subject to greater restrictions than those applicable to other limited liability entities, such as a higher minimum registered capital (the minimum registered capital for other types of LLCs is RMB 30,000), a prohibition on multiple establishments, and unlimited liability for the shareholder of an OPLLC if it cannot prove that the company's assets are independent from its own.

7.2. Rights of minority shareholders

The amendments to the Company Law in 2005 strengthened the rights of minority shareholders by recognizing their rights to receive information, to conduct audits and inspections of the company's books and, of particular significance, to require redemption of their shares as well as to petition for dissolution.

Article 183 requires that when a company faces serious difficulties and the pursuit of its operations will cause serious losses to minority shareholders, shareholders with 10 percent or more of all voting rights may petition the people's court for dissolution of the company. Under the former Company Law, a company could be dissolved only through bankruptcy petitions brought by third parties or with the consent of the controlling shareholders. The right of minority shareholders to petition for dissolution protects their economic interests when the company suffers serious losses.

Article 75 grants minority shareholders the right to request redemption. Shareholders who vote against resolutions with respect to the following matters have the right to request that the company redeem their shares at a reasonable price:

- a company that has been profitable for five consecutive years and fulfils the conditions for distribution of profits specified in the law does not distribute profits to shareholders;
- the company transfers substantially all of its assets through merger or division; or
- the operating term of a company has expired or the conditions for termination under the company's articles of association have been met, but the shareholders' meeting resolves to amend the articles of association so as not to terminate the company.

If, within 60 days after the shareholders' meeting, the shareholders voting against the above resolutions cannot reach an agreement with the company to redeem their shares, they may bring suit in the people's court within 90 days after the shareholders' meeting.

7.3. Piercing the Corporate Veil

A corporate veil piercing doctrine was introduced into the Company Law by amendment in 2005 to prevent the abuse of corporate form. If a shareholder abuses the independence of the corporate legal entity or the limited liability of shareholders to escape debts and seriously damages the interests of the company's creditors, such shareholder loses its limited liability and assumes joint and several liability for the company's debts.[102] Although such provision allows courts to pierce the corporate veil to inquire into the investor when necessary, the provision lacks specificity with respect to the meaning of "abuse of corporate independent status and shareholder's limited liability status" and what constitutes "serious loss to creditors" and thus may be difficult to implement in practice.

7.4. Forms of capital contribution including intellectual property rights and shareholder rights

The 2005 amendments to the Company Law allow shareholders to make contributions to registered capital in the form of in-kind contributions, intellectual property rights, land use rights, and other transferable non-cash assets provided that an appraisal is conducted with respect to such non-cash assets.[103] One major reform was the increase of the limit on capital contributions in the form of intellectual property rights, industrial property rights and non-patentable technology from 20% to 70%. In the past, only shareholders in high-tech enterprises were allowed to contribute IP rights and other non-cash assets up to 70% of total registered capital.[104]

7.5. Rights to dividends and to subscribe for additional shares

The distribution of profits need no longer be proportionate to shareholders' respective equity interests in the company's registered capital. Article 35 allows shareholders to agree on the profits distribution ratio through contractual arrangements and to receive dividends or enjoy priority to subscribe for new equity in proportions that vary from their capital contribution percentages.

7.6. Restrictions on investments in other companies

The rule prohibiting a company from making investments in other enterprises in amounts exceeding 50% of its net assets was abolished by the 2005 amendments to the Company Law. In the past this rule deterred many companies, including FIEs, from establishing subsidiaries and acquiring other companies. In theory, a company may now invest up to 100% of its net asset value to acquire other enterprises or to establish subsidiaries. However, this may have negative implications, as it may facilitate the evasion of debts through recycling capital injections among affiliates or by transferring assets of bankrupt affiliates to other entities. Consequently, although the 50% investment limit has been abolished, local AICs and other government authorities may maintain some restrictions in this regard.

7.7. Capital requirements for LLCs and listed companies

The amendments of 2005 no longer vary minimum registered capital requirements for LLCs by type of business undertaken (manufacturing, wholesaling, retailing, technology development, consulting and services) and instead apply a uniform minimum registered capital requirement for all types of LLCs. Furthermore, the minimum registered capital requirement was reduced from RMB 100,000 to RMB 30,000 unless laws and regulations provide otherwise.[105]

With respect to the timing of capital contributions, contribution by instalment is now allowed, provided that the first instalment is not less than 20% of total registered capital and the balance of the registered capital is contributed within two years after the company's establishment. For investment companies, the deadline for completing capital contributions was extended to five years.

The 2005 amendments reduced the minimum registered capital for a CLS from RMB 10 million to RMB 5 million.[106] Where a CLS is established through subscription of shares by its promoters, contributions of registered capital by installments is allowed provided that the first instalment corresponds to not less than 20% of the total registered capital and provided that the balance is contributed within two years after the CLS's establishment.

