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Doing Business in China

Abstract
[Excerpt] This publication provides an introduction to the major forms of investment and business operations open to foreign investors under current Chinese law and policy. Different chapters survey equity and cooperative joint ventures, wholly foreign-owned enterprises, representative offices, processing and assembly operations, mergers and acquisitions and more specialized areas such as wholesaling and retailing, intellectual property protection, technology licensing and trading operations. The final part of the publication includes collected translations of China's key foreign investment laws.

Keywords
China, foregn investment, trade, commerce, business, law, imports

Comments
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BAKER & McKENZIE

Doing Business in China

2005

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INTRODUCTION

This publication provides an introduction to the major forms of investment and business operations open to foreign investors under current Chinese law and policy. Different chapters survey equity and cooperative joint ventures, wholly foreign-owned enterprises, representative offices, processing and assembly operations, mergers and acquisitions and more specialized areas such as wholesaling and retailing, intellectual property protection, technology licensing and trading operations. The final part of the publication includes collected translations of China's key foreign investment laws.

EQUITY JOINT VENTURES

Legal Status

An equity joint venture is a Chinese legal person with limited liability. It is established on the basis of a joint venture contract between Chinese and foreign parties after approval by the Ministry of Commerce ("MOFCOM"), or its local counterpart, and other relevant departments.

Equity joint ventures are regulated primarily by the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures (the "Joint Venture Law") and the Implementing Regulations for the Joint Venture Law (the "Joint Venture Regulations"). In addition, supplementary legislation covers such issues as contributions of registered capital, debt-equity ratios, registration, labor, imports and exports, foreign exchange, accounting and taxation. The Company Law of the People's Republic of China (the "Company Law") also includes certain provisions that apply to equity joint ventures. These pieces of legislation, however, do not cover all relevant issues.

There is a lack of regulations and precedents to provide guidance in resolving some issues of corporate organization, management and procedures. In some cases, these issues can be resolved by including appropriate provisions in the joint venture contract or articles of association. In other cases, uncertainties may be resolved by consultation with MOFCOM or its local counterpart.

Establishment

Approval Procedures

Generally speaking, project applications for the establishment of equity joint ventures in certain key sectors are approved by the State Council, the National Development and Reform Commission ("NDRC") or local authorities depending on the size and the nature of the project. Local governments can stipulate their own rules for approval of project applications that can be approved at the local level.

The parties will also have to negotiate and draft the joint venture contract and articles of association. When the parties have completed these documents, they

must apply to MOFCOM or local authorities by submitting an application, the joint venture contract and articles of association, as well as other documents. Upon receipt of these documents, MOFCOM or local authorities have three months to decide whether to approve the proposed joint venture.

After approval by MOFCOM or local authorities, the joint venture must register with the local bureau of the State Administration for Industry and Commerce ("SAIC") within one month. The joint venture will then be issued with a formal business license and be officially established.

The above description is a general outline and may not apply in specific situations. Service sector companies in particular are often subject to specialized approval procedures.

Documentation

The Joint Venture Regulations do not set forth detailed requirements for the form or contents of the letter of intent, the project application, the joint venture contract and articles of association. The Chinese authorities have, however, published model forms for joint venture contracts and articles of association that are closely adhered to by the Chinese parties to joint ventures. By law, the joint venture contract and articles of association may be drafted in both Chinese and a foreign language. Under the Joint Venture Regulations the joint venture contract must be governed by Chinese law.

In addition to the above documents, the parties will often simultaneously negotiate and execute contracts related to the joint venture's operations, such as those for technology transfer, trademark licenses, and supplies of parts or raw materials, as well as for the distribution of finished products. These related contracts may be attached to the joint venture contract as attachments.

Parties' Investments

The most important concepts relating to the capitalization of an equity joint venture are "registered capital" and "total investment". In the joint venture legislation, "registered capital" refers to the total amount of paid-in capital contributions by the parties to the joint venture. The "total investment" equals "registered capital" plus permitted financing for the joint venture. The capital of

joint ventures must meet certain debt to equity ratios. For example, if the total investment is less than US$3 million, at least 70 percent of the total investment must be registered capital.

Capital contributions may take several forms, including cash, buildings, equipment, technology, materials and the right to use land. If the capital contributions are in a form other than cash, the parties must agree on the appropriate value of the contributions on the basis of fairness and reasonableness or agree to have a third party make the evaluation. In addition, the valuation is subject to verification by official appraisers. Limits also apply to the amount of intangible capital contributions.

The timing of capital contributions must also conform with certain schedules. For example, if the registered capital is contributed at one time, it must be contributed within six months following issuance of the business license.

An equity joint venture must obtain approval from the examination and approval authorities for increases or reductions of its registered capital.

Operation

Term and Scope of Activities

Joint ventures in China are typically limited to a fixed term, which must be stipulated in the joint venture contract. In practice, the usual range is between 15 years and 50 years depending on the size and nature of the project, with most substantial manufacturing ventures having a term of 25 years or more. Indefinite terms are permitted subject to government approval, but joint ventures in the service industries, land development and real estate, natural resource exploration and exploitation projects, and other areas, which are restricted must have a fixed term. Upon the expiration of its term, an equity joint venture is to be dissolved, with the property remaining after clearance of debts to be distributed in accordance with the ratio of the parties' capital contributions except where the joint venture agreement, contract or articles of association have other stipulations.

Under the current PRC corporate law regime, all entities in China (whether domestic- or foreign-invested) have definitive "business scopes" approved by

the governmental authorities, which specify the range of business activities in which they are permitted to engage. The business scopes are generally brief and quite specific. They require careful drafting and are often the subject of negotiation between investors and the government authorities in the pre-establishment stage.

Foreign Exchange

China's national currency, the Renminbi, is not freely convertible into other currencies. Nevertheless, China has introduced a form of current account convertibility, under which joint ventures may purchase foreign exchange for current account expenditures without the necessity of obtaining government approval. China also permits the conversion of Renminbi into foreign exchange for remittances of after-tax profits or dividends to foreign investors in equity joint ventures. Foreign exchange remittances and receipts must go through banks that have been designated to handle foreign exchange transactions. Instead of government approval for foreign exchange remittances and receipts, the designated banks examine the documentation for the underlying transaction to ensure that the proposed payment or receipt qualifies as a current account item. Joint ventures also have access to the interbank market for the purchase and sale of foreign exchange through the designated banks.

Current account freedom is not unlimited. The government imposes caps on the amount of foreign exchange that a joint venture can retain. If a joint venture's current account foreign exchange exceeds the cap it must be converted into Renminbi. The cap for a new joint venture is generally not supposed to exceed US$100,000. Subsequently, the cap is to be set at either 30 or 50 percent of foreign exchange receipts in the previous year (depending on the ratio of current account expenditures to current account receipts in the previous year).

However, import/export enterprises and production enterprises may be eligible to retain all of their current account receipts because of actual business requirements.

Government approval is still required for the purchase and remittance of foreign exchange for capital account transactions. Moreover, the foreign exchange re-

forms do not guarantee the availability of foreign exchange whenever required by equity joint ventures.

Management

The board of directors is the highest authority in a joint venture. There are no shareholders' meetings. The appointment of members of the board of directors is generally done in proportion to each party's equity contribution to the joint venture. The joint venture contract may give either the Chinese or foreign party the right to appoint the chairman of the board in the joint venture. In such cases the other party appoints the vice-chairman.

Meetings of the board of directors must be held at least once a year. The quorum for meetings of the board is two-thirds of the members. A member of the board may appoint a proxy to attend board meetings and vote on his behalf.

The general manager is responsible for carrying out the decisions of the board and for the day-to-day management of the joint venture.

Labor

In theory, joint ventures have the right to full authority over the hiring and dismissal of their employees. In practice, the exercise of such autonomy is subject to government interference at various levels. Under the Joint Venture Regulations, the Chinese employees of a joint venture have the right to establish trade unions to represent the employees in signing labor contracts with the joint venture and supervise the implementation of the contracts.

Financial Administration

An equity joint venture is required to adopt accounting procedures based on a dual-entry, accrual system. All accounting records, books and statements are required to be prepared and kept in Chinese. The accounting system adopted by the joint venture must be reported, for the record, to the competent government authorities and the local financial and tax departments. Chinese legislation also requires an accountant registered in China to act as the auditor of the joint venture. Many of the large international accounting firms now have joint ventures that are registered in China.

An annual profit distribution plan has to be prepared and then approved by the board of directors. The distribution of profits among the parties should be in proportion to their respective contributions to the registered capital of the joint venture.

Equity joint ventures are required to allocate a certain percentage of after-tax profits to a reserve fund, enterprise expansion fund and incentive and welfare fund for staff and workers.

Taxation

An equity joint venture is subject to 30 percent national income tax plus 3 percent local income tax. Production joint ventures with a term of ten years or more are eligible for a 100 percent tax exemption for the initial two profit-making years and a 50 percent reduction during the subsequent three years. Longer tax holidays are available to export-oriented enterprises and technologically advanced enterprises. Even more preferential tax incentives are available in state development zones and for special industries.

No withholding tax is levied on dividends remitted to the foreign partner outside of China. A 10 percent withholding tax applies to royalties, rental and interest income.

Equity joint ventures are also subject to other significant taxes, including value added tax, business tax, consumption tax, real estate tax, land value added tax, customs duties, stamp tax and vehicle and vessel license tax. Whether a particular joint venture will be subject to all or some of these taxes depends on the nature of its activities.

COOPERATIVE JOINT VENTURES

Legal Status

Cooperative joint ventures, in which the Chinese and foreign parties cooperate on the basis of a joint venture contract, became common in the early 1980s. The Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures (the "Cooperative Joint Venture Law"), promulgated in 1988 and amended on October 31, 2000, essentially confirmed the established practice. "Contractual joint venture" is another term for cooperative joint venture. The Detailed Implementing Rules for the Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures (the "Cooperative Joint Venture Regulations"), promulgated on September 4, 1995, will presumably be amended at some point to reflect changes made to the Cooperative Joint Venture Law in 2000. Until then, the 1995 Cooperative Joint Venture Regulations are still in force.

Cooperative joint ventures take one of two different forms:

- a "pure" cooperative joint venture in which no legal entity separate from the contracting parties is established and the parties make their contributions to the project and bear the risk of profit and loss directly; and
- a "hybrid" cooperative joint venture in which a separate business entity is established and registered and the parties' liabilities are generally limited to their capital contributions to the entity.

Although the Cooperative Joint Venture Law does not explicitly distinguish between these two types of ventures, it provides that cooperative joint ventures that meet the relevant legal requirements may qualify as "legal persons" under Chinese law. The Cooperative Joint Venture Regulations make further distinctions concerning the treatment of cooperative joint ventures with legal person status and those without. A hybrid form cooperative joint venture would generally qualify as a legal person, while a pure form cooperative joint venture would not.

Establishment

Approval Procedures and Documentation

The documentation required for the establishment of a cooperative joint venture and the procedures for obtaining approval of the project are very similar to those outlined above with respect to equity joint ventures.

In the case of a cooperative joint venture, the examination and approval authority (generally MOFCOM or its local counterpart) has 45 days after receiving the joint venture contract and other relevant documents to decide whether to approve the proposed joint venture. The contract and articles of association become effective upon issuance of an approval certificate.

Parties' Contributions

One of the reasons many investors in the past have chosen to utilize a cooperative joint venture structure instead of an equity joint venture has been that the investors are able to make their contributions to the joint venture in forms other than those allowed for an equity joint venture.

The Chinese party to a cooperative joint venture might, for example, be made responsible for providing the required local labor, including the payment therefor. The Chinese party might also be responsible for providing the necessary factory or office facilities.

Relevant rules have become more restrictive in light of the issuance of the Cooperative Joint Venture Regulations. In some cases, it may not be permitted to count some of these forms of assistance as joint venture contributions, although practice in this regard varies considerably. Foreign investors should focus on how to categorize and structure the parties' contributions to a cooperative joint venture.

Unlike the case of an equity joint venture, a foreign party's investment in a cooperative joint venture may be repatriated prior to the expiration of the term of the joint venture, if the joint venture contract provides that ownership of all of the fixed assets of the joint venture shall revert to the Chinese party upon expiration of the joint venture term. However, the methods by which early

repatriation may be accomplished are limited, and careful planning is required before establishment of the cooperative joint venture.

Operation

Term and Scope of Activities

Pure cooperative joint ventures will usually have a shorter term than equity joint ventures, while hybrid cooperative joint ventures may have longer terms similar to those of equity joint ventures. Cooperative joint ventures are favored for hotels and commercial complexes and in infrastructure projects where the parties intend that the joint venture assets will stay with the Chinese party at the end of the joint venture term. Cooperative joint ventures are also commonly used for projects where the Chinese partner lacks material assets to contribute to the joint venture. Cooperative joint ventures in manufacturing are generally discouraged. The operational activities of cooperative joint ventures are restricted in much the same way as those of equity joint ventures.

It is common for cooperative joint venture contracts, especially those of pure cooperative ventures, to provide for the reversion of all of the assets of the joint venture to the Chinese party upon termination of the venture. In other cases, the liquidation procedures follow those applicable to equity joint ventures.

Foreign Exchange

Cooperative joint ventures are generally subject to the same foreign exchange rules as equity joint ventures.

Management

Under the Cooperative Joint Venture Law, a cooperative joint venture should have either a board of directors or a joint management committee. A hybrid cooperative joint venture is likely to have a board of directors since it will adopt a management system similar to that of an equity joint venture. A cooperative joint venture without legal person status, however, is required to establish a joint management committee.

There must be at least three members on the board of directors or joint management committee. The distribution of these positions can be determined by the parties through consultation. The chairman of the board or head of the committee is the legal representative. The general rules on quorum and convention of meetings are the same as for equity joint ventures.

Labor

In a pure cooperative joint venture, it is often the Chinese party's responsibility to provide the required labor force. In such cases, the joint venture will not have its own employees and all staff will continue to be the responsibility of the Chinese party. The foreign party, however, may contractually stipulate the authority of the management body of the venture to select, discipline and dismiss employees. The foreign party may also desire the contractual joint venture to be able to make incentive payments directly to Chinese staff and workers.

Profits

A substantial advantage of cooperative joint ventures is that the parties may agree on the distribution of profits at a ratio different from that of the parties' capital contributions.

Financial Administration

An accountant registered in the People's Republic of China must be engaged to audit and verify accounts. The parties may engage the accountant jointly or individually. A cooperative joint venture without legal person status must keep unified account books, and the parties must, in addition, keep their own separate account books.

Taxation

In a pure cooperative joint venture, each party is responsible for paying its own taxes on its share of the profits of the joint venture. The foreign party's net income is subject to a 30 percent income tax plus a 3 percent local tax. The taxation of hybrid cooperative joint ventures is analogous to the taxation of

equity joint ventures already outlined above. Exemptions and reductions of taxes and customs duties are also available to cooperative joint ventures, but generally on a more limited basis than to equity joint ventures.

WHOLLY FOREIGN-OWNED ENTERPRISES

Legal Status

Wholly foreign-owned enterprises ("WFOEs") are entities established under the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises (the "WFOE Law") and the Detailed Implementing Rules for the WFOE Law (the "WFOE Regulations"). A WFOE can be a limited liability company or, upon approval, take another form. Currently, most WFOEs in China are established by one foreign investor, although the WFOE Regulations allow two or more foreign investors to apply jointly for the establishment of a WFOE.

Amendments were made to the WFOE Law on October 31, 2000 which, among other things, removed the requirement that WFOEs be either "high-tech" or "export-oriented". Now, "high-tech" or "export-oriented" WFOEs are encouraged rather than required.

Establishment

Approval Procedures and Documentation

The procedures for establishing WFOEs are similar to those for equity joint ventures. MOFCOM is the examination and approval authority, but the local government may have the authority to examine and approve applications in certain cases. If the WFOE's products involve export licenses, export quotas, import licenses, or import restrictions, the local commerce department must give its prior consent before applications will be approved.

Prior to filing an application for the investment, the foreign investor in a proposed WFOE must submit to the local government a report detailing the enterprise's purpose, its scope and scale of business, products, technology and equipment, land use requirements, etc. The foreign investor should receive a reply in writing from the local government within 30 days after submitting the report.

The foreign investor is required to submit to the examination and approval authority the following documents:

- an application;
- a feasibility study for the investment project;
- articles of association for the proposed WFOE;
- the foreign investor's certificate of incorporation;
- a letter of creditworthiness issued by the bank of the foreign investor;
- the name of the legal representative of the WFOE;
- a written response from the local government on the project; and
- other items designated by the examination and approval authority.

The examination and approval authority should announce its decision on the application within ninety days after receiving the application.

Within thirty days after receiving approval, the foreign investor must register the new entity with the local bureau of the SAIC and obtain a business license.

Parties' Investments

As in the case of equity joint ventures, foreign investors' capital contributions to a WFOE may be in the form of foreign currency, machinery, equipment, industrial property, proprietary technology or, upon approval, Renminbi profits derived from their other investments in China. Capital contributions are subject to the prescribed debt to equity ratios and restrictions on reduction or increase of registered capital applicable to equity joint ventures.

Operation

Term and Scope of Activities

A WFOE is permitted to operate for the period provided for in its approval from the examination and approval authority. Requests for an extension of the term of operation must be submitted to this authority 180 days prior to expiry.

Under the WFOE Regulations and the Catalog for Guiding Foreign Investment in Industry (which is revised and amended from time to time), the

establishment of WFOEs is prohibited in certain industries, such as publishing, public utilities and telecommunications.

Foreign Exchange

WFOEs are generally subject to the same foreign exchange controls as joint ventures.

Management

The daily operations of a WFOE will be controlled solely by its own management, and should not be subject to interference by the government when operating in accordance with its approved articles of association.

Labor

WFOEs are subject to labor and labor union rules similar to those applicable to equity joint ventures. Labor contracts between the enterprise and its staff and workers specify the terms of employment and employment-related issues.

Financial Administration

The accounting rules applicable to WFOEs are similar to those applicable to equity joint ventures. Accounting vouchers, books and statements printed by WFOEs themselves must be written in Chinese. For those written in foreign languages, notes in Chinese must be included. Only Chinese registered accountants can verify annual accounting statements. Annual balance sheets and profit-and-loss statements must be submitted to the financial and tax authorities for the record. A WFOE must allocate at least 10 percent of after-tax profits to its statutory reserve fund for a certain number of years, whereas in equity joint ventures, the board of directors decides the proportion to be allocated to the reserve fund.

Taxation

WFOEs are generally subject to the same taxes as equity joint ventures.

REPRESENTATIVE OFFICES

Legal Status

Representative offices established in China by foreign companies are regulated by several national regulations, as well as local legislation, which supplement the national regulations. In general, representative offices may not conduct direct business activities. A representative office is permitted only to make business contacts and render services on behalf of its head office. Personnel employed by the representative office of a foreign company should not sign contracts on behalf of either the foreign company or third parties.

Registration

Pursuant to a 2004 State Council decision, it is no longer necessary to obtain approval for establishment of the most common types of representative office. Instead, direct registration with the industry and commerce authorities is permitted. Certain local registration authorities require an applicant company to submit application materials through designated agencies, and different registration authorities may require different documents.

Documents to be submitted generally include:

- a registration form for the representative office;
- a letter of creditworthiness from the foreign company's bank;
- registration forms for the chief representative and any other representatives; and
- copies of the foreign company's incorporation certificate and business registration certificate.

In addition to attending to the above registration, the foreign company must register the representative office and its foreign staff with the local tax bureau, and a number of other government departments including the public security bureau (for residence permits) and with the local customs authority (for importation of personal belongings).

Employment of Staff

A representative office may hire employees from foreign countries. The foreign employees are normally considered representatives of the office no matter what positions they take, and must register with the various authorities and hold representative identification cards during their period of employment.

A representative office may also hire local Chinese employees, but in such case it is usually required to hire them through an employment services agency authorized by the government to supply Chinese employees to representative offices of foreign companies.

Taxation

In a wide range of circumstances, the representative office of a foreign company will be subject to both enterprise income tax and business tax on the basis that its activities either generate revenue, or through attribution, may be considered to generate revenue for the foreign company. The same rate of enterprise income tax that applies to equity joint ventures will generally apply to a representative office. Business tax is levied on gross revenue from the provision of certain categories of services and the assignment of certain assets. Representative offices that engage in trading, agency and other such service activities will generally be taxed on an imputed income method under which revenue is imputed to the representative office for enterprise income tax and business tax purposes on an "expenses-plus" or "deemed commission" basis. Representative offices that engage in consulting activities such as legal, accounting, tax and business consulting as well as other types of representative offices will generally be taxed on their actual income.

In certain circumstances, a foreign company's representative office may be eligible for an exemption from enterprise income tax and business tax, depending on the nature and extent of its activities.

PROCESSING AND ASSEMBLY OPERATIONS

Legal Status

Another form of doing business in China is a processing and assembly arrangement with a Chinese entity. Most processing and assembly operations involve the shipment of raw materials or semi-processed goods to a Chinese workshop or factory, which then processes or assembles the imported materials or goods and re-exports the finished products back to the foreign party. Under this arrangement, the foreign party will retain title to all imported materials and the subsequent processed products throughout the entire process. Typically, the Chinese factory receives a fee for its work, generally termed a "labor fee," which is usually computed on a unit or lot basis.

Approval

The foreign party can conclude processing and assembly contracts only with qualified "operation units." Operation units can be processing and assembly service companies that have obtained permission to engage in processing using materials supplied by foreign parties, import/export companies and foreign-invested companies. Actual processing will often be carried out by a production enterprise appointed by the operation unit or a factory established by the operation unit. The entity that will do the actual processing must have obtained a certificate of processing capability from the relevant local commerce authorities.

If the operation unit will not be doing the processing itself, it must enter into an "entrusted processing contract" with the processing enterprise it appoints. After the operation unit has concluded the processing and assembly contract with the foreign party and the entrusted processing contract with the processing enterprise, it must make an application to engage in processing business to the commerce authorities. With its application it must submit the contracts, the processing capability certificate and other required documents. If the application is approved, the commerce authorities will issue a Processing Trade Business Approval Certificate.

Customs Requirements

The operation unit is next required to submit the processing and assembly contract and other relevant documents to Customs. This registration will result in the creation of a Registration Handbook that will record subsequent imports of parts, materials and equipment. The Registration Handbook is to be presented by the operation unit to Customs upon the import of materials and export of processed goods in relation to the processing and assembly contract.

Incentives

China offers a number of incentives for processing and assembly operations. For instance, materials and parts imported for processing will normally not be subject to quota and licensing requirements. Imported parts, materials and equipment are exempted from import duties and import value-added tax. In some circumstances a deposit equal to the potential duties and tax on imported parts and materials is payable, but the deposit will be refunded with interest if the processed products are exported within the stipulated time limits. Generally, the time limit for export may not exceed one year.

Guangdong and Fujian provinces, Guangzhou Municipality, the Shenzhen Special Economic Zone and other localities offer additional incentives for processing and assembly operations. Incentives contained in such local legislation include the following:

- financial incentives for domestic enterprises engaged in processing and assembly operations, including tax holidays;
- a relaxation of Customs supervision, including, where feasible, moving the point of Customs control from the port of entry and exit to bonded warehouses and the waiver of certain licensing formalities; and
- a guarantee of the foreign party's right to manage a processing and assembly operation if the contract so provides.

MERGERS AND ACQUISTIONS

Investment by means of merger and acquisition is becoming increasingly popular as the government continues to encourage and facilitate privatization. With increasing openness, M&A opportunities continue to expand. But caution is required so that potential pitfalls presented by China's increasingly sophisticated, and complicated, regulatory framework can be avoided.

Equity Acquisitions

A foreign investor can acquire equity in a foreign-invested enterprise or, pursuant to regulations introduced in 2003, acquire equity in a wholly Chinese-owned enterprise and convert it into a foreign-invested enterprise. Investor qualification requirements and industrial policy requirements must be met. The post-acquisition equity structure must comply with the foreign investment limitations set forth in the Catalog for Guiding Foreign Investment In Industry.

When a foreign investor acquires equity in domestic entities other than foreign-invested enterprises, the parties will have to have the value of the equity appraised before transfer. Prices considerably lower than the appraisal result are forbidden. If state-owned equity is acquired, the transaction price and the appraisal result may generally not differ by more than 10%. The acquisition will have to be approved, generally by MOFCOM or its local counterparts. Also, an antitrust review will have to be conducted by MOFCOM or the State Administration for Industry and Commerce in certain circumstances, such as where the acquisition would result in the purchaser and affiliates obtaining 25% of the market share.

Another form of equity acquisition is the "offshore" or "indirect" acquisition. If the purchaser wants to acquire a foreign-invested enterprise, it could simply acquire the foreign parent of the target rather than the target itself. This form of acquisition is particularly suitable when the parent is a special purpose vehicle established for the sole purpose of holding the foreign-invested enterprise. Offshore acquisitions are in many ways simpler and more convenient than direct acquisitions because Chinese approval requirements are normally avoided.

Asset Acquisitions

When assets, rather than equity, are acquired, it is necessary to establish a commercial presence in the PRC in order to use the assets for operational purposes. In these circumstances, a foreign-invested enterprise may be established prior to the acquisition or, in some circumstances, may be established as part of the acquisition process.

Asset acquisitions have some advantages over equity acquisitions. The foreign investor can pick and choose which parts of the PRC target company it wants to buy. Generally speaking, existing obligations, liabilities or restrictions of the PRC target company will remain the sole responsibility of the PRC target company. Asset acquisitions tend to be more complex than equity acquisitions since the transaction may involve the transfer of different categories of assets and liabilities, each carrying separate statutory requirements. In addition, if a new foreign-invested enterprise is to be established for the purpose of carrying out the asset acquisition, separate approval from the Chinese authorities will be required for its establishment. Finally, there may be tax considerations for the parties in relation to the transfer of assets, as asset acquisitions are taxable in the PRC.

State-Owned Equity Acquisitions

Under rules that came into force in January 2003, if a foreign investor is purchasing state-owned equity and the target is to be reorganized as an foreign-invested enterprise, special procedures must be followed. The seller will have to submit a reorganization program to the relevant government authorities for approval. The seller must also appoint a qualified institution to carry out an asset appraisal.

Subsequently the examination and approval procedures for foreign-invested enterprises must be carried out with the foreign investment authorities on the strength of the approval documents for the reorganization application and the assignment agreement.

Also, under regulations that came into force on February 1, 2004, any transfer of state-owned equity (other than state-owned equity in financial enterprises or listed companies) must be carried out at one of China's property rights

exchanges. Under the regulations, sellers must make a public announcement through a property rights exchange concerning the equity they propose to sell. If more than one prospective buyer emerges during the prescribed notice period, the equity must be sold by means of an auction or tendering process. The main difficulty with this requirement is that foreign investors may find themselves competing with other bidders in an auction or tendering situation after devoting significant time and resources to researching the target, negotiation and due diligence work.

Mergers

Western-style mergers between two companies are possible but are rarely seen in the PRC. PRC statutory mechanisms recognize two means of mergers: a "merger by absorption" or a "merger by new establishment." A "merger by absorption" involves the absorption by one company of another pursuant to which the absorbed company is dissolved and its registered capital and assets merged into the surviving entity. In a "merger by new establishment", each of the pre-merger companies is dissolved and a new company is established holding an aggregate of the pre-merger companies' assets and registered capital.

Cross-border mergers are currently unavailable under PRC law, i.e. it is not possible to directly merge a foreign entity with a domestic company (including foreign-invested enterprises). As far as foreign investors are concerned, the only permissible forms of mergers in China are between foreign-invested enterprises and foreign-invested enterprises, or between foreign-invested enterprises and domestic companies. In practice, however, mergers are rarely seen and acquisitions are much more common.

OTHER ACTIVITIES AND ISSUES

Holding Companies

A "holding company" is a limited liability company, and can be established either as a WFOE or equity joint venture to hold interests in other WFOEs or joint ventures. Holding companies may also provide limited support and other services to these investments in China but cannot themselves engage in production activity.

A holding company allows a foreign investor to centralize certain operations for its other investments in China. It can engage in, among other things, the following business activities:

- centrally purchase raw materials and equipment
- act as a distributor for the sale of investee products in and outside the PRC
- provide transportation and warehousing facilities for its investees
- export domestic products as agent, distributor or by establishing an export purchasing organization
- sell in China (otherwise than by retail sale) products of its parent company that it imports
- offer after-sales service for investee products that it sells and products that it imports
- provide technical training to staff and domestic distributors and agents
- establish research and development centers
- act as sponsor for the establishment of foreign-invested joint stock companies
- purchase investee products, integrate them and sell the integrated products in and outside the PRC
- provide outsourcing of service functions for its parent and affiliates

A holding company can also assist its investee companies in conducting research and development, raising loans and negotiating with central government authorities.

Also, holding companies that qualify as a "Regional Headquarters of a Multinational" can, among other things, import and sell (otherwise than by retail sale) the products of the multinational company and affiliates in which the multinational holds the controlling interest, provide logistics services, import materials and parts needed for maintenance services provided for the products of its investees and the multinational, establish financial companies to provide financial services for itself and its investees and undertake certain outsourcing functions.

Branch Offices

Foreign companies, subject to a few exceptions (including financial and insurance institutions), are not allowed to establish branch offices in China. This is the case notwithstanding the fact that the Company Law contemplates the establishment in China of branch offices of foreign companies. The relevant provisions of the Company Law refer to State Council implementing regulations which have not yet been promulgated. It seems likely that in the future foreign companies will be able, upon application and approval, to establish branch offices in China to engage in a wider range of activities than they are currently allowed to conduct through representative offices.

Wholesaling and Retailing

China's policy on foreign investment has always emphasized manufacturing projects, particularly those that export. The activities open to foreign-invested enterprises are, however, expanding. One example is the opening up of China's wholesale and retail sectors.

Foreign investment in wholesale and retail activities is governed by the Measures for the Administration of Foreign Investment in the Commercial Sector (the "Commercial Sector Measures"), which came into force on June 1, 2004. Promulgation of the Commercial Sector Measures represents partial fulfillment of China's WTO obligations to open up its wholesale and retail

sectors to foreign investment. Under the Commercial Sector Measures, foreign investors can establish 100% wholly foreign-owned wholesale or retail enterprises. There is a cap of 49% foreign ownership, however, when more than 30 stores are opened and the stores sell the following types of products sourced from different suppliers: books, newspapers, periodicals, automobiles (beginning from December 11, 2006, automobiles will not be one of the products that give rise to this equity restriction), pharmaceuticals, pesticides, mulching film, chemical fertilizers, grain, vegetable oil, sugar, cotton, etc. In addition to liberalizing equity restrictions, the Commercial Sector Measures lift all geographic restrictions on foreign-invested wholesale and retail enterprises: such enterprises can be opened anywhere in China. Before that date, retail joint ventures and stores may be established only in provincial capitals, capitals of autonomous regions, municipalities directly under the central government, municipalities with independent development plans and special economic zones. The minimum capital is RMB 500,000 for foreign-invested wholesale enterprises and RMB 300,000 for foreign-invested retail enterprises, though local requirements may in some cases be higher.

Foreign-invested wholesalers and retailers are permitted to engage in a fairly broad scope of activities. In addition to wholesaling, foreign-invested wholesalers will be permitted to engage in commission agency (excluding auctioneering), the import and export of merchandise and related ancillary services. Foreign-invested retailers will be permitted to engage in retailing, the import of merchandise that they sell, sourcing and procurement of China-produced goods for export, television marketing, telephone marketing, mail order sales, Internet sales, vending machine sales and related ancillary services.

Some restrictions do remain however. Foreign-invested wholesalers will not be permitted to wholesale chemical fertilizers, processed oil or crude oil before December 11, 2006. Wholesaling of salt and tobacco is prohibited. Foreign-invested retailers will not be able to retail chemical fertilizers before December 11, 2006. Tobacco retailing is prohibited.

Franchise Operations

China permits foreign investors to engage in franchising activities through wholly foreign-owned or joint venture commercial enterprises. Cross-border franchising is also permitted.

In order for a foreign investor or foreign-invested commercial enterprise to become a franchisor, the applicant company or its subsidiaries, or holding companies must have at least two or more directly-operated stores in China that have been operating for at least one year.

Applications to establish a foreign-invested commercial enterprise to engage in franchising activities must be submitted to the commerce authorities, and a specimen franchise contract must be submitted together with other application materials.

Import/Export Rights and Trading Companies

China's implementation of its WTO commitment to grant import/export rights to foreign-invested enterprises has been controversial. However, a significant step forward was taken when China amended the Law of the People's Republic of China on Foreign Trade (the "Foreign Trade Law"). The amendments replace the system of special, licensed import/export companies with a registration system under which an enterprise, other organization or individual may engage in import/export business after registering with the foreign trade authorities. To implement the new changes, MOFCOM issued the Measures for the Registration of Foreign Trade Operators (the "Registration Measures") on June 24, 2004. Prior to introduction of the new registration system, joint ventures and WFOEs have generally only been authorized to import goods, materials and equipment for their own use and to export products of their own manufacture. Now they should be able to obtain import/export rights for all types of product other than goods subject to state trading. However, it is important to note that import rights do not equal distribution rights. Even if a foreign-invested enterprise obtains import rights, it will not be able to sell the imports unless it also has distribution rights (see the previous section).

Prior to introduction of the new registration system, foreign investors that wished to engage in import/export business could establish a trading joint venture. This type of vehicle, though less important since introduction of the registration system, is still available. But establishment requirements are prohibitive. The foreign investor must have had an annual average of US$ 30 million worth of trade with China for the three years preceding an establishment application. This threshold is reduced to US$ 20 million for

trading joint ventures to be established in western or central China. The Chinese partner must have foreign trade rights. The minimum registered capital for a trading joint venture is RMB 50 million—RMB 30 million for joint ventures in western or central China. Hong Kong investors, including qualifying Hong Kong subsidiaries of multinationals, are eligible for lower establishment requirements and are also permitted to establish wholly owned trading companies.

Special Zones

Starting in 1980, China began to establish a series of specially designated areas and granted them a certain degree of autonomy to provide a more favorable foreign investment environment. The primary benefit of the specially designated areas has been tax reduction and exemption. The first of these areas were the Special Economic Zones. Currently there are five Special Economic Zones: Shantou, Shenzhen, Zhuhai, Xiamen and Hainan. The primary tax benefit of the Special Economic Zones is an income tax rate of 15 percent.

In addition to the Special Economic Zones, other specially designated areas now include the Open Coastal Cities, the Open Coastal Economic Areas, the Economic and Technological Development Zones, the High and New Technology Development Zones, the Bonded Zones and the Export Processing Zones. All these areas offer preferential treatment to foreign-invested enterprises, primarily tax benefits, but the benefit packages available in these specially designated areas differ from one to the other. In addition, encouraged types of foreign-invested enterprise established in "western China" are eligible for an income tax rate of 15 percent until 2010. "Western China" includes Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Ningxia, Qinghai, Xinjiang, Inner Mongolia and Guangxi.

In some local areas, officials have even established special zones and offered preferential tax treatment that are not approved by the central government. Foreign investors should therefore take care to confirm that the benefits offered by local officials are properly authorized by the central authorities.