7.8. Legal representatives

Whereas under the former Company Law, the chairman of the board of directors of a company was designated as its legal representative, the 2005 amendments allow the chairman, the managing director or the general manager of a company to be appointed as its legal representative in accordance with the company's articles of association.[107] However, the regulations with respect to FIEs still designate the chairman of an FIE as sole legal representative.

7.9. Self-dealing

The amendments of 2005 further tightened controls over self-dealing transactions by requiring controlling shareholders to abstain from voting on certain transactions in which they may have a conflict of interest. For example, article 16 provides that if the company is to provide a guarantee or use its assets to provide security for the liabilities of the company's *de facto* controlling shareholders, the resolution approving such guarantee or provision of security is required to be adopted by votes of more than one-half of the shareholders entitled to vote and attending the meeting. Those whose liabilities are to be secured by the guarantee or assets of the company are not allowed to vote on such matters. Thus, the Company Law amendments of 2005 restrict controlling shareholders' self-dealing transactions by requiring their approval by disinterested shareholders at a duly convened shareholders' meeting.

7.10. Governance in listed companies

The Company Law amendments of 2005 mandate that listed companies must have independent directors, although detailed implementing rules remain to be formulated by competent State Council departments.[108] Under the current regime, independent directors are mostly required for companies listed on overseas stock exchanges (such as H shares and N shares) in accordance with the model articles of association published by the CSRC. The 2005 amendments for the first time introduced the concept of an independent director for companies listed on domestic stock exchanges to harmonize and improve corporate governance mechanisms. However, the 2005 amendments only provide generally that listed companies must have independent directors, and the detailed roles and responsibilities of such directors are to be determined in regulations to be formulated by the State Council.

In addition to independent directors, the amendments of 2005 added provisions concerning the convening of meetings and the adoption of resolutions for listed companies to clarify the roles of the shareholders' general meetings and of the board of directors and to strengthen the authority and influence of the board of supervisors.

7.11. Lock-up period in listed companies

Under the 2005 amendments, the lock-up period on the transfer of promoters' shares was shortened from three years to one year after the establishment of a CLS. Moreover, directors, supervisors, and other senior officers of a CLS may transfer their shares in the company one year after the date on which the company's shares are publicly listed on a stock exchange.[109]

7.12. Share issues

The 2005 amendments to the Company Law deleted the conditions on issuing of new shares in a CLS and listing its shares on stock exchanges. These changes reduced the barriers to IPOs and give more authority to shareholders' meetings to decide the timing and criteria of share issues.

However, the CSRC's regulations with respect to IPOs remain in force and are more stringent, e.g., with respect to disclosure requirements and standardization of the articles of association.

8. Conclusion

The 2005 amendments to the Company Law provide major improvements, including with respect to establishment, capital formation, governance and shareholder rights. However, there remain areas that merit improvement in the future, including the role of the board of supervisors. State Council action is needed to authorize the creation of different classes of shares. Moreover, the lack of specificity in a number of amendments places a large burden of clarification on administrative bodies through regulations and decisions, and on the people's courts through judgments.

Notes

[1] The Law was adopted on April 13, 1988 at the First Session of the Seventh National People's Congress (NPC), effective on August 1, 1988.

[2] The Regulations were adopted on May 11, 1990 by the State Council, promulgated on June 3, 1990 and entered into effect on July 1, 1990.

[3] The Regulations were adopted on June 21, 1991 by the State Council, promulgated on September 9, 1991 and entered into effect on July 1, 1990.

[4] The Regulations were promulgated by the State Council on August 5, 1987.

[5] The Law was adopted on August 29, 2002 at the 29th Session of the Standing Committee of the Ninth NPC, effective on March 1, 2003.

[6] The Law was adopted on October 29, 1996 at the 22nd Session of the Standing Committee of the Eighth NPC, promulgated on the same date, and became effective on January 1, 1997.

[7] The Company Law was adopted at the Fifth Session of the Standing Committee of the Eighth NPC on December 29, 1993 with effect on July 1, 1994. It was amended for the first time on December 25, 1999 in accordance with the Decision of the 13th Session of the Standing Committee of the NPC on Amending the Company Law and further amended on August 28, 2004 in accordance with the Decision of the 11th Session of the Standing Committee of the 10th NPC on Amending the Company Law and it was amended for the third time at the 18th Session of the 10th NPC on October 27, 2005 with effect on January 1, 2006.

[8] The Law was adopted at the 24th Session of the Standing Committee of the 8th NPC on February 23, 1997 with effect on August 1, 1997. It was amended on August 27, 2006 at the 23rd Session of the Standing Committee of the NPC.