In some Bonded Zones, local authorities permit foreign investment in business areas that are generally off limits to foreign companies. A significant example

is trading, and a large number of foreign companies have established Bonded Zone trading companies, which typically undertake trading activities within and outside the Bonded Zones.

Technology Transfer

In accordance with its WTO commitments, China has issued a number of regulations for the transfer of technology between foreign and local parties. These regulations include the Regulations for the Administration of Technology Import and Export issued by the State Council, and a number of implementing regulations from MOFCOM. The term "technology transfer" encompasses both assignment and licensing of technology. Both import and export of technology, whether assigned or licensed, are covered under the PRC technology transfer regime. MOFCOM, or its local counterpart, is the administrative bureau responsible for technology transfer.

The new regime specifies three categories of technology:

- prohibited technology, which cannot be imported or exported at all;
- restricted technology, the import or export of which is subject to an approval regime; and
- freely tradable technology, the transfer of which only needs to be filed and registered.

Technologies not classified as being "restricted" or "prohibited" technologies are categorized under the "freely tradable" category.

Both import and export of technologies categorized as "restricted" will be subject to an approval and registration requirement. For technology export contracts, the approval process would involve two applications, including a preliminary approval prior to the parties' negotiation of the relevant contract, and a separate approval of the final executed contract, whereas for technology import contracts the two processes can be combined into a single approval of the executed contract. A contract for transfer of restricted technology takes legal effect only upon application for and the eventual grant of an approval from MOFCOM and the completion of the necessary registration requirements.

Material amendments to an approved or registered contract would require a repetition of the original approval or registration process, although termination of technology license contracts merely requires registration.

Technology import and export contracts for freely tradable technology become effective upon signing of the relevant contracts. However, executed contracts must be registered.

Technology transfer contracts involving restricted technology will not take legal effect until approved by the competent authority. Under the regulations, evidence that a technology import contract has been properly approved or registered is strictly required to facilitate the remittance overseas of royalties and other payments under technology import contracts. Other penalties for violations of the import or export restrictions range from warnings for technical violations to possible criminal penalties for exportation of prohibited technologies.

Under the relevant statutes there are certain requirements in relation to the essential terms of the technology import contracts, compulsory warranties to be made by foreign transferors, and restrictions on the foreign transferor's rights to contractually limit the Chinese transferee's use of licensed technology. However, similar restrictions upon the transferors are not found in relation to technology export contracts where the Chinese parties are the transferors.

Intellectual Property Protection

As a member of the WTO and a signatory to the Paris Convention, the Patent Cooperation Treaty of the World Intellectual Property Organization, the Berne Convention, the Universal Copyright Convention, the Geneva Convention and the Madrid Agreement Concerning the International Registration of Marks, the Chinese government has shown strong determination to enhance the protection of intellectual property.

Patent

The Patent Law of the People's Republic of China (the "Patent Law") and its implementing regulations were amended with effect from July 1, 2001. The implementing regulations were also amended effective from February 1, 2003.

The Patent Law adopts a "first-to-file" system. Under the Paris Convention, however, if a patent application for an invention or utility model is first filed in another Convention-member country within 12 months before the filing date in the PRC, the prior filing date will be regarded as the priority date in the PRC. In the case of design patent applications, the relevant priority period is six months.

The Patent Law grants protection to inventions, utility models, designs, pharmaceutical products and substances obtained by means of a chemical process. An "invention" comprises any new technical solution regarding a product that is capable of practical use. "Designs" relate to any new shape, pattern or color of a product or to the combination thereof that creates an aesthetic feeling and that is suitable for industrial application. Inventions are protected for twenty years from the application filing date. Utility models and industrial designs are accorded ten years of protection.

Foreign applicants are required to submit patent applications in the PRC through an officially designated patent agent. International applications may be granted a Chinese patent only after an applicant has gone through the relevant procedure of the PRC Patent Office. A patent applicant whose application is rejected by the Patent Office may request a re-examination of its application by the Patent Review Board ("PRB"), whose decision may be appealed to court.

The right to apply for patents in relation to inventions or designs created as a result of carrying out employment duties or primarily by using the material and resources of the employer belongs to the employer. However, the right to apply for patents in relation to inventions or designs unrelated to employment belongs to the inventors or designers. The Patent Law further states that in cases where inventions or designs are created as a result of using the material resources of the employer, if the employer and the employee have entered into a contract stipulating the ownership of the patent application rights and patent rights, the contract will prevail.

From the date a patent is granted, any party may apply to the PRB to invalidate the patent on the grounds that its grant does not comply with the Patent Law. The PRB's decision in an invalidation application may be judicially reviewed.

Patent infringement occurs when aspects of a product fall within the scope of the protected claims of a patented item. The time limit for patentees to file infringement actions is two years from the date the patentee becomes aware or should have become aware of the infringing activity. Infringement suits may be brought either through the People's Courts or through local Patent Management Bureaus. Administrative decisions may be appealed, however, to the People's Courts. As an interim measure, the patent owner may request the court to issue orders for preservation of property and/or preservation of evidence. Security must be provided with the application.

The Patent Law stipulates that compensation for patent infringement should be calculated by reference to the loss suffered by the patent owner or the gain reaped by the infringer as a result of the infringement. If the patent owner's loss or the infringer's gain is difficult to calculate, one to three times the relevant reasonable patent license fee may be considered. If there is no patent license fee for reference or if the patent license fee available is clearly unreasonable, compensation may generally be set between RMB 5,000 to RMB 300,000 but not more than RMB 500,000, depending on the situation.

Trademark

The latest amendments to the Trademark Law of the People's Republic of China (the "Trademark Law"), which came into effect on December 1, 2001, were intended primarily to put the law in compliance with the minimum requirements of the Agreement on Trade-related Aspects of Intellectual Property Rights (the "TRIPs Agreement"). The implementing regulations, which supplement various provisions in the Trademark Law, were also amended and came into effect on September 15, 2002.

The Trademark Law imposes a strict "first-to-file" rule for obtaining trademark rights whereby the first party to file for registration of a mark pre-empts later applicants. Prior use of an unregistered mark is generally irrelevant unless the mark in question is well-known and therefore arguably protected either under the Paris Convention or the provisions for "well-known" marks pursuant to the revised Trademark Law and its implementing regulations, . An application for trademark registration must be filed with the Trademark Office of the SAIC.

After a trademark registration application has been granted preliminary approval by the Trademark Office, it will be published in the PRC Trademark Gazette. The PRC Trademark Office will publish an announcement in the Trademark Gazette and, i if no opposition is filed within the statutory three-month opposition period, issue a registration certificate.

The Trademark Law provides that any "visually perceptible" sign capable of distinguishing the goods of one natural person, legal person or other organization from those of another may qualify for registration as a trademark. The sign may take the form of words, figures, letters, numbers, three-dimensional signs, color combinations or a combination of any of these elements. Collective marks and certification marks can be registered as trademarks in the PRC.

A trademark registration is valid for ten years from the final date of approval (i.e. upon expiration of the three-month opposition period), with further ten-year renewal terms available.

Trademark owners pursuing oppositions and cancellations may seek formal recognition of their marks as "well-known" (*chi ming*), thereby aiding in attempts to block others from registering similar marks covering dissimilar goods or services. However, determinations on well-known status are made on a case-by-case basis.

Where a PRC-registered trademark is assigned, the assignor and assignee must execute an application form, which must be filed for approval with the Trademark Office. Upon approval, the assignment will be gazetted. Legal title to the registration is not deemed to pass until the assignment has been approved by the Trademark Office.

The Trademark Law requires a trademark registrant to enter into a written license contract when licensing a PRC-registered trademark to third parties. Trademark license contracts must be submitted to the Trademark Office for recordal in the name of the licensor. Currently, there are no penalties for failure to record a trademark license.

The most significant changes brought by the revised Trademark Law relate to enforcement. Preliminary injunctions are now available in trademark

infringement cases brought before civil courts, including the issuance of injunctions and seizure of evidence by judicial authorities. Statutory damages up to RMB 500,000 are possible in cases where the plaintiff's damage or the infringer's profits cannot be determined. Administrative enforcement authorities and civil courts are authorized to confiscate and destroy infringing products and trademark representations and the equipment used to make them.

The maximum fines that may be imposed against infringers have been significantly increased to three times the infringer's "illegal business amount" (turnover). The new regulations also provide for discretionary fines up to RMB 100,000 in cases where it is impossible to ascertain the illegal business amount.

Copyright

The Copyright Law of the People's Republic of China (the "Copyright Law"), amended with effect from October 27, 2001, and the implementing regulations, amended with effect from September 15, 2002, attempt to bring China's copyright regime closer to full compliance with the TRIPs Agreement.

The revised Copyright Law introduces protection for architectural works, graphic works, model works, and databases. The implementing regulations provide protection for performances and sound recordings produced or distributed by foreigners and stateless persons. Likewise, protection is explicitly recognized for rights in radio and television programs broadcast by foreign radio and television stations.

In compliance with Article 3 of the Berne Convention (1971), the implementing regulations clarify that works created by a foreigner or stateless person that are published in China within 30 days after first publication outside China will be deemed to have been simultaneously published in China. Under the old implementing regulations, such works were regarded as having been first published in China.

Registration is not a precondition to copyright enforcement but may be helpful as evidence of ownership in enforcement actions.

The implementing regulations require exclusive license agreements to be in writing, and they also provide for voluntary recordal of licenses, as well as

assignments. The restriction in the earlier law that copyright licenses be limited to ten years has been removed. The amended law specifically permits the full or partial assignment of economic rights in copyright subject matter.

The revised law introduces strengthened provisions on the enforcement of copyright through civil and administrative measures. Preliminary injunctions can now be sought against copyright infringers. In cases where the plaintiff's damage or the infringer's profits cannot be determined, statutory damages up to RMB 500,000 may be awarded. The National Copyright Administration and local copyright bureaus, the primary government bodies designated to handle administrative enforcement against infringers, are explicitly authorized under the revised law to exercise a wide range of powers. These include the power to issue administrative injunctions, confiscate illegal income of infringers, confiscate and destroy infringing copies, impose fines, and confiscate materials, tools, facilities, etc., primarily used for the production of infringing copies.

Computer software

Copyright in computer software is governed by the general provisions in the Copyright Law and the Regulations for the Protection of Computer Software ("Software Regulations") issued in 1991 and amended in 2002.

The Software Regulations accord protection for new types of uses of software, including rental rights and the right to authorize "broadcast over information networks", which presumably includes the Internet. Consequently, on-line distribution of software without authorization (whether for profit or otherwise) is considered a prohibited form of reproduction under the new Software Regulations. Further, the Software Regulations provide explicit protection against activities that attempt to circumvent or sabotage technological measures used by software copyright owners. Likewise, the Software Regulations outlaw the removal or alteration of electronic rights management information incorporated into works to facilitate copyright protection.

In the case of software owned by legal persons and other organizations, the period of protection is now 50 years, ending on December 31 of the fiftieth year after the work was published. If the software is not published within 50 years after its creation, no protection is to be afforded.

The Software Regulations permit registration for the purpose of providing *prima facie* evidence of ownership and validity of software. The Measures for the Registration of Copyright in Computer Software apply to the registration of software copyright and to the registration of exclusive software copyright license contracts and assignment contracts.

Under the Software Regulations, administrative and civil liability for infringement by reproducers of software appears to be provided on a strict liability basis, and reproducers will only be able to avoid liability if they can prove they were lawfully authorized. Meanwhile, parties that are accused of distributing or renting software can be pursued if they are unable to provide evidence that the software was from a "lawful source". The Software Regulations impose a significant limitation on the ability of copyright owners to pursue end-users piracy, i.e. parties that use, but do not copy software in the routine sense. A party that possesses infringing software will not be liable to pay compensation, provided he did not know or have reasonable grounds to know that the software was infringing. However, the holder may be ordered to immediately stop using and destroy infringing copies.

Permit rights holders can file complaints with either civil courts or administrative enforcement authorities. The Software Regulations also give administrative authorities more explicit powers to deal with infringement than previously available, including the power to issue injunctions, confiscate illegal income of infringers, confiscate or destroy infringing products, and impose fines. In "serious cases", administrative authorities may also confiscate materials, tools, and facilities primarily used for the production of infringing copies.

The Software Regulations specify that a maximum fine of RMB 100 for each infringing item, or alternatively five times "the value of the goods", may be imposed in cases involving unauthorized copying of all or a portion of the software, as well as for unauthorized distribution, rental or transmission via information networks (the Internet). Furthermore, fines up to RMB 50,000 may be imposed for willful evasion or destruction of anti-circumvention measures.

The Software regulations refer to the possibility of obtaining preliminary injunctions in software disputes brought before Chinese courts. In addition, the software regulations refer explicitly to the possibility of pursuing copyright violations under China's Criminal Code.

Domain names

China has issued various new domain name regulations in 2002, in particular the Detailed Implementing Rules of the China Internet Network Information Center for the Registration of Domain Names and in December 2004 issued the "Administrative Measures on China Internet Domain Names" (the "Registration Rules").

The Registration Rules cover applications to register domain names with ".cn" as the top-level domain and Chinese-language domain names administered by the China Internet Network Information Center ("CNNIC"). Only organizations that have been registered in accordance with the law and that can independently assume civil liability may apply for domain name registration. Application may be effected by on-line registration, e-mail or other means. The "first-to file" principle continues to apply: that is, priority is given to the first applicant who files a valid application. Applications can be made to the domain name registrar for the assignment of domain names.

Except where an applicant makes a special declaration that disclosure is not permitted, the domain name registry administrator or the domain name registrar will put all information which the applicant has included in its domain name registration application form into the database for public enquiries.

New domain name dispute resolution measures were also introduced in September 2002. The new measures apply to disputes that arise in relation to ".cn" domain names or Chinese-language domain names under the administration of CNNIC. Such disputes can be accepted and resolved by special dispute resolution bodies recognized by the CNNIC (these bodies include the Domain Name Dispute Settlement Center of the China International Economic and Trade Arbitration Commission and the Hong Kong International Arbitration Center). Any organization or person who believes that there is a conflict between a domain name registered by another party and the lawful rights and interests of the organization or individual may submit a complaint to one of these dispute resolution bodies. If the complaint meets the specified conditions, the domain name holder is required to participate in the dispute resolution proceedings. Rulings of the dispute resolution bodies, however, are not final. Either party is entitled to commence litigation in court before, during or after such proceedings.

The Supreme People's Court explanation issued in October 2002 also makes clear that the following conduct constitutes trademark infringement: registering words that are identical or similar to anothers registered trademark as a domain name and using it to carry out electronic commerce in related goods, thereby causing mistaken recognition on the part of the relevant public.

Trade secrets

Trade secrets are protected under the Anti-Unfair Competition Law. Under the Law, business operators are prohibited from infringing upon commercial secrets by obtaining the commercial secrets of other owners by theft, inducement, coercion or other illicit means; revealing, using or allowing others to use commercial secrets obtained by such means; and revealing, using or allowing others to use commercial secrets of other owners which are in their possession by violation of agreements or other requests for confidentiality by the owners concerned. If a third person knew or should have known of such acts violating the law, but obtains, uses or reveals commercial secrets of others, this also constitutes an infringement.

China's Criminal Law, effective October 1, 1997, imposes criminal sanctions for a variety of crimes of infringing intellectual property rights, including the crime of infringing rights in trade secrets.

China's legal framework for the protection of intellectual property is now relatively complete, but the challenge for China's to implement this legislation effectively. China's efforts to implement this legislation have been perceived as inadequate by some foreign investors, particularly in the software, movie and recording industries.

Conclusion

As China has undergone the transformation from a socialist planned economy to a "socialist market economy" and opened previously restricted areas to foreign investment, opportunities for doing business have increased considerably. It seems likely that this trend will continue in the future as China's policy and legal framework for doing business move closer to general international norms.

However, with opportunity comes risk. China has indeed made tremendous progress in the last 25 years in establishing a legislative basis for foreign investment and a legal system to uphold the rule of law. But much remains to be done before China's legal environment approximates that of many developed or some developing countries.

Accordingly, while foreign companies will find many opportunities in what is arguably the world's largest market, they will want to pay particular attention to protecting their interests to the greatest degree possible through careful planning based on a full appreciation and understanding of the rapidly changing legal environment for doing business in China.

SELECTED FOREIGN INVESTMENT LAWS

English translations of the following major PRC laws relating to foreign investment are appended.

- Law of the People's Republic of China on Sino-foreign Equity Joint Ventures
- Implementing Regulations for the Law of the People's Republic of China on Sino-foreign Equity Joint Ventures
- Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures
- Detailed Implementing Rules for the Law of the People's Republic of China on Sino-foreign Cooperative Joint Ventures
- Law of the People's Republic of China on Wholly Foreign-owned Enterprises
- Detailed Implementing Rules for the Law of the People's Republic of China on Wholly Foreign-owned Enterprises

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LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON SINO-FOREIGN EQUITY JOINT VENTURES

(Adopted on July 1, 1979 at the 2nd Session of the 5th National People's Congress, amended on April 4, 1990 at the 3rd Session of the 7th National People's Congress, and amended for the 2nd time on March 15, 2001 at the 4th Session of the 9th National People's Congress.)

Article 1. The People's Republic of China, in order to expand international economic cooperation and technological exchange, permits foreign companies, enterprises and other economic organizations or individuals ("Foreign Parties") to jointly establish and operate equity joint ventures within the People's Republic of China with Chinese companies, enterprises or other economic organizations ("Chinese Parties") based on the principle of equality and mutual benefit, and upon the approval of the Chinese government.

Article 2. The Chinese government protects in accordance with the law the investments of the Foreign Party, the profits due to it and its other lawful rights and interests in an equity joint venture under the agreement, contract and articles of association approved by the Chinese government.