[9] The Law was adopted at the 11th Session of the Standing Committee of the Ninth NPC on August 30, 1999, promulgated on the same date and effective on January 1, 2000.

[10] The Law was adopted at the Second Session of the Fifth NPC on July 1, 1979 and effective on the same date, amended at the Third Session of the Seventh NPC on April 4, 1990, and again amended in accordance with the Resolution on Amendment of the Law on Chinese-Foreign Equity Joint Ventures at the Fourth Session of the Ninth NPC on March 15, 2001.

[11] The Law was adopted on April 13, 1988 at the First Session of the Seventh NPC, and amended on October 31, 2000 at the 18th Session of the Standing Committee of the Ninth NPC by the Decision on the Revision of the Law on Sino-foreign Co-operative Enterprises, promulgated and effective as of the same date.

[12] The Law was adopted on April 12, 1986 at the Fourth Session of the Sixth NPC and amended on October 31, 2000 at the 18th Session of the Standing Committee of the Ninth NPC by the Decision on Amendment of the Law Concerning Wholly Foreign-owned Enterprises.

[13] The Ministry of Commerce (MOFCOM) promulgated the Regulations on November 23, 2004 with effect on December 23, 2004. The Regulations liberalized some provisions governing foreign-invested holding companies. In particular, certain qualification requirements were lowered and the permissible scope of business was somewhat expanded.

[14] These Regulations were approved by the State Council on September 7, 2005 and jointly promulgated by the National Development and Reform Commission, Ministry of Science and Technology, Ministry of Finance, MOFCOM, People's Bank of China, State Administration of Taxation, State Administration for Industry & Commerce, China Banking Regulatory Commission, China Securities Regulatory Commission and State Administration of Foreign Exchange with effect on March 1, 2006.

[15] All promulgated by the former State Commission for Economic Restructuring on May 15, 1992.

[16] Urban COE Regulations, Article 2.

[17] Articles 2 and 3 of the IICH Regulations.

[18] Both were adopted at the Fourth Session of the Sixth NPC, promulgated on April 12, 1986, and effective as of January 1, 1987.

[19] Articles 3 and 5 of the RLCOH Law.

[20] An LLC's capital is defined in terms of registered capital, rather than net asset value, which complicates credit analysis.

[21] Article 132 of the Company Law of 2005 establishes the statutory foundation for multiple classes of stock upon the promulgation of competent regulations by the State Council, although there is apparently no immediate prospect of such action by the State Council.

[22] State Council, March 10, 2003.

[23] NPC, May 10, 1995.

[24] The Securities Law was adopted at the Sixth Session of the Standing Committee of the Ninth NPC on December 29, 1998 and promulgated by Presidential Order No. 12 on July 1, 1999, and entered into effect on the same day. It was subsequently amended on October 27, 2005 with effect from January 1, 2006.

[25] Insurance Company Regulations, Article 3.

[26] Insurance Company Regulations, Article 15.

[27] Insurance Company Regulations, Article 47.

[28] Insurance Company Regulations, Article 48.

29 Offices of foreign law firms, which must take the form of representative offices, are an exception in that they are authorized to conduct business within the scope of their licences.

30 Adopted at the Fourth Session of the Sixth NPC, April 12, 1986.

31 Articles 12 and 25 of the Company Law.

32 Beijing Municipal Government, February 15, 2004.

33 Guangdong Provincial Government, October 13, 2003.

34 Article 3 of the Company Law.

35 Currently, almost all FIEs are established in accordance with the EJV Law, CJV Law or WFOE Law or other FIE regulations, such as the Interim Provisions on Investment Companies Established with Foreign Investment issued by MOFCOM on November 17, 2004, and the Interim Provisions on Certain Questions Concerning the Establishment of Foreign-invested Companies Limited by Shares issued by MOFCOM on January 10, 1995.

36 Adopted at the Third Session of the Ninth NPC, effective on July 1, 2000.

37 Articles 19 and 23 of the Company Law.

38 Article 29 of the Company Law.

39 If an LLC is not established within six months after pre-registration of the enterprise name, the name will automatically become invalid and re-registration is required if shareholders later decide to use the same name for the proposed LLC.

40 Article 27 of the Company Law.

41 Article 30 of the Company Law.

42 Article 32 of the Company Law.

43 Article 3 of the Company Law.

44 Article 78 of the Company Law.

45 Article 90 of the Company Law.

46 Article 93 of the Company Law.

47 Article 23 of the former Company Law specified a minimum registered capital of RMB 500,000 for a production company, RMB 500,000 for a commodity wholesale company, RMB 300,000 for a commercial retail company, and RMB 100,000 for a scientific research and service company.

48 Article 23 of the former Company Law.

49 Article 26 of the Company Law.

50 Article 24 of the former Company Law.

51 Article 128 of the Company Law.

52 Article 137 of the former Company Law provided that to issue new shares, a CLS must satisfy the following conditions: (i) the previous issuance was fully subscribed and at least one year has elapsed since then; (ii) the company has been profitable and able to pay dividends to its shareholders for the past three consecutive years; (iii) the company has not been found to have falsified records in its financial accounts during the past three consecutive years; and (iv) the forecasted rate of profit of the company is not less than the interest rate on bank deposits of the same duration. Article 152 of the former Company Law provided that to issue new shares on public stock exchanges, a CLS must satisfy the following additional requirements: the shares in its application shall be issued to the public upon CSRC approval; the total capital raised shall not be less than RMB 50 million; its business has been in operation for over three years and profitable during the past three consecutive years; the number of shareholders who hold shares valued at more than RMB 1,000 is not less than 1,000; the public issue accounts for not less than 25% of the total capital of the company; and the company has not been found to have committed any serious violations or to have falsified any of its financial records.

53 Administrative Measures Concerning Stock Separation Reform of Listed Companies (CSRC September 2, 2005).

54 Article 35 of the Company Law.

55 Article 72 of the Company Law.

56 Article 142 of the Company Law.

57 Article 142 of the Company Law.

58 Article 37 of the Company Law.

59 Article 38 of the Company Law.

60 Article 101 of the Company Law.

61 Articles 47 and 109 of the Company Law.

62 Article 51 of the Company Law.

63 Article 52 of the Company Law further provides that small-sized LLCs need have only one executive director instead of forming an entire board.

64 Article 109 of the Company Law.

65 Article 110 of the Company Law.

66 Article 110 of the Company Law.

67 Articles 111 and 112 of the Company Law.

[68] Article 113 of the Company Law.

[69] Note that the relevant regulations do not differentiate between "manager" and "officer".

[70] Article 114 of the Company Law.

[71] Decisions Concerning Strengthening Technological Innovation, Developing High-Technology and Realizing Industrialization, adopted by the State Council on August 20, 1999. The government also began to study the feasibility of SOEs granting stock options to their management to encourage the appreciation of State-owned assets. Although the government has yet to promulgate formal regulations in this regard, press reports show that competent State Council departments are actively engaged in research on this issue.

[72] Articles 52 and 118 of the Company Law.

[73] Accounting Regulations (Ministry of Finance December 29, 2000), which apply to all enterprises including companies.

[74] Article 165 of the Company Law.

[75] Article 166 of the Company Law.

[76] Article 172 of the Company Law.

[77] The Accounting Law was adopted by the Standing Committee of the NPC on January 21, 1985 and was amended December 29, 1993 and October 31, 1999.

[78] Accounting Systems for CLSs (CSRC May 20, 1998).

[79] Article 172 of the Company Law.

[80] Article 167 of the Company Law.

[81] Article 168 of the Company Law.

[82] Under Article 183 of the Company Law, if a company is in serious difficulty and the continuance of the company's business will incur serious losses, the people's court may order the company's dissolution upon application by shareholders with more than 10% of the voting power.

[83] Chapter 19 of the Civil Procedure Law.

[84] Article 168 of the Company Law.

[85] Article 199 of the Company Law.

[86] Article 200 of the Company Law.

[87] Article 203 of the Company Law.

[88] Article 208 of the Company Law.

[89] Article 215 of the Company Law.

[90] Criminal Law, Part 2, Chapter 3, Section 3.

[91] SAIC Notice, May 21, 1991.

[92] Implementing Measures on Registration and Administration of Enterprise Names (SAIC, December 8, 1999, amended June 14, 2004).

[93] State Council, June 24, 1994.

[94] State Council, May 13, 1988.

[95] SAIC, June 14, 2004.

[96] Administrative Regulations concerning the Registration of Legal Representatives of Legal Person Enterprises (SAIC February 22, 1998, amended June 23, 1999).

[97] Before the amendments to the Company Law of 2005 became effective, the registered capital of an enterprise (except for FIEs) was required to be fully paid up and verified by a qualified third party prior to its establishment.

[98] Articles 49 and 50 of the Company Registration Regulations.

[99] Articles 58 and 59 of the Company Law.

[100] Article 59 of the Company Law.

[101] Article 64 of the Company Law.

[102] Article 20 of the Company Law.

[103] Article 27 of the Company Law.

[104] It is unclear whether this provision also applies to FIEs, which have been allowed in such localities as Tianjin, Chongqing, Shanghai and Guangzhou, to contribute up to 35% of total registered capital in intangible assets in high-tech enterprises.

[105] Article 26 of the Company Law.

[106] Article 81 of the Company Law.

[107] Article 13 of the Company Law.

[108] Article 123 of the Company Law.

[109] Under the former Company Law, directors, supervisors and other senior officers could not transfer their shares during their term of office.