All the activities of an equity joint venture shall comply with the provisions of the laws and regulations of the People's Republic of China.

The state will not nationalize or expropriate equity joint ventures. Under special circumstances, the state, based on the public interest, may expropriate equity joint ventures pursuant to legal procedures and give commensurate compensation.

Article 3. The agreement and/or contract for, and the articles of association of, an equity joint venture signed by the parties to the venture shall be submitted to the state department in charge of foreign economic relations and trade (the "Examination and Approval Authority") for examination and approval. The Examination and Approval Authority shall decide whether to approve or disapprove the application within three months. After an equity joint venture has been approved, it shall register with the state administration for industry and commerce, obtain its business license, and commence business operations.

Article 4. The form of an equity joint venture shall be a limited liability company.

The proportion of the Foreign Party's contribution to the registered capital of an equity joint venture shall in general not be less than 25 percent.

The parties to the venture shall share profits and bear risks and losses in proportion to their respective contributions to the registered capital.

The assignment of a party's contribution to the registered capital shall be subject to the consent of each party to the venture.

Article 5. The parties to an equity joint venture may make their investments in cash, in kind, in industrial property rights, etc.

The technology and equipment contributed by a Foreign Party as its investment must be advanced technology and equipment which is truly suited to the needs of China. In case of losses caused by deception through the intentional provision of outdated technology and equipment, compensation shall be made for such losses.

The investment of a Chinese Party may include providing the right to use a site during the term of operation of the equity joint venture. If the right to use a site is not a part of

the investment by the Chinese Party, the venture shall pay the Chinese government a fee for its use.

The various investments mentioned above shall be specified in the contract for, and articles of association of, the equity joint venture, and the value of each contribution (except the site) shall be appraised and determined through discussions between the parties to the venture.

Article 6. An equity joint venture shall establish a board of directors. The size and composition of the board of directors stipulated in the contract and the articles of association after consultation between the parties to the venture; and each party to the venture shall appoint and replace its own director(s). The chairman and the vice chairman of the board shall be determined through consultation between the parties to the venture or elected by the board. Where a director appointed by the Chinese Party or the Foreign Party serves as chairman, a director appointed by the other party shall serve as vice chairman. The board of directors shall decide important issues concerning the equity joint venture based on the principle of equality and mutual benefit.

The functions and powers of the board of directors shall be to discuss and decide, pursuant to the provisions of the articles of association of the equity joint venture, all important issues concerning the venture, namely the enterprise's development plans, production and business programs, budgets, distribution of profits, plans concerning labor and wages, the termination of business, and the appointment or hiring of the general manager, the deputy general manager(s), the chief engineer, the chief accountant and the auditor, as well as their functions and powers and their remuneration, etc.

The positions of general manager and deputy general manager(s) (or the factory manager and deputy factory manager(s)) shall be assumed by nominees of the respective parties to the venture.

Matters such as the employment, dismissal, remuneration, benefits, labor protection, labor insurance, etc. of the staff and workers of an equity joint venture shall be provided for through the conclusion of contracts according to law.

Article 7. The staff and workers of an equity joint venture shall lawfully establish a labor union, which shall carry on labor union activities and protect the lawful rights and interests of the staff and workers.

An equity joint venture shall provide its labor union with the conditions necessary for the latter's activities.

Article 8. From the gross profit earned by an equity joint venture, after payment of the venture's income tax in accordance with the provisions of the tax laws of the People's Republic of China, deductions shall be made for a reserve fund, a bonus and welfare fund for staff and workers and an enterprise development fund as stipulated in the articles of association of the venture and the net profit shall be distributed to the parties to the venture in proportion to their respective contributions to the registered capital.

An equity joint venture may enjoy preferential treatment in the form of tax reductions and exemptions in accordance with the provisions of state laws and administrative regulations relating to taxation.

When a Foreign Party uses its share of the net profit as reinvestment within the territory of China, it may apply for a refund of part of the income tax already paid.

Article 9. An equity joint venture shall, on the basis of its business license, open a foreign exchange account with a bank or another financial institution which is permitted by the state foreign exchange control authority to engage in foreign exchange business.

Matters concerning the foreign exchange of an equity joint venture shall be handled in conformity with the foreign exchange control regulations of the People's Republic of China.

An equity joint venture may, in the course of its business activities, raise funds directly from foreign banks.

All items of insurance of an equity joint venture shall be taken out from insurance companies in China.

Article 10. Supplies such as raw materials and fuel needed by an equity joint venture within the approved scope of business may be purchased on the domestic or international market, according to the principle of fairness and reasonableness.

Equity joint ventures are encouraged to sell their products outside China. Export products may be sold on foreign markets by equity joint ventures directly or by entrusted institutions related to them, and they may also be sold through China's foreign trade institutions. The products of equity joint ventures may also be sold on the Chinese market.

When necessary, equity joint ventures may set up branches outside China.

Article 11. The net profit received by a Foreign Party after fulfillment of its obligations at law and under the provisions of agreements and contracts, the funds received by it upon the expiration or termination of the equity joint venture as well as other funds may be remitted abroad in accordance with foreign exchange control regulations in the currency stipulated in the joint venture contract.

Foreign Parties are encouraged to deposit in the Bank of China the foreign exchange which may be remitted abroad.

Article 12. The wage income and other legitimate income of expatriate staff and workers of an equity joint venture may be remitted abroad in accordance with foreign exchange control regulations after payment of individual income tax under the tax laws of the People's Republic of China.

Article 13. Different terms of operation of equity joint ventures may be agreed upon according to different lines of business and

different circumstances. The term of operation of equity joint ventures engaged in some lines of business shall be fixed while the term of operation of equity joint ventures engaged in other lines of business may or may not be fixed. Where the parties to an equity joint venture with a fixed term of operation agree to extend the term of operation, they shall submit an application to the Examination and Approval Authority not later than six months prior to the expiration of the term. The Examination and Approval Authority shall decide whether to approve or disapprove the application within one month of the date of receipt thereof.

Article 14. If serious losses are incurred by an equity joint venture, or one party fails to fulfill its obligations under the contract and the articles of association, or an event of force majeure occurs, etc., the contract may be terminated after consultation and agreement between the parties to the venture, subject to approval by the Examination and Approval Authority and to registration with the state administration for industry and commerce. In case of losses caused by breach of contract, financial liability shall be borne by the breaching party.

Article 15. When a dispute arises between the parties to a venture and the board of directors is unable to resolve it through consultation, the dispute shall be settled through conciliation or arbitration conducted by an arbitration institution of China, or through arbitration by another arbitration institution agreed upon by the parties to the venture.

If the parties to a venture have not included an arbitration clause in their contract or if they have not subsequently reached a written arbitration agreement, legal proceedings may be commenced in a People's Court.

Article 16. This Law shall come into force on the date of publication.

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IMPLEMENTING REGULATIONS FOR THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON SINO-FOREIGN EQUITY JOINT VENTURES

(Published by the State Council on September 20, 1983 and amended by the State Council on January 15, 1986, December 21, 1987 and July 22, 2001.)

Chapter 1. General Provisions

Article 1. These Regulations are formulated in order to facilitate the smooth implementation of the *Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures* (the "Equity Joint Venture Law").

Article 2. Sino-foreign equity joint ventures ("Equity Joint Ventures") established in China in accordance with the Equity Joint Venture Law are Chinese legal persons governed and protected by the laws of China.

Article 3. Joint ventures established in China shall be able to promote the development of China's economy and the enhancement of its scientific and technical capabilities, and benefit socialist modernization and construction.

The industries in which the state encourages, permits, restricts or prohibits the establishment of joint ventures shall be as set forth in the state's regulations for guiding the direction of foreign investment and catalog for guiding foreign investment in industry.

Article 4. Applications for the establishment of joint ventures shall not be approved in any of the following circumstances:

(1) China's sovereignty would be harmed;

(2) Chinese law would be violated;

(3) the requirements for the development of China's national economy would not be satisfied;

(4) environmental pollution would be caused; or

(5) the agreement, contract or articles of association signed are obviously unfair, harming the rights and interests of one joint venture party.

Article 5. Joint ventures have the right to conduct operations and management autonomously to the extent stipulated in Chinese laws and regulations and the joint venture agreement, contract and articles of association. The various relevant authorities shall provide support and assistance.

Chapter 2. Establishment and Registration

Article 6. The establishment of joint ventures in China shall be subject to examination and approval by the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China (hereinafter referred to as "MOFTEC"). MOFTEC shall issue a certificate of approval after approval.

The State Council authorizes the People's Government of the relevant province, autonomous region or municipality directly under the central government, or the relevant State Council authority, to carry out examination and approval in any of the following situations:

(1) the total amount of investment does not exceed the sum stipulated by the State Council and the source of capital of the Chinese party has already been ascertained; or

(2) the additional allocation of raw materials by the state is not required and the national balance in such areas as fuel, power, transportation and foreign trade export quotas will not be not affected.

Joint ventures the establishment of which is approved pursuant to the preceding paragraph shall be reported to MOFTEC for the record.

MOFTEC, and the People's Governments of provinces, autonomous regions and municipalities directly under the central government or the relevant State Council authorities authorized by MOFTEC, are hereinafter collectively referred to as the "Examination and Approval Authorities".

Article 7. When applying for the establishment of a joint venture, the Chinese party and the foreign party shall jointly submit the following documents to the Examination and Approval Authority:

(1) application for the establishment of a joint venture;

(2) a feasibility study jointly prepared by the joint venture parties;

(3) the joint venture agreement, contract and articles of association signed by authorized representatives of the joint venture parties;

(4) a list of the names of the persons appointed by the joint venture parties as chairman of the board, vice chairman of the board and directors of the joint venture; and

(5) other documents as specified by the Examination and Approval Authority.

The documents specified in the preceding paragraph must be written in the Chinese language. The documents mentioned in items (2), (3) and (4) may additionally be written in a foreign language decided on by the joint venture parties. Documents written in both languages shall have equal validity.

If the Examination and Approval Authority discovers that any of the documents submitted is not in order, it shall require the same to be amended within a certain period.

Article 8. The Examination and Approval Authority shall decide whether or not to grant approval within three months of the date of receipt of all the documents stipulated in Article 7 of these Regulations.

Article 9. Applicants shall, within one month of the date of receipt of the certificate of approval, carry out registration procedures with the administration for industry and commerce (the "Registry") in accordance with the relevant state regulations. The date of issue of the business license of a joint venture is the date of establishment of the said joint venture.

Article 10. For the purposes of these Regulations, the term "joint venture agreement" means a document concluded by the joint venture parties upon arrival at a consensus on certain main points and principles concerning the establishment of a joint venture; the term "joint venture contract" means a document concluded by the joint venture parties upon arrival at a consensus on their mutual rights and obligations, for the purpose of establishing a joint venture; and the term "articles of association of a joint venture" means a document that, in accordance with the principles stipulated in the joint venture contract and upon unanimous agreement by all the joint venture parties, stipulates such items as the purpose, organizational principles and operation and management methods of the joint venture.

If there is a conflict between the joint venture agreement and the joint venture contract, the joint venture contract shall prevail.

Upon agreement by the joint venture parties, they may also conclude only a joint venture contract and articles of association and not conclude a joint venture agreement.

Article 11. A joint venture contract shall include the following main contents:

(1) the name, country of registration and legal address of each joint venture party, and the name, position and nationality of the legal representative of each joint venture party;

(2) the name, legal address, purpose and scope and scale of business of the joint venture;

(3) the total amount of investment and the registered capital of the joint venture, the amount, ratio, form and time limit of each joint venture party's capital contribution, and stipulations on shortfalls in paying in capital contributions and the assignment of equity interests;

(4) the ratio of distribution of profits to and bearing of losses by the joint venture parties;

(5) the composition of the board of directors of the joint venture, the distribution of seats on the board of directors, and the responsibilities, limits of authority and method of employment of the general manager, deputy general managers and other senior management personnel;

(6) the main production equipment and production technology to be adopted and their sources;

(7) the methods of purchase of raw materials and sale of products;

(8) principles for the handling of financial, accounting and auditing matters;

(9) stipulations regarding such matters as labor management, wages, welfare and labor insurance;

(10) the term, dissolution and the liquidation procedures of the joint venture;

(11) liability for breach of the contract;

(12) means and procedures for the resolution of disputes between the joint venture parties; and

(13) the language adopted for the contract text and the conditions for the entry into effect of the contract.

Appendices to joint venture contracts shall be as valid as the joint venture contract.

Article 12. The conclusion, validity, interpretation and implementation of joint venture contracts and the resolution of disputes thereunder shall all be governed by Chinese law.

Article 13. The articles of association of a joint venture shall include the following main contents:

(1) the name and legal address of the joint venture;

(2) the purpose, scope of business and term of the joint venture;

(3) the name, country of registration and legal address of each joint venture party, and the name, position and nationality of the legal representative of each joint venture party;

(4) the total amount of investment and the registered capital of the joint venture, the amount and ratio of each joint venture party's capital contribution, stipulations on the assignment of equity interests, and the ratio of distribution of profits to and bearing of losses by the joint venture parties;

(5) the composition, authority and rules of procedure of the board of directors, the terms of office of the directors, and the duties of the chairman of the board of directors and vice chairman of the board of directors;

(6) the establishment of the management organization, administrative rules, the duties and method of appointment and dismissal of the general manager, deputy general managers and other senior management personnel;

(7) principles of the financial, accounting and auditing systems;

(8) dissolution and liquidation; and

(9) the procedure for amendment of the articles of association.

Article 14. Joint venture agreements, contracts and articles of association, and any amendments thereto, shall take effect after approval by the Examination and Approval Authorities.

Article 15. The Examination and Approval Authorities and the Registries are responsible for supervising and inspecting the implementation of joint venture contracts and articles of association.

Chapter 3. Form of Organization and Registered Capital

Article 16. Joint ventures shall be limited liability companies.

The liability of the joint venture parties to a joint venture shall be limited to the amounts of the respective capital contributions subscribed by them.

Article 17. The term "total amount of investment of a joint venture" (including loans) means the sum of the capital construction funds and production working capital needed to be injected in accordance with the scale of production stipulated in the joint venture contract and articles of association.

Article 18. The term "registered capital of a joint venture" means the total amount of capital for the establishment of the joint venture, as registered with the Registry, and shall be the sum of the amounts of capital contribution subscribed by the joint venture parties.

The registered capital of joint ventures shall generally be denominated in Renminbi; alternatively, it may be denominated in a foreign currency agreed upon by the joint venture parties.

Article 19. Joint ventures may not reduce their registered capital during their terms. If such reductions are truly necessary as a result of changes in the total amount of investment, the scale of production and business, etc., approval must be obtained from the Examination and Approval Authority.

Article 20. Assignment by one joint venture party to a third party of all or part of its equity interest shall be subject to the consent of the other joint venture party and the approval of the Examination and Approval Authority, and require that procedures for change of the registration be carried out with the Registry.

When one joint venture party is to assign all or part of its equity interest, the other joint venture party has a preemptive right of purchase.

The conditions under which one joint venture party assigns its equity interest to a third party may not be more preferential than the conditions for assignment to the other joint venture party.

Assignments in violation of the above provisions are void.

Article 21. The increase or reduction of the registered capital of a joint venture shall require approval at a meeting of the board of directors, the approval of the Examination and Approval Authority and the carrying out of change of registration procedures with the Registry.

Chapter 4. Forms of Capital Contribution

Article 22. Joint venture parties may use currency as capital contributions and may also use items such as valued buildings, factories, machinery, equipment or other materials, industrial property rights, proprietary technology and site use rights, etc. as capital contributions. In cases where buildings, factories, machinery, equipment or other materials, industrial property rights or proprietary technology are used as capital contributions,

their valuation shall be discussed and determined by the joint venture parties in accordance with the principles of fairness and reasonableness, or a third party agreed upon by the joint venture parties shall be retained to make an assessment.

Article 23. Foreign currency contributed by foreign parties as capital shall be converted into Renminbi in accordance with the basic exchange rate announced by the People's Bank of China on the day of its payment or shall be cross converted into the agreed foreign currency.

If it is required to convert the Renminbi cash contributed by the Chinese party as capital into foreign currency, it shall be converted in accordance with the basic exchange rate announced by People's Bank of China on the day of the payment.

Article 24. The machinery, equipment or other materials contributed by the foreign party as capital shall be indispensable to the joint venture's production.

The valuation of the machinery, equipment or other materials mentioned in the preceding paragraph may not be higher than the current international market price for similar machinery, equipment or other materials.

Article 25. The industrial property rights or proprietary technology contributed by the foreign party as capital must meet one of the following conditions:

(1) they must enable the making of marked improvements in the performance and quality of existing products and the raising of productivity; or

(2) they must enable marked conservation of raw materials, fuel or power.

Article 26. Foreign parties that contribute industrial property rights or proprietary technology as capital shall present relevant documentation on the said industrial property rights or

proprietary technology, including such relevant documents as photocopies of the patent certificates or trademark registration certificates, documents indicating the validity status, technical characteristics, practical value, the basis for valuation and the valuation agreement signed with the Chinese party. The said documents shall serve as appendices to the joint venture contract.

Article 27. Machinery, equipment, other materials, industrial property rights or proprietary technology contributed by the foreign party as capital shall be subject to the approval of the Examination and Approval Authority.

Article 28. Joint venture parties shall pay in the amounts of their respective capital contributions in full in accordance with the time limit stipulated in the contract. In case of overdue payment or incomplete payment, delay interest or damages shall be paid in accordance with the stipulations of the contract.

Article 29. After the joint venture parties have paid up their capital contributions, a Chinese registered accountant shall verify the same and issue a capital contribution verification report, whereupon the joint venture shall issue investment certificates. An investment certificate shall specify the following particulars: the name of the joint venture, the day, month and year of the establishment of the joint venture, the names of the joint venture parties, the amounts of their capital contributions and the day, month and year on which they are made, and the day, month and year of issuance of the investment certificate.

Chapter 5. Board of Directors and Management Organization

Article 30. The board of directors shall be the highest authority of the joint venture, and shall decide upon all the important issues of the joint venture.

Article 31. The board of directors shall have not less than three members. The distribution of seats on the board of directors shall be determined by the joint venture parties following consultations, making reference to the ratio of capital contributions.

Directors shall serve terms of four years and may serve consecutive terms if reappointed by the joint venture party that originally appointed them.

Article 32. Meetings of the board of directors meeting shall be held at least once a year. The chairman of the board shall be responsible for convening and presiding over the board meetings. If the chairman of the board is unable to convene a meeting, he shall entrust the vice chairman of the board or another director with convening and presiding over the meeting. The chairman of the board may convene an interim board meeting upon proposal by one-third or more of the directors.

A meeting of the board of directors may be held only if two-thirds or more of the directors are present. If a director is unable to attend, he may issue a proxy entrusting another person to attend and vote at the meeting on his behalf.

Meetings of the board of directors shall generally be held in the place of the joint venture's legal address.

Article 33. Resolutions involving any of the following matters may be adopted only with the unanimous affirmative vote of the directors attending the board meeting:

(1) amendment of the articles of association of the joint venture;

(2) termination and dissolution of the joint venture;

(3) increase or reduction of the registered capital of the joint venture; or

(4) merger or division of the joint venture.

Resolutions on other matters may be made according to the rules of procedure stated in the articles of association of the joint venture.

Article 34. The chairman of the board of directors shall the legal representative of the joint venture. If the chairman of the board of directors is unable to perform his duties, he shall authorize the vice chairman of the board of directors or another director to represent the joint venture.

Article 35. A joint venture shall establish an operation and management organization, which shall be responsible for the day-to-day operation and management of the joint venture. The operation and management organization shall have one general manager and several deputy general managers. The deputy managers shall assist the general manager in his work.

Article 36. The general manager shall implement all the resolutions adopted at meetings of the Board of Directors and organize and direct the day-to-day operation and management of the joint venture. Within the scope of authority delegated to him by the board of directors, the general manager shall represent the joint venture in external affairs and appoint and dismiss subordinate personnel and exercise other functions and powers delegated by the board of directors.

Article 37. The general manager and deputy general managers shall be retained by the board of directors of the joint venture. These positions may be held by Chinese citizens and may also be held by foreign citizens.

The chairman of the board, the vice chairman of the board and the directors may be retained by the board of directors to act concurrently in the capacity of general manager, deputy general manager or another senior management position in the joint venture.

In handling important issues, the general manager shall discuss them with the deputy general managers.

The general manager or a deputy general manager may not concurrently act as general manager or deputy general manager of another economic organization, and may not participate in commercial competition of other economic organizations against his own joint venture.

Article 38. If the general manager, a deputy general manager or other senior management personnel practices graft or commits serious dereliction of duty, he may be dismissed at any time by resolution of the board of directors.

Article 39. If a joint venture needs to establish branches (including sales branches) abroad or in the Hong Kong or Macao region, it shall report the matter to MOFTEC for approval.

Chapter 6. Import of Technology

Article 40. For the purposes of these Regulations, the term "import of technology" means a joint venture's acquisition of needed technology by means of technology transfer from a third party or a joint venture party.

Article 41. The technology imported by a joint venture shall be appropriate and advanced, and cause the resulting products to generate marked social and economic benefits domestically or to be competitive on the international market.

Article 42. When a technology transfer agreement is concluded, the right of a joint venture to conduct operations and management independently must be safeguarded, and the technology exporter shall be required to provide relevant documentation by reference to Article 26 hereof.

Article 43. A technology transfer agreement concluded by a joint venture shall be subject to the approval of the Examination and Approval Authority.

A technology transfer agreement must meet the following stipulations:

(1) the fees for the use of technology shall be fair and reasonable;

(2) unless otherwise agreed upon by both parties, the technology exporter may not restrict the regions, quantities or prices of the technology importer's exports of the resulting products;

(3) the term of the technology transfer agreement shall generally not exceed 10 years;

(4) after the expiration of the technology transfer agreement, the technology importer shall have the right to continue to use the technology in question;

(5) the terms for mutual exchange of improvements in the technology between the parties to the technology transfer agreement shall be reciprocal;

(6) the technology importer shall have the right to purchase needed machinery, equipment, parts and raw materials from sources which it, in its own discretion, considers suitable; and

(7) no unreasonable restrictive clauses prohibited by Chinese laws and regulations may be included.

Chapter 7. Site Use Rights and the Fees Therefor

Article 44. In using its site, a joint venture must implement the principle of conservation in the use of land. A joint venture shall submit an application for its required site to the municipal (county) level department in charge of land in the location of the joint venture and, after approval, obtain the site use rights by signing a contract. The contract shall specify such particulars as the area, location and purpose of the site, the contract term and the fee for the sight use rights (the "Site Use Fee"), the rights and obligations of the parties, the penalties for breach of contract, etc.

Article 45. If the Chinese party already possesses the site use rights required by the joint venture, the Chinese party may use it as a capital contribution to the joint venture. The amount of its valuation shall be equivalent to the use fee to be paid for obtaining the use rights to a similar site.

Article 46. The Site Use Fee rates shall be stipulated by the People's Government of the province, autonomous region or municipality directly under the central government where the site is located according to such factors as the purpose, geographic and environmental conditions, expenses for the requisitioning the site and the demolition, relocation and resettlement, and the joint venture's requirements with regard to infrastructure. The rates stipulated shall be filed for the record with MOFTEC and the department in charge of land.

Article 47. A joint venture engaged in agriculture or animal husbandry may pay its Site Use Fee to the department in charge of land in its locality based on a percentage of the joint venture's operating revenue, subject to the consent of the People's Government of the province, autonomous region or municipality directly under the central government where it is located.

In the case of projects of a development nature in economically undeveloped regions, special preferences may be granted in respect of Site Use Fees, subject to the agreement of the local People's Government.

Article 48. Site Use Fees shall not be adjusted within five years from the start of use of a site. Afterwards, when adjustments are needed in line with changes in economic development, the circumstances of supply and demand, and changes in geographic and environmental conditions, the interval between adjustments shall not be less than three years.

Site Use Fees used as capital contributions by Chinese parties may not be adjusted during the term of the contract in question.

Article 49. The Site Use Fee for the site use rights obtained by a joint venture in accordance with Article 44 hereof shall be paid annually over the period of use of the site stipulated in the contract starting from the beginning of the period. If the period of use of the site in the first calendar year exceeds half a year, the fee shall be calculated on the basis of half a year; if it is less than half a year, the fee shall be exempted. If Site Use Fees are adjusted during the contract period, the joint venture shall pay the fee in accordance with the new rates starting from the year of adjustment.

Article 50. In addition to obtaining site use rights pursuant to this Chapter, a joint venture may obtain site use rights in accordance with relevant state regulations.

Chapter 8. Purchases and Sales

Article 51. In their purchases of such items as required machinery, equipment, raw materials, fuel, accessories, means of transportation, articles for office use, etc. ("Supplies"), joint ventures have the right to decide on their own whether to purchase the same in China or abroad.

Article 52. The articles for office and personal use that joint ventures need to purchase in China may be purchased in accordance with the amounts needed and are not subject to restrictions.

Article 53. The Chinese government encourages joint ventures to sell their products on the international market.

Article 54. Joint ventures have the right to export their products by themselves and may also entrust the sales organizations of the foreign party or Chinese foreign trade corporations with selling their products as agents or distributors.

Article 55. With respect to any machinery, equipment, parts, fittings, raw materials or fuel needed for a joint venture's production

which the enterprise imports within the scope of business stipulated in the joint venture contract and for which the state requires an import license, the joint venture shall prepare a plan once a year and apply for the licenses once every six months. Machinery, equipment and other materials that the foreign party contributes as capital may be imported by applying directly for import licenses on the strength of the approval document from the Examination and Approval Authority. Separate import license applications shall be filed for those Supplies which are to be imported beyond the scope stipulated in the joint venture contract and for which the state requires an import license.

A joint venture may export on its own the products it produces. With respect to those for which the state requires an export license, the joint venture shall apply for licenses once every six months based on its annual export plan.

Article 56. The treatment of joint ventures in terms of the prices for domestic purchases of Supplies and the fees charged for such services as water, electricity, gas, heat, transportation of goods, labor services, engineering design, consultancy, advertising, etc. shall be equal to that of other domestic enterprises

Article 57. In economic transactions between joint ventures and other Chinese economic organizations, the parties shall undertake financial liability and resolve contractual disputes in accordance with the relevant laws and regulations and the contracts concluded between the parties.

Article 58. Joint ventures shall provide statistical information and submit statistical forms in accordance with the *Law of the People's Republic of China on Statistics* and China's system for statistics on the use of foreign investment.

Chapter 9. Taxation

Article 59. Joint ventures shall pay various taxes in accordance with the relevant laws of the People's Republic of China.

Article 60. Staff and workers of joint ventures shall pay individual income tax in accordance with the *Individual Income Tax Law of the People's Republic of China*.

Article 61. Joint ventures shall be granted duty and tax reductions and exemptions on the import of the following Supplies, in accordance with the relevant provisions of Chinese tax laws:

(1) machinery, equipment, parts and other materials (the term "other materials" as used here and hereinafter means materials required for a joint venture's construction of the factory (site) and for installation and reinforcement of machinery) which serve as capital contributions of the foreign party in accordance with the stipulations of the contract;

(2) machinery, equipment, parts and other materials imported by joint ventures using funds within their total amount of investment;

(3) machinery, equipment, parts and other materials of which the production and supply cannot be guaranteed in China and which, with the approval of the Examination and Approval Authorities, are imported by joint ventures using additional capital; and

(4) raw materials, auxiliary materials, components, parts and packaging materials imported by joint ventures from abroad for the production of export products.

Duties and tax shall be paid or made up according to regulations on those of the above-mentioned Supplies imported with a reduction in, or free of, duty and tax which are, upon approval, diverted for sale domestically in China or diverted to use in products to be sold domestically in China.

Article 62. Tax and duty reductions, exemptions or refunds shall be granted in accordance with the relevant provisions of Chinese tax laws on export products produced by joint ventures other than products the export of which is restricted by China.

Chapter 10. Exchange Control

Article 63. All foreign exchange matters of joint ventures shall be handled in accordance with the *Regulations of the People's Republic of China on Exchange Control* and relevant control measures.

Article 64. Joint ventures shall open foreign exchange and Renminbi accounts with banks in China on the strength of their business licenses. The payments into and out of such accounts shall be supervised by the banks with which they have been opened.

Article 65. Joint ventures which wish to open foreign exchange accounts with banks abroad or in the Hong Kong and Macao regions shall obtain the approval of SAFE or one of its branches, and shall report details of the receipts and disbursements and provide the banks' account statements to SAFE or its branch.

Article 66. Branches established by joint ventures abroad or in the Hong Kong and Macao regions shall submit their annual balance sheets and annual profit statements to SAFE or one of its branches through the joint venture.

Article 67. Joint ventures may, as business requires, apply to financial institutions in China for foreign exchange loans and Renminbi loans. Joint ventures may also borrow foreign exchange funds from banks abroad or in the Hong Kong or Macao region in accordance with relevant state regulations, in which they case shall carry out registration or recordal procedures with SAFE or one of its branches.

Articles 68. Expatriate, Hong Kong and Macao staff and workers of joint ventures, after paying tax according to law and after taking out money for expenses in China, may remit out of the country the remaining portion of their wages and other legitimate income.

Chapter 11. Financial affairs and Accounting

Article 69. The financial and accounting systems of a joint venture shall be formulated in accordance with the relevant laws and financial and accounting systems of China, and in the light of the circumstances of the joint venture, and shall be reported to the local finance and tax authorities for the record.

Article 70. Joint ventures shall have a chief accountant to assist the general manager in his responsibility for the financial and accounting work of the enterprise. When necessary, there may be a deputy chief accountant.

Article 71. Joint ventures shall have an auditor (small enterprises may elect not to have one) to be responsible for examining and checking financial receipts and disbursements and the accounts of the joint venture. The auditor shall submit reports to the board of directors and the general manager.

Article 72. The calendar year shall be adopted as the fiscal year of joint ventures, a fiscal year running from January 1 to December 31 of the Gregorian calendar.

Article 73. In their accounting, joint ventures shall adopt the internationally used accrual system and debit and credit method for the keeping of accounts. All vouchers, account books, and statements prepared by the enterprise itself must be made and kept in the Chinese language. They may additionally be made and kept in a foreign language decided upon by the joint venture parties.

Article 74. Joint ventures in principle shall adopt the Renminbi as the standard bookkeeping currency. Alternatively, a given foreign currency may be adopted as the standard bookkeeping currency if the joint venture parties so agree.

Article 75. Cash, bank deposits, other currency amounts and items such as claims, debts, earnings and expenses, etc. of a joint venture which are in currencies other than the standard bookkeeping currency shall, in addition to the standard bookkeeping

currency, be recorded in the accounts in the currencies actually received or paid.

The financial and accounting reports compiled and submitted by joint ventures that use a foreign currency as the standard bookkeeping currency shall be converted into Renminbi.

Differentials upon conversion into the standard accounting currency resulting from differences in exchange rates shall be recorded as exchange gains or losses. In the event of fluctuation in an exchange rate, the book amounts of the various accounts in the foreign currency concerned shall, at the time of the year-end closing, be subjected to accounting treatment in accordance with the provisions of the relevant Chinese laws and financial and accounting systems.

Article 76. The principles of profit distribution after the payment of income tax by joint ventures in accordance with the *Income Tax Law of the People's Republic of China Concerning Foreign Investment Enterprises and Foreign Enterprises* are as follows:

(1) allocations shall be made to a reserve fund, a bonus and welfare fund for staff and workers and an enterprise expansion fund, at ratios to be determined by the board of directors;

(2) in addition to being used to make up the losses of the joint venture, the reserve fund may be used to increase the capital of the enterprise and expand production, subject to the approval of the Examination and Approval Authority; and

(3) the profits available for distribution after the allocations to the three funds in accordance with item (1) hereof shall, if the board of directors decides to distribute them, be distributed in proportion to the capital contributions of the joint venture parties.

Article 77. Profits may not be distributed until the losses from preceding years have been made up. Retained profits from preceding years may be distributed together with the profits of the current year.

Article 78. Joint ventures shall submit quarterly and annual accounting statements to the joint venture parties, the local tax authorities and the finance authorities.

Article 79. The following documents, certificates and statements of a joint venture are valid only if examined and certified by a Chinese registered accountant:

(1) the investment certificates of the joint venture parties (where materials, site use rights, industrial property rights or proprietary technology is used as capital contribution, the list of estimated property values signed and agreed to by the joint venture parties and the written agreement thereon shall be included);

(2) annual accounting statements of the joint venture; and

(3) accounting statements on liquidation of the joint venture.

Chapter 12. Staff and Workers

Article 80. Matters relating to the staff and workers of joint ventures such as their recruitment, employment, dismissal, resignation, wages, benefits, labor insurance, labor protection, labor discipline, etc. shall be handled in accordance with state regulations concerning labor and social insurance.

Article 81. Joint ventures shall strengthen vocational and technical training of their staff and workers and establish strict assessment systems, in order that the production and management skills of their staff and workers are sufficient to meet the requirements of a modern enterprise.

Article 82. The wage and bonus systems of joint ventures must comply with the principles of each according to his work and more pay for more work.

Article 83. The wage package of such senior management personnel as the general and deputy general managers, chief and deputy chief engineers, chief and deputy chief accountants and auditors shall be decided upon by the board of directors.

Chapter 13. Labor Union

Article 84. The staff and workers of joint ventures have the right to establish basic-level labor unions and carry on labor union activities in accordance with the *Labor Union Law of the People's Republic of China* and the *China Labor Union Charter*.

Article 85. The labor union of a joint venture shall represent the interests of the staff and workers. It shall have the right to enter into a labor contract with the joint venture on behalf of the staff and workers and to supervise the implementation thereof.

Article 86. The basic tasks of the labor union of a joint venture shall be to protect the democratic rights and material interests of the staff and workers in accordance with the law; to assist the joint venture in arranging and rationally using the bonus and welfare fund; to organize the staff and workers to engage in political, vocational, scientific and technological and professional knowledge; to organize literary, artistic and athletic activities, and to teach the staff and workers to observe labor discipline and make efforts to accomplish the various economic tasks of the enterprise.

Article 87. A representative of the labor union shall have the right to attend as a non-voting attendee meetings of the board of directors at which major matters such as development plans and production and operational activities of the joint venture are discussed, in order to make known the opinions and requests of the staff and workers.

When the board of directors of a joint venture studies and decides on matters such as rewards, punishment, the wage

system, benefits, labor protection, labor insurance, etc., of staff and workers, a representative of its labor union shall have the right to attend the meeting as a non-voting attendee. The board of directors shall listen to the opinions of the labor union and obtain its cooperation.

Article 88. Joint ventures shall actively support the work of their labor unions and, in accordance with the *Labor Union Law of the People's Republic of China*, provide them with the necessary premises and equipment for office work and meetings and for use in organizing collective welfare, cultural and athletic activities for staff and workers. Joint ventures shall each month allocate labor union funds at the rate of 2 percent of the total take-home pay of their staff and workers. Such funds shall be used by their labor unions in accordance with the measures for the use of labor union funds formulated by the All-China Federation of Trade Unions.

Chapter 14. Term, Dissolution and Liquidation

Article 89. The term of a joint venture shall be in accordance with the *Provisional Regulations Concerning the Terms of Sino-Foreign Equity Joint Ventures*.

Article 90. A joint venture shall be dissolved:

(1) upon expiration of its term;

(2) if it incurs serious deficits, making it impossible to continue to operate;

(3) if one of the joint venture parties fails to perform its obligations under the joint venture agreement, contract or articles of association, making it impossible for the enterprise to continue to operate;

(4) if serious loss is suffered as a result of an event of force majeure such as a natural disaster or war, making it impossible to continue to operate;

(5) if the joint venture has been unable to attain its business goals and has no development prospects; or

(6) if other reasons for dissolution stipulated in the joint venture contract or articles of association has occurred.

If circumstances as mentioned in item (2), (4), (5) or (6) of the preceding paragraph arise, the board of directors shall submit an application for dissolution to the Examination and Approval Authority for approval. If circumstances as mentioned in item (3) arise, the party performing the contract shall submit the application to the Examination and Approval Authority for approval.

If circumstances as mentioned in item (3) of the first paragraph hereof arise, the party that has failed to perform its obligations under the joint venture agreement, contract or articles of association shall be liable to compensate the joint venture for the losses caused thereby.

Article 91. When a joint ventures announces its dissolution, it shall be liquidated. The board of directors shall establish a liquidation committee, which shall take charge of liquidation matters, in accordance with the *Measures for the Liquidation of Foreign Investment Enterprises*.

Article 92. The members of the liquidation committee generally shall be appointed from among the directors of the joint venture. When the directors cannot serve or are unsuitable to serve as members of the liquidation committee, the joint venture may retain Chinese registered accountants or lawyers to serve on the committee. When the Examination and Approval Authority considers it necessary, it may send people to conduct supervision.

The liquidation expenses and remuneration of members of the liquidation committee shall be paid out of the property currently held by the joint venture on a priority basis.

Article 93. The tasks of the liquidation committee shall be to conduct a complete check of the joint venture's property, claims and debts, to prepare a balance sheet and a list of property, to put forward a valuation of the property and specify the basis of calculation thereof, and to formulate a liquidation plan and implement the same upon approval at a meeting of the board of directors.

During the period of liquidation, the liquidation committee shall represent the joint venture when it is suing or being sued.

Article 94. A joint venture shall be liable for its debts with all of its assets. The property remaining after the clearance of the joint venture's debts shall be distributed in proportion to the capital contributions of the joint venture parties, unless the joint venture agreement, contract or articles of association provide otherwise.

When a joint venture is being dissolved, that portion of its net amount of assets or remaining property (less the enterprise's undistributed profit, funds to which allocations have been made and liquidation expenses) which exceeds its paid-in capital shall be income from liquidation and income tax shall be paid thereon according to law.

Article 95. Upon conclusion of the liquidation of a joint venture, the liquidation committee shall submit a report on the conclusion of liquidation to a meeting of the board of directors, after adoption by which it shall be submitted to the Examination and Approval Authority, and de-registration procedures shall be carried out with, and the business license returned for cancellation to, the Registry.

Article 96. After a joint venture has been dissolved, its various account books and documents shall be preserved by the Chinese party.

Chapter 15. Resolution of Disputes

Article 97. If a dispute arises over the interpretation or performance of the joint venture agreement, contract or articles of association, the joint venture parties shall exert their greatest efforts to resolve it through friendly consultations or mediation. If consultations or mediation is ineffective, the dispute shall be submitted to arbitration or the judiciary for resolution.

Article 98. On the basis of the written arbitration agreement, the joint venture parties may conduct arbitration before an arbitration institution in China; alternatively, they may conduct arbitration before another arbitration institution.

Article 99. If there is no written arbitration agreement between the joint venture parties, either party to a dispute may institute proceedings in a People's Court according to law.

Article 100. While a dispute is being resolved, the joint venture parties shall continue to perform all provisions of the joint venture agreement, contract and articles of association except for those which form the subject matter of the dispute.

Chapter 16. Supplementary Provisions

Article 101. The Chinese authorities in charge of visas may simplify procedures to convenience expatriate, Hong Kong and Macao staff and workers of joint ventures (including their family members) who need to enter and exit China frequently.

Article 102. Chinese staff and workers of joint ventures who, because of their work requirements, need to leave the country (territory) for observation, business negotiations, study or training shall carry out exit procedures in accordance with relevant state regulations.

Article 103. Expatriate, Hong Kong and Macao staff and workers of joint ventures may bring in necessary means of transportation and office articles, paying customs duty and tax in accordance with the relevant provisions of Chinese tax law.

Article 104. Where laws or administrative regulations provide otherwise in respect of joint ventures established in special economic zones, such provisions shall prevail.

Article 105. These Regulations shall be implemented from the date of publication.

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LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON SINO-FOREIGN COOPERATIVE JOINT VENTURES

(Adopted at the 1st Session of the 7th National People's Congress on April 13, 1988, and promulgated by Order No. 4 of the President on, and effective from, April 13, 1988. Amended at the 18th Session of the Standing Committee of the 9th National People's Congress on October 31, 2000.)

Article 1. This Law is specially formulated in order to expand foreign economic cooperation and technological exchange, and to promote the joint establishment of Sino-foreign cooperative joint ventures ("Cooperative Joint Ventures") in China by foreign enterprises, other economic organizations or individuals (hereinafter referred to as "Foreign Parties") and enterprises or other economic organizations of the People's Republic of China (hereinafter referred to as "Chinese Parties") in accordance with the principle of equality and mutual benefit.

Article 2. When a Chinese Party and a Foreign Party establish a Cooperative Joint Venture, they shall, in accordance with the provisions of this Law, provide in the Cooperative Joint Venture contract for matters such as the investment or cooperation conditions, the distribution of earnings or products, the sharing of risks and losses, the form of operation and management, and the ownership of property upon termination of the Cooperative Joint Venture.

A Cooperative Joint Venture that meets the requirements regarding legal persons as stipulated by Chinese law will obtain the status of a Chinese legal person according to law.

Article 3. The lawful rights and interests of a Cooperative Joint Venture and of the Chinese Party and the Foreign Party thereto will be protected by the state according to law.

A Cooperative Joint Venture must observe Chinese laws and regulations and shall not harm the public interest of China.

The relevant authorities of the state shall supervise Cooperative Joint Ventures according to law.

Article 4. The state encourages the establishment of production-type Cooperative Joint Ventures that export their products or are technologically advanced.

Article 5. Applications for the establishment of a Cooperative Joint Venture shall be made by submitting for examination and approval such documents as the agreement, contract and articles of association entered into by and between the Chinese Party and the Foreign Party to the department under the State Council in charge of foreign economic relations and trade or the department or local government authorized by the State Council (the "Examination and Approval Authority"). The Examination and Approval Authority shall decide whether to approve or disapprove the application within 45 days of the date of receipt thereof.

Article 6. After the application for establishment of a Cooperative Joint Venture has been approved, an application for registration shall be made to the administration for industry and commerce within 30 days of the date of receipt of the approval certificate, and a business license shall be obtained. The date on which the business license of a Cooperative Joint Venture is issued shall be the date such venture is established.

A Cooperative Joint Venture shall, within 30 days of the date of its establishment, carry out tax registration procedures with the tax authorities.

Article 7. Major amendments to a Cooperative Joint Venture contract agreed upon by the Chinese Party and the Foreign Party during the term of cooperation shall be submitted to the Examination and Approval Authority for approval. If the content to be changed involves statutory particulars of business registration or tax registration, the registration with the administration for industry and commerce or the tax authorities shall be amended.

Article 8. The investment made or cooperation conditions provided by the Chinese and Foreign Parties may be in the form of cash, material objects, land use rights, industrial property rights, non-patented technology and other property rights.

Article 9. The Chinese and Foreign Parties shall perform their obligations in respect of making the full investment or providing the cooperation conditions according to schedule and in accordance with laws, regulations and the Cooperative Joint Venture contract. If the Parties fail to perform the said obligations according to schedule, the administration for industry and commerce shall impose a time limit for the performance thereof. If the Parties have still not performed the said obligations upon the expiration of the imposed time limit, the matter shall be dealt with by the Examination and Approval Authority and the administration for industry and commerce in accordance with relevant regulations of the state.

The investment made by or cooperation conditions provided by the Chinese and Foreign Parties shall be verified by an accountant registered in China or a relevant organization, who (which) shall issue a certificate.

Article 10. If a Chinese or Foreign Party wishes to assign all or part of its rights and obligations under the Cooperative Joint Venture contract, it must obtain the consent of the other Party and submit the assignment to the Examination and Approval Authority for approval.

Article 11. A Cooperative Joint Venture shall conduct its operational and management activities in accordance with its approved contract and articles of association. The autonomy of a Cooperative Joint Venture in terms of operation and management shall not be interfered with.

Article 12. A Cooperative Joint Venture shall form a board of directors or a joint management committee, which shall decide the important issues concerning the Cooperative Joint Venture in accordance with the contract for, or the articles of association of, the Cooperative Joint Venture. Where a director appointed by the Chinese Party or the Foreign Party serves as chairman of the board of directors or head of the joint management committee, a director appointed by the other party shall serve as vice chairman or deputy head. The board of directors or joint management committee may decide to appoint or engage a general manager to take charge of the day-to-day operation and management of the Cooperative Joint Venture. The general manager shall report to the board of directors or joint management committee.

If, upon the establishment of a Cooperative Joint Venture, a party other than the Chinese Party and Foreign Party thereto is entrusted with the operation and management thereof, such change shall be subject to the unanimous consent of the board of directors or joint management committee and be submitted to the Examination and Approval Authority for approval. In addition, the registration with the administration for industry and commerce shall be amended.

Article 13. Matters such as the employment, dismissal, remuneration, welfare benefits, labor protection and labor insurance of the staff and workers of a Cooperative Joint Venture shall be provided for in contracts according to law.

Article 14. The staff and workers of a Cooperative Joint Venture shall lawfully establish a labor union, which shall carry out labor union activities and protect the lawful rights and interests of the staff and workers.

A Cooperative Joint Venture shall provide its labor union with the conditions necessary for the latter's activities.

Article 15. A Cooperative Joint Venture must keep account books in China, submit accounting statements in accordance with regulations, and accept supervision by the finance and tax authorities.

If a Cooperative Joint Venture violates the preceding paragraph by failing to keep account books in China, the finance and tax authorities may impose a fine and the administration for industry and commerce may order it to stop its business operations or revoke its business license.

Article 16. Cooperative Joint Ventures shall, on the strength of their business licenses, open foreign exchange accounts with banks or other financial institutions that are permitted by the state administration for exchange control to engage in foreign exchange business.

Matters concerning foreign exchange of a Cooperative Joint Venture shall be handled in accordance with state regulations concerning foreign exchange control.

Article 17. Cooperative Joint Ventures may borrow funds from financial institutions in China, and may also borrow funds outside China.

Loans taken out by the Chinese Party and the Foreign Party for the purpose of making their investments or providing their cooperation conditions, and the security therefor, shall be arranged by each Party itself.

Article 18. All items of insurance of a Cooperative Joint Venture shall be taken out from insurance institutions in China.

Article 19. A Cooperative Joint Venture may, within its approved scope of business, import supplies it requires and export products it has produced. Supplies such as raw materials and fuel needed by a Cooperative Joint Venture within the approved scope of business may be purchased on the domestic or international market, according to the principle of fairness and reasonableness.

Article 20. A Cooperative Joint Venture shall pay tax in accordance with state regulations concerning taxation and may enjoy preferential treatment in the form of tax reductions and exemptions.

Article 21. The Chinese Party and the Foreign Party shall distribute earnings or products, and share risks and losses, in accordance with the Cooperative Joint Venture contract.

If the Chinese Party and the Foreign Party stipulate in the Cooperative Joint Venture contract that the Chinese Party shall become the owner of all fixed assets of the Cooperative Joint Venture upon expiration of the term of cooperation, they may provide in the Cooperative Joint Venture contract for a method whereby the Foreign Party first recovers its investment during the term of cooperation. If the Cooperative Joint Venture contract stipulates that the Foreign Party shall recover its investment before the payment of income tax, an application must be filed with the finance and tax authorities, which shall examine and approve the same in accordance with state regulations concerning taxation.

If the Foreign Party first recovers its investment during the term of cooperation in accordance with the preceding paragraph, the Chinese Party and the Foreign Party shall be liable for the debts of the Cooperative Joint Venture in accordance with the relevant laws and the Cooperative Joint Venture contract.

Article 22. After performing its statutory obligations and its obligations under the Cooperative Joint Venture contract, the Foreign Party may remit out of China, according to law, the profit distributed to it, other income lawfully derived by it, and the funds distributed to it upon termination of the Cooperative Joint Venture.

The wage income and other lawful income of expatriate staff and workers of a Cooperative Joint Venture may be remitted abroad after payment of individual income tax according to law.

Article 23. Upon the expiration or early termination of the term of a Cooperative Joint Venture, its assets, claims and debts shall be liquidated in accordance with statutory procedures. The Chinese Party and the Foreign Party shall determine the ownership of the property of the Cooperative Joint Venture in accordance with the Cooperative Joint Venture contract.

Upon the expiration or early termination of the term of a Cooperative Joint Venture, de-registration procedures shall carried out with the administration for industry and commerce and the tax authorities.

Article 24. The term of cooperation of a Cooperative Joint Venture shall be discussed by the Chinese Party and the Foreign Party and specified in the Cooperative Joint Venture contract. If the Chinese Party and the Foreign Party agree to extend the term of cooperation, they shall, no later than 180 days prior to the expiration of such term, file an application with the Examination and Approval Authority, which shall decide to approve or disapprove the application within 30 days of the date of receipt thereof.

Article 25. When a dispute arises in connection with the performance of the contract for, or the articles of association of, a Cooperative Joint Venture, the Chinese Party and the Foreign Party shall resolve the dispute through consultations or mediation. If the Chinese Party and the Foreign Party are unwilling to resolve the dispute through consultations or mediation, or if consultations or mediation is unsuccessful, the dispute may be submitted for arbitration to a Chinese arbitration institution or other arbitration institution in accordance with the arbitration clause of the Cooperative Joint Venture contract or a written arbitration agreement subsequently reached.

If the Chinese Party and the Foreign Party have neither included an arbitration clause in the Cooperative Joint Venture contract nor subsequently reached a written arbitration agreement, legal proceedings may be commenced in a Chinese court.

Article 26. The department under the State Council in charge of foreign economic relations and trade shall, on the basis of this Law, formulate detailed implementing rules which shall be implemented after being submitted to and approved by the State Council.

Article 27. This Law shall be implemented from the date of publication.

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DETAILED IMPLEMENTING RULES FOR THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON SINO-FOREIGN COOPERATIVE JOINT VENTURES

(Approved by the State Council on August 7, 1995. Promulgated by the Ministry of Foreign Trade and Economic Cooperation on, and effective from, September 4, 1995.)

Chapter 1. General Provisions

Article 1. These Detailed Implementing Rules are formulated in accordance with the *Law of the People's Republic of China on Sino-Foreign Cooperative Joint Ventures*.

Article 2. The establishment of Sino-foreign cooperative joint ventures ("Cooperative Joint Ventures") in China shall conform to the development policies and industrial policies of the state and comply with the regulations concerning the guidance of foreign investment.

Article 3. Cooperative Joint Ventures shall develop their business and engage in operation and management activities autonomously and according to law within the scope of the approved agreements and contracts for, and articles of association of, such Cooperative Joint Ventures, and shall not be subject to interference by any organization or individual.

Article 4. Cooperative Joint Ventures shall include Cooperative Joint Ventures that obtain the status of a Chinese legal person according to law and Cooperative Joint Ventures without the status of a legal person.

Those Cooperative Joint Ventures without the status of a legal person for which Chapter 9 hereof contains special provisions shall be subject to such provisions.

Article 5. The department in charge of a Cooperative Joint Venture shall be the department in charge of the Chinese party to the Cooperative Joint Venture. If a Cooperative Joint Venture has two or more Chinese parties, the department in charge of the Cooperative Joint Venture shall be determined by the examination and approval authority in conjunction with the relevant departments through consultations, unless laws and administrative regulations provide otherwise.

The department in charge of a Cooperative Joint Venture shall coordinate and provide assistance with relevant matters of the Cooperative Joint Venture according to law.

Chapter 2. Establishment of a Cooperative Joint Venture

Article 6. The establishment of a Cooperative Joint Venture shall be subject to examination and approval by the Ministry of Foreign Trade and Economic Cooperation or by departments and local People's Governments authorized by the State Council.

The establishment of a Cooperative Joint Venture shall be subject to examination and approval by a department or local People's Government authorized by the State Council:

(1) if the total amount of investment does not exceed the investment limit specified by the State Council for examination and approval by a department or local People's Government authorized by the State Council;

(2) if the funds are raised by the parties themselves and the state is not required to balance construction or production conditions;

(3) if the export of products does not require export quotas or licenses from relevant competent state authorities or, although such quotas or licenses are required, consent has been obtained from the relevant competent state authorities prior to submission of the project proposal; or

(4) in other circumstances for which laws or administrative regulations provide for examination and approval by a department or local People's Government authorized by the State Council.

Article 7. To establish a Cooperative Joint Venture, the Chinese party shall submit the following documents to the examination and approval authority:

(1) a project proposal concerning the establishment of the Cooperative Joint Venture, accompanied by documents containing the approval granted by the competent authorities upon examination;

(2) a feasibility study jointly prepared by the parties, accompanied by documents containing the approval granted by the competent authorities upon examination;

(3) the agreement and/or contract for, and the articles of association of, the cooperative joint venture signed by the joint venture parties' legal representatives or representatives authorized thereby;

(4) the business license or proof of registration and a certificate of creditworthiness of each party, and valid credentials of each party's legal representative; if the foreign party is a natural person, valid documentary proof of his identity, education, work experience and creditworthiness shall be provided;

(5) a list of the names of the persons to hold the positions of chairman of the board, vice chairman of the board and director of the cooperative joint venture, or the

positions of head, deputy head and member of the joint management committee of the cooperative joint venture, as determined by the parties through consultations; and

(6) such other documents as the examination and approval authority may require to be submitted.

All documents specified in the preceding paragraph, except the documents to be provided by the foreign party as specified in item (4), must be submitted in Chinese. The documents specified in items (2), (3) and (5) may additionally be submitted in a foreign language agreed upon by the parties.

The examination and approval authority shall decide whether or not to grant approval within 45 days of the date of receipt of all the prescribed documents. If the examination and approval authority considers that the documents submitted are incomplete or not in order, it shall have the right to require the parties to provide the missing documents or to correct the items that are not in order.

Article 8. Where the establishment of a cooperative joint venture was approved by the Ministry of Foreign Trade and Economic Cooperation or a department authorized by the State Council, the Ministry of Foreign Trade and Economic Cooperation shall issue the approval certificate.

Where the establishment of a cooperative joint venture was approved by a local People's Government authorized by the State Council, the relevant local People's Government shall issue the approval certificate and, within 30 days of the date of approval, submit the relevant approval document to the Ministry of Foreign Trade and Economic Cooperation for the record.

Cooperative joint ventures the establishment of which has been approved shall apply for registration to and obtain a business license from the administration for industry and commerce according to law.

Article 9. Applications for approval to establish a cooperative joint venture shall not be approved:

(1) if the sovereignty of the state or the public interest would be harmed;

(2) if national security would be jeopardized;

(3) if pollution damage would be caused to the environment; or

(4) in other circumstances where laws, administrative regulations or the state's industrial policy would be violated.

Article 10. For the purposes of these Detailed Implementing Rules, the term "cooperative joint venture agreement" means a written document created after the parties have arrived at a consensus on the principles for and main issues concerning the establishment of a Cooperative Joint Venture.

For the purposes of these Detailed Implementing Rules, the term "Cooperative Joint Venture contract" means a written document created after the parties have arrived at a consensus on their mutual rights and obligations, for the purpose of establishing a Cooperative Joint Venture.

For the purposes of these Detailed Implementing Rules, the term "articles of association of a Cooperative Joint Venture" means a written document providing for the organizational principles, operation and management methods, etc. of a Cooperative Joint Venture that is formulated in accordance with the provisions of the Cooperative Joint Venture contract and unanimously agreed upon by all the parties.

In the case of discrepancy between the contents of the Cooperative Joint Venture agreement or the articles of association of a Cooperative Joint Venture and the contents of the Cooperative Joint Venture contract, the Cooperative Joint Venture contract shall prevail.

The parties shall have the option not to conclude a Cooperative Joint Venture agreement.

Article 11. The agreement and/or contract for and the articles of association of a Cooperative Joint Venture shall become effective on the date of issuance of the approval certificate by the examination and approval authority. Major amendments to the agreement or contract for or the articles of association of a Cooperative Joint Venture that are made during the term of cooperation shall be subject to approval by the examination and approval authority.

Article 12. A Cooperative Joint Venture contract shall specify the following particulars:

(1) the name, place of registration and domicile of each joint venture party and the name, position and nationality of the legal representative of each joint venture party (or, if the foreign joint venture party is a natural person, the name, nationality and domicile of the foreign joint venture party);

(2) the name, domicile and scope of business of the Cooperative Joint Venture;

(3) the total amount of investment and the registered capital of the Cooperative Joint Venture and the method by and time limit in which each joint venture party should make its investment or provide its cooperation conditions;

(4) assignment of the investment made or cooperation conditions provided by each joint venture party;

(5) the distribution of gains or products and the sharing of risks or losses between the joint venture parties;

(6) the formation of the board of directors or joint management committee of the Cooperative Joint Venture, the distribution of seats on the board of directors or joint management committee, and the duties and methods for

appointment and dismissal of the general manager and other senior management personnel;

(7) the main production equipment and production technology to be adopted, and the sources thereof;

(8) arrangements for the sale of products in and outside China;

(9) arrangements for the receipt and disbursement of foreign exchange by the Cooperative Joint Venture;

(10) the term, dissolution and liquidation of the Cooperative Joint Venture;

(11) other obligations of the joint venture parties and liability for breach of contract;

(12) the principles for the handling of financial, accounting and auditing matters;

(13) the handling of disputes between the joint venture parties; and

(14) the procedure for amendment of the Cooperative Joint Venture contract.

Article 13. The articles of association of a Cooperative Joint Venture shall specify the following particulars:

(1) the name and domicile of the Cooperative Joint Venture;

(2) the scope of business and term of the Cooperative Joint Venture;

(3) the name, place of registration and domicile of each joint venture party and the name, position and nationality of the legal representative of each joint venture party (or, if the foreign joint venture party is a natural person, the name, nationality and domicile of the foreign joint venture party);

(4) the total amount of investment and the registered capital of the Cooperative Joint Venture and the method of and time limit for making investment or providing cooperation conditions by each joint venture party;

(5) the distribution of gains or products and the sharing of risks or losses between the joint venture parties;

(6) the formation, powers, functions and rules of procedure of the board of directors or joint management committee of the Cooperative Joint Venture, the terms of office of members of the board of directors or joint management committee, and the duties of the chairman and vice chairman of the board or the head and deputy head of the joint management committee;

(7) the establishment, powers, functions and working procedures of the operation and management organization, and the duties and methods for appointment and dismissal of the general manager and other senior management personnel;

(8) provisions concerning labor management issues such as the employment, training, labor contracts, wages, social insurance, welfare benefits, occupational safety and hygiene, etc. of staff and workers;

(9) the financial, accounting and auditing systems of the Cooperative Joint Venture;

(10) methods for the dissolution and liquidation of the Cooperative Joint Venture; and

(11) the procedure for amendment of the articles of association of the Cooperative Joint Venture.

Chapter 3. Investments and Cooperation Conditions

Article 14. A Cooperative Joint Venture that obtains the status of a Chinese legal person according to law shall be a limited liability company. The parties shall be liable to the Cooperative Joint Venture to the extent of their respective investments made or cooperation conditions provided, unless the Cooperative Joint Venture contract provides otherwise.

A Cooperative Joint Venture shall be liable for its debts with all of its assets.

Article 15. The term "total amount of investment of a Cooperative Joint Venture" means the total amount of funds that needs to be injected according to the scale of production and business provided for in the contract for and articles of association of the Cooperative Joint Venture.

Article 16. The term "registered capital of a Cooperative Joint Venture" means the sum of the capital contributions subscribed by each party for the purpose of establishment of the Cooperative Joint Venture as registered with the administration for industry and commerce. The registered capital shall be denominated in Renminbi or in a freely convertible foreign currency agreed upon by the parties.

The registered capital of a Cooperative Joint Venture may not be reduced during the term of cooperation. However, if such reduction is truly necessary as a result of changes in the total amount of investment and the scale of production and business, approval must be obtained from the examination and approval authority.

Chapter 4. Form of Organization and Registered Capital

Article 17. The parties shall invest in or provide cooperation conditions to the Cooperative Joint Venture in accordance with relevant laws and administrative regulations and the Cooperative Joint Venture contract.

Article 18. The investments made in or cooperation conditions provided to the Cooperative Joint Venture by the parties may be in currency, and may also be in kind or in the form of property rights such as industrial property, proprietary technology, land use rights, etc.

If the investment made or cooperation conditions provided by the Chinese party are state-owned assets, asset appraisal shall be carried out in accordance with relevant laws and administrative regulations.

The foreign party's investment in a Cooperative Joint Venture that has obtained the status of a Chinese legal person according to law shall generally not be less than 25 percent of the registered capital of the Cooperative Joint Venture. Specific requirements for the investments made or cooperation conditions provided to a Cooperative Joint Venture without the status of a legal person by the parties thereto shall be prescribed by the Ministry of Foreign Trade and Economic Cooperation.

Article 19. The parties shall use their self-owned property or property rights as investments or cooperation conditions. Such investments or cooperation conditions may not be encumbered by mortgage or other forms of security.

Article 20. The time limit for the making of investments or provision of cooperation conditions to a Cooperative Joint Venture shall be stipulated by the parties in the Cooperative Joint Venture contract on the basis of the production and operation requirements of the Cooperative Joint Venture and in accordance with relevant laws and administrative regulations.

If the parties fail to pay up their investments or to provide their cooperation conditions in accordance with the Cooperative Joint Venture contract, the administration for industry and commerce shall set a time limit for performance of such obligation. If the parties fail to perform such obligation within such time limit, the examination and approval authority shall revoke the approval certificate of the Cooperative Joint Venture and the administration for industry and commerce shall revoke its business license and make a public announcement.

Article 21. A party that fails to pay up its investment or to provide its cooperation conditions in accordance with the Cooperative Joint Venture contract shall be liable for breach of contract towards the party (parties) that has (have) paid up his (their) investment(s) or provided his (their) cooperation conditions in accordance with the Cooperative Joint Venture contract.

Article 22. After the parties have paid up their investments or provided their cooperation conditions, an accountant registered in China shall verify the same and issue a capital contribution verification report, whereupon the Cooperative Joint Venture shall issue an investment certificate to each party. An investment certificate shall specify the following particulars:

(1) the name of the Cooperative Joint Venture;

(2) the date of establishment of the Cooperative Joint Venture;

(3) the names of the parties;

(4) the contents of the investments made or cooperation conditions provided by the parties;

(5) the date on which each party made its investment or provided its cooperation conditions; and

(6) the number and date of issuance of the investment certificate.

Copies of the investment certificates shall be sent to the examination and approval authority and the authority for the administration of industry and commerce.

Article 23. Assignment by one joint venture party to another joint venture party or to a third party of all or part of its rights under the Cooperative Joint Venture contract shall be subject to the written consent of the other joint venture party (parties) and the approval of the examination and approval authority.

The examination and approval authority shall decide whether or not to grant approval within 30 days of the date of receipt of the documents concerning the assignment.

Chapter 5. Organizational Structure

Article 24. A Cooperative Joint Venture shall have a board of directors or a joint management committee. The board of directors or joint management committee shall be the authority of the Cooperative Joint Venture, and shall decide upon the important issues of the Cooperative Joint Venture in accordance with the provisions of the articles of association of the Cooperative Joint Venture.

Article 25. A board of directors or joint management committee shall have not less than three members. The distribution of seats on the board of directors or joint management committee shall be determined by the Chinese and foreign parties following consultations, making reference to their investments made or cooperation conditions provided.

Article 26. The members of the board of directors or joint management committee shall be appointed or replaced by the parties themselves. Measures for the determination of the persons to serve as chairman and vice chairman of the board or head and deputy head of the joint management committee shall be provided for in the articles of association of the Cooperative

Joint Venture. If the position of chairman of the board of directors or head of the joint management committee is assumed by a person from the (a) Chinese party or the (a) foreign party, the position of vice chairman or deputy head shall be assumed by a person from the (an) other party.

Article 27. The term of office of directors or committee members shall be provided for in the articles of association of the Cooperative Joint Venture; however, each term may not exceed three years. Upon the expiration of their terms, directors or committee members may serve consecutive terms if reappointed by the party that originally appointed them.

Article 28. Meetings of the board of directors or joint management committee shall be held at least once a year, and shall be convened and presided over by the chairman of the board or the head of the committee. If the chairman of the board or the head of the committee is unable to perform his duties due to special reasons, he shall designate the vice chairman of the board or the deputy head of the committee or another director or committee member to convene and preside over the meeting. The convention of a meeting of the board of directors or the joint management committee may be proposed by one-third or more of the directors or committee members.

A meeting of the board of directors or the joint management committee may be held only if two-thirds or more of the directors or committee members are present. A director or committee member who is unable to attend a meeting of the board of directors or the joint management committee shall appoint another person in writing to attend and vote at the meeting as his proxy. Resolutions of a meeting of the board of directors or the joint management committee must receive affirmative votes from more than half of all the directors or committee members. If a director or committee member fails both to attend a meeting of the board of directors or the joint management committee without legitimate reason and

to appoint another person to attend the meeting as his proxy, he shall be deemed to have attended such meeting and to have abstained from voting.

All directors or committee members shall be notified 10 days prior to the date on which a meeting of the board of directors or the joint management committee is to be held. Meetings of the board of directors or the joint management committee may also adopt resolutions by means of teleconferencing.

Article 29. Resolutions involving any of the following matters may be adopted only with the unanimous affirmative vote of the directors or committee members attending the meeting of the board of directors or the joint management committee:

(1) amendment of the articles of association of the Cooperative Joint Venture;

(2) increase or reduction of the registered capital of the Cooperative Joint Venture;

(3) dissolution of the Cooperative Joint Venture;

(4) mortgage of assets of the Cooperative Joint Venture;

(5) merger, division or change in the form of organization of the Cooperative Joint Venture; or

(6) other matters in respect of which resolutions may only be adopted unanimously at a meeting of the board of directors or the joint management committee, as agreed upon by the parties.

Article 30. The methods of conducting business and voting procedures of the board of directors or joint management committee, except for those provided for in these Detailed Implementing Rules, shall be provided for in the articles of association of the Cooperative Joint Venture.

Article 31. The chairman of the board or head of the committee shall be the legal representative of the Cooperative Joint Venture. If the chairman of the board or the head of the committee is unable to perform his duties due to special reasons, he shall authorize the vice chairman of the board or the deputy head of the committee or another director or committee member to represent the Cooperative Joint Venture vis-à-vis third parties.

Article 32. A Cooperative Joint Venture shall have one general manager, who shall be responsible for the day-to-day operation and management of the Cooperative Joint Venture and report to the board of directors or the joint management committee.

The general manager of a Cooperative Joint Venture shall be appointed and dismissed by the board of directors or the joint management committee.

Article 33. The positions of general manager and other senior management personnel may be held by Chinese citizens, and may also be held by foreign citizens.

Upon appointment by the board of directors or the joint management committee, a director or committee member may concurrently hold the position of general manager or another senior management position in the Cooperative Joint Venture.

Article 34. If the general manager or other senior management personnel is incompetent, practices graft or commits serious dereliction of duty, he may be dismissed upon the adoption of a pertinent resolution by the board of directors or the joint management committee. If such incompetence, graft or dereliction of duty causes the Cooperative Joint Venture to suffer loss, he shall be liable according to law.

Article 35. If, following its establishment, a Cooperative Joint Venture wishes to entrust a third party with operation and management, such entrustment shall be subject to the unanimous consent of the board of directors or the joint management committee and

require the entry into a contract for entrustment of operation and management with the entrusted party.

The Cooperative Joint Venture shall submit documents such as the resolution of the board of directors or the joint management committee, the executed contract for entrustment of operation and management and proof of the creditworthiness of the entrusted party to the examination and approval authority for approval. All such documents shall be submitted together. The examination and approval authority shall decide whether or not to grant approval within 30 days of the date of receipt of the relevant documents.

Chapter 6. Purchase of Supplies and Sale of Products

Article 36. A Cooperative Joint Venture shall formulate its own production and business plan in accordance with the approved scope of business and scale of production and business.

Governmental authorities may not order Cooperative Joint Ventures to implement production and business plans determined by governmental authorities.

Article 37. A Cooperative Joint Venture may decide on its own whether to purchase in or outside China the machinery, equipment, raw materials, fuel, parts, components, accessories, elements, means of transportation, office articles, etc. for its own use ("Supplies").

Article 38. The state encourages Cooperative Joint Ventures to sell their products on the international market. Cooperative Joint Ventures may sell their products on the international market by themselves, and may also entrust sales organizations abroad or Chinese foreign trade corporations with selling their products as agents or distributors.

The prices of products sold by Cooperative Joint Ventures shall be determined according to law by the Cooperative Joint Ventures themselves.

Article 39. Machinery, equipment, parts, components and other materials that are imported by the foreign party as investment, and machinery, equipment, parts, components and other materials required for production and operation that are imported by the Cooperative Joint Venture with funds within its total amount of investment, shall be exempt from import duty and turnover taxes at the import stage. If, upon approval, above-mentioned Supplies imported duty- and tax-free are re-sold in China or used for the purpose of domestic sale, duty and tax shall be paid or made up according to law.

Article 40. Cooperative Joint Ventures may not export products at prices obviously lower than reasonable prices for similar products on the international market, and may not import Supplies at prices higher than prices for similar products on the international market.

Article 41. Cooperative Joint Ventures shall sell their products in accordance with the approved Cooperative Joint Venture contracts.

Article 42. Cooperative Joint Ventures shall, in accordance with relevant state regulations, carry out procedures for application for and obtaining of licenses or quotas for those of their imports or exports that are merchandise subject to import or export licensing or to quotas.

Chapter 7. Distribution of Gains and Recovery of Investment

Article 43. The Chinese and foreign parties may distribute gains by means of distribution of profits, distribution of products or such other means as they may agree upon.

If the method of product distribution or another method is used for distribution of gains, the amount of tax payable shall be calculated in accordance with the relevant provisions of the tax laws.

Article 44. If the Chinese and foreign parties stipulate in the Cooperative Joint Venture contract that the Chinese Party shall become the owner of all fixed assets of the Cooperative Joint Venture upon expiration of the term of cooperation without compensation, the foreign party may apply for approval to first recover its investment during the term of cooperation by the following methods:

(1) provision in the Cooperative Joint Venture contract for an increase in the proportion of the gains to be distributed to the foreign party on the basis of distribution according to the investment made or cooperation conditions provided;

(2) recovery by the foreign party of its investment prior to the payment of income tax by the Cooperative Joint Venture, after examination and approval by the finance and tax authorities in accordance with relevant tax regulations of the state; or

(3) another method of recovery of investment approved by the finance and tax authorities and the examination and approval authority.

If the foreign party first recovers its investment during the term of cooperation pursuant to the preceding paragraph, the Chinese party and the foreign party shall be liable for the debts of the Cooperative Joint Venture in accordance with the relevant laws and the Cooperative Joint Venture contract.

Article 45. If the foreign party applies for approval to first recover its investment pursuant to item (2) or (3) of Article 44 hereof, it shall specifically describe the total amount, term and method of the early recovery of investment and, following examination and approval by the finance and tax authorities, submit the

application to the examination and approval authority for approval.

The foreign party may not first recover its investment before the losses of the Cooperative Joint Venture have been made up.

Article 46. A Cooperative Joint Venture shall, in accordance with the relevant regulations of the state, engage an accountant registered in China to audit and verify the accounts. The parties may jointly or individually engage an accountant registered in China to audit the accounts; the expenses necessary for such audit shall be borne by the engaging parties or party.

Chapter 8. Terms and Dissolution

Article 47. The term of a Cooperative Joint Venture shall be determined through consultations between the Chinese and foreign parties and be specified in the Cooperative Joint Venture contract.

If, following consultations, the parties agree to request an extension of the term of cooperation upon expiration thereof, an application shall be submitted to the examination and approval authority 180 days prior to expiration of the term. Such application shall describe the implementation of the original Cooperative Joint Venture contract and the reason for extension of the term of cooperation, and shall be accompanied by the agreement reached between the parties with respect to issues such as each party's rights and obligations etc. during the extension. The examination and approval authority shall decide to approve or disapprove the application within 30 days of the date of receipt thereof.

If an extension of the term of cooperation is approved, the Cooperative Joint Venture shall carry out the procedures for change of registration with the administration for industry and commerce on the strength of the approval document. The extension of the term shall be counted from the first day after the expiration of the term.

If the Cooperative Joint Venture contract provides that the foreign party shall recover its investment first, and such recovery of investment has been completed, then the term of the Cooperative Joint Venture shall no longer be extended upon expiration thereof. However, if the foreign party increases its investment and all parties reach an agreement following consultations, an application may be submitted to the examination and approval authority for an extension of the term of cooperation in accordance with the second paragraph hereof.

Article 48. A Cooperative Joint Venture shall be dissolved:

(1) upon expiration of the term of cooperation;

(2) if it incurs serious deficits, or suffers serious loss as a result of force majeure, making it impossible to continue to operate;

(3) if one, several or all of the Chinese and foreign parties fail(s) to perform its or their obligations under the contract for, or the articles of association of, the Cooperative Joint Venture, making it impossible for the Cooperative Joint Venture to continue to operate;

(4) if another cause for dissolution as provided for in the contract for, or the articles of association of, the Cooperative Joint Venture has arisen; or

(5) if the Cooperative Joint Venture violates a law or administrative regulation and is ordered closed according to law.

If circumstances as mentioned in item (2) or (4) of the preceding paragraph arise, the board of directors or joint management committee shall make a decision and submit the same to the examination and approval authority for approval. If circumstances as mentioned in item (3) of the preceding paragraph arise, the Chinese and/or foreign party or parties that fail(s) to perform its or their obligations under the contract

for, or the articles of association of the Cooperative Joint Venture shall be liable to compensate for the losses suffered as a result thereof by the non-breaching party or parties, and the non-breaching party or parties shall have the right to apply to the examination and approval authority for dissolution of the Cooperative Joint Venture.

Article 49. Matters concerning the liquidation of Cooperative Joint Ventures shall be handled in accordance with the relevant laws and administrative regulations of the state and the contracts for and articles of association of the Cooperative Joint Ventures.

Chapter 9. Special Provisions for Cooperative Joint Ventures without the Status of a Legal Person

Article 50. Cooperative Joint Ventures without the status of a legal person and the parties thereto shall bear civil liability in accordance with the relevant provisions of China's civil law.

Article 51. Cooperative Joint Ventures without the status of a legal person shall register the investments made or cooperation conditions provided by the parties with the administration for industry and commerce.

Article 52. The investments made or cooperation conditions provided by the parties to a Cooperative Joint Venture without the status of a legal person shall be owned by the parties individually. The same may also be owned in common, or partly owned individually and partly owned in common, if the parties so agree. Property accumulated by the Cooperative Joint Venture in the course of business shall be owned in common by the parties.

The investments made or cooperation conditions provided by the parties to a Cooperative Joint Venture without the status of a legal person shall be administered and used by the Cooperative

Joint Venture in a unified manner and may not be disposed by any party without the consent of the other party or parties.

Article 53. Cooperative Joint Ventures without the status of a legal person shall establish joint management committees. A joint management committee shall be formed by representatives delegated by the parties and shall jointly manage the Cooperative Joint Venture on behalf of the parties.

The joint management committee shall decide upon all important issues of the Cooperative Joint Venture.

Article 54. Cooperative Joint Ventures without the status of a legal person shall keep unified account books at the places where they are located. The parties to such Cooperative Joint Ventures shall additionally keep their own account books.

Chapter 10. Supplementary Provisions

Article 55. The conclusion, validity, interpretation and performance of, and the settlement of disputes in connection with, Cooperative Joint Venture contracts shall be governed by the laws of China.

Article 56. Matters not covered herein, including the administration of financial, accounting, auditing, foreign exchange, taxation, labor affairs and the labor unions of Cooperative Joint Ventures, etc. shall be governed by relevant laws and administrative regulations.

Article 57. Cooperative Joint Ventures established by companies, enterprises and other economic organizations or individuals from Hong Kong, Macao or Taiwan or by Chinese citizens residing abroad shall be handled by reference to these Detailed Implementing Rules.

Article 58. These Detailed Implementing Rules shall be implemented from the date of promulgation.

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LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON WHOLLY FOREIGN-OWNED ENTERPRISES

(Adopted at the 4th Session of the 6th National People's Congress on April 12, 1986 and amended at the 18th Session of the Standing Committee of the 9th National People's Congress on October 31, 2000.)

Article 1. In order to expand international economic cooperation and technological exchange and to promote the development of China's national economy, the People's Republic of China permits foreign enterprises and other economic entities or individuals ("Foreign Investors") to establish wholly foreign-owned enterprises in China and will protect the lawful rights and interests of such enterprises.

Article 2. For the purposes of this Law, the term "wholly foreign-owned enterprises" means enterprises established in China in accordance with the relevant laws of China, the entire capital of which is invested by Foreign Investors. Such enterprises do not include branches and offices established in China by foreign enterprises and other economic entities.

Article 3. The establishment of wholly foreign-owned enterprises must be beneficial to the development of China's national economy. The state encourages the establishment of wholly foreign-owned enterprises that export their products or are technologically advanced.

The State Council shall stipulate the industries in which the establishment of wholly foreign-owned enterprises is forbidden or restricted by the state.

Article 4. The investments of, the profits obtained by and other lawful rights and interests of Foreign Investors in China are protected by Chinese law.

Wholly foreign-owned enterprises must observe Chinese laws and regulations and shall not harm the public interest of China.

Article 5. The state will not nationalize or expropriate wholly foreign-owned enterprises. Under special circumstances, the state, based on the public interest, may expropriate wholly foreign-owned enterprises pursuant to legal procedures and give commensurate compensation.

Article 6. Applications for the establishment of wholly foreign-owned enterprises shall be subject to examination and approval by the department under the State Council in charge of foreign economic relations and trade or authorities authorized by the State Council. The examination and approval authorities shall decide whether to approve or disapprove the application within 90 days of the date of receipt thereof.

Article 7. After the application for establishment of a wholly foreign-owned enterprise has been approved, the Foreign Investor shall, within 30 days of the date of receiving the approval certificate, apply for registration to the administration for industry and commerce and obtain a business license. The date on which the business license of a wholly foreign-owned enterprise is issued shall be the date such enterprise is established.

Article 8. A wholly foreign-owned enterprise that meets the requirements regarding legal persons as stipulated by Chinese law will obtain the status of a Chinese legal person according to law.

Article 9. A wholly foreign-owned enterprise shall make its investment in China within the period approved by the examination and approval authority. If no investment has been made at the end of the period, the administration for industry and commerce shall have the right to revoke the business license.

The administration for industry and commerce shall examine and supervise the investments of wholly foreign-owned enterprises.

Article 10. Division, merger or other important changes of a wholly foreign-owned enterprise shall be submitted to the examination and approval authority for approval and require change of the registration with the administration for industry and commerce.

Article 11. No interference is allowed in the operation and management activities of a wholly foreign-owned enterprise conducted according to its approved articles of association.

Article 12. A wholly foreign-owned enterprise employing Chinese staff and workers shall enter into contracts with them according to law. Such contracts shall stipulate matters such as employment, dismissal, remuneration, benefits, labor protection and labor insurance.

Article 13. The staff and workers of a wholly foreign-owned enterprise shall lawfully establish a labor union, which shall carry on labor union activities and protect the lawful rights and interests of the staff and workers.

A wholly foreign-owned enterprise shall provide its labor union with the conditions necessary for the latter's activities.

Article 14. A wholly foreign-owned enterprise must keep account books in China, carry out independent accounting, submit accounting statements according to regulations and accept supervision by the finance and tax authorities.

If a wholly foreign-owned enterprise refuses to keep account books in China, the finance and tax authorities may impose a fine on the enterprise, and the administration for industry and commerce may order it to stop its business operations or revoke its business license.

Article 15. Supplies such as raw materials and fuel needed by a wholly foreign-owned enterprise within the approved scope of business may be purchased on the domestic or international market, according to the principle of fairness and reasonableness.

Article 16. All items of insurance of a wholly foreign-owned enterprise shall be taken out from insurance companies in China.

Article 17. A wholly foreign-owned enterprise shall pay taxes in accordance with the relevant tax regulations of the state and may enjoy preferential treatment in the form of tax reductions and exemptions.

If a wholly foreign-owned enterprise reinvests its after-tax profits in China, it may apply for a refund of part of the income tax already paid on the reinvested amount in accordance with the regulations of the state.

Article 18. The foreign exchange matters of wholly foreign-owned enterprises shall be handled in accordance with the exchange control regulations of the state.

Wholly foreign-owned enterprise shall open accounts with the Bank of China or other banks designated by state's exchange control authority.

Article 19. The lawful profits and other lawful revenue obtained by Foreign Investors from wholly foreign-owned enterprises and the proceeds they obtain from liquidation may be remitted abroad.

Salaries and other lawful income of foreign staff and workers of wholly foreign-owned enterprises may be remitted abroad after payment of individual income tax according to law.

Article 20. The term of operation of a wholly foreign-owned enterprise shall be submitted by the Foreign Investor and be subject to approval by the examination and approval authority. If an extension is needed upon the expiration of the term, an application shall be filed 180 days prior to the expiration of the

term with the examination and approval authority, which shall decide to approve or disapprove the application within 30 days of the date of receipt thereof.

Article 21. When a wholly foreign-owned enterprise terminates, a timely public announcement shall be made and liquidation shall be conducted in accordance with legal procedures.

Prior to the completion of the liquidation, the Foreign Investor shall not dispose of the assets of the enterprise except for purposes of the liquidation.

Article 22. When a wholly foreign-owned enterprise terminates, de-registration procedures shall be carried out with, and the business license shall be returned to, the administration for industry and commerce.

Article 23. The department under the State Council in charge of foreign economic relations and trade shall, on the basis of this Law, formulate detailed implementing rules which shall come into force after being submitted to and approved by the State Council.

Article 24. This Law shall be implemented from the date of publication.

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DETAILED IMPLEMENTING RULES FOR THE LAW OF THE PEOPLE'S REPUBLIC OF CHINA ON WHOLLY FOREIGN-OWNED ENTERPRISES

(Approved by the State Council on October 28, 1990, promulgated by the Ministry of Foreign Economic Relations and Trade on December 12, 1990, effective from December 12, 1990, and amended by the State Council on April 12, 2001.)

Chapter 1. General Provisions

Article 1. These Detailed Implementing Rules are formulated pursuant to the *Law of the People's Republic of China on Wholly Foreign-Owned Enterprises*.

Article 2. Wholly foreign-owned enterprises shall be governed and protected by the laws of China.

In their business activities in China, wholly foreign-owned enterprises must abide by the laws and regulations of China and may not harm China's public interest.

Article 3. The establishment of wholly foreign-owned enterprises must be beneficial to the development of China's national economy and yield notable economic benefits. The state encourages wholly foreign-owned enterprises to adopt advanced technologies and equipment, to engage in the development of new products, to achieve upgrading and replacement of existing products and to save energy and raw materials. The state also encourages the establishment of wholly foreign-owned enterprises that export their products.

Article 4. The industries in which the state prohibits or restricts the establishment of wholly foreign-owned enterprises shall be as set forth in the state's regulations for guiding the direction of foreign investment and catalog for guiding foreign investment in industry.

Article 5. Applications for the establishment of wholly foreign-owned enterprises shall not be approved in any of the following circumstances:

(1) China's sovereignty or public interest would be harmed;

(2) China's national security would be jeopardized;

(3) China's laws and regulations would be violated;

(4) the requirements for the development of China's national economy would not be satisfied; or

(5) environmental pollution might be caused.

Article 6. Wholly foreign-owned enterprises shall enjoy autonomy, and shall not be subject to interference, in their operation and management activities when operating within their approved scope of business.

Chapter 2. Establishment Procedures

Article 7. The examination and approval of applications for the establishment of wholly foreign-owned enterprises shall be carried out by the Ministry of Foreign Trade and Economic Cooperation of the People's Republic of China (hereinafter referred to as "MOFTEC"). MOFTEC shall issue a certificate of approval upon examination and approval.

The State Council authorizes the People's Government of the provinces, autonomous regions, municipalities directly under the central government, municipalities with independent development plans and Special Economic Zones to examine

and approve applications, and to issue approval certificates, for the establishment of wholly foreign-owned enterprises in the following situation:

(1) the total amount of investment does not exceed the maximum amount which the State Council has authorized the People's Government in question to examine and approve; and

(2) the state will not need to allocate raw materials, and the nationwide comprehensive balance of energy, communications, transportation, foreign trade export quotas, etc. will not be affected.

Within 15 days after the People's Government of a province, autonomous region, municipality directly under the central government, municipality with independent development plans or Special Economic Zone has approved the establishment of a wholly foreign-owned enterprise within its authority as delegated by the State Council, it shall report its approval to the MOFTEC for the record (MOFTEC and the People's Governments of the provinces, autonomous regions, municipalities directly under the central government, municipalities with independent development plans and Special Economic Zones are hereinafter collectively referred to as "Examination and Approval Authorities").

Article 8. For the approval of applications for the establishment of wholly foreign-owned enterprises whose products would involve export licenses, export quotas or import licenses or would be products the import of which is restricted by the state, prior consent shall be obtained from the department in charge of foreign economic relations and trade in accordance with the limits of administration authority.

Article 9. Prior to applying for the establishment of a wholly foreign-owned enterprise, foreign investors shall submit a report covering the following matters to the local People's

Government at or above county level of the place where they intend to establish the enterprise. The contents of such report shall include the purpose of the wholly foreign-owned enterprise to be established; the scope and scale of business; the products to be produced; the technology and equipment to be used; the area of and requirements for the land to be used; the conditions for and quantities of the water, electricity, coal, coal gas or other energy sources required; requirements for public facilities; etc.

Local People's Governments at or above county level shall reply to the foreign investors in writing within 30 days after the date of receipt of their reports.

Article 10. A foreign investor which wishes to establish a wholly foreign-owned enterprise shall apply and submit the following documents to the Examination and Approval Authorities through the local People's Government at or above county level of the place where it intends to establish the enterprise:

(1) an application for the establishment of a wholly foreign-owned enterprise;

(2) a feasibility study;

(3) the articles of association of the wholly foreign-owned enterprise;

(4) the name of the legal representative (or a list of the names of the members of the board of directors) of the wholly foreign-owned enterprise;

(5) the legal certificates and a certificate of creditworthiness of the foreign investor;

(6) the written reply from the local People's Government at or above county level of the intended place of establishment of the wholly foreign-owned enterprise;

(7) a list of the supplies requiring to be imported; and

(8) other documents to be submitted.

The documents mentioned under items (1) and (3) of the preceding paragraph must be written in Chinese. Those mentioned under items (2), (4) and (5) may be written in a foreign language, but, if written in a foreign language, shall be accompanied by Chinese translations.

Where two or more foreign investors jointly apply for the establishment of a wholly foreign-owned enterprise, a duplicate of the contract between them shall be submitted to the Examination and Approval Authorities for the record.

Article 11. Examination and Approval Authorities shall decide whether to approve or to disapprove an application for the establishment of a wholly foreign-owned enterprise within 90 days from the date of receipt of all the documents pertaining to such application. If the Examination and Approval Authorities find that not all of the aforementioned documents have been submitted or that they are not in order, they may demand that the missing document(s) be submitted or that the submitted documents be amended within a specified period of time.

Article 12. Upon approval by the Examination and Approval Authorities of an application for the establishment of a wholly foreign-owned enterprise, the foreign investor shall, within 30 days from the date of receipt of the approval document, apply to the administration for industry and commerce for registration and obtain a business license. The date of issuance of the business license of the wholly foreign-owned enterprise shall be the date of establishment of the enterprise.

The approval certificate for a wholly foreign-owned enterprise shall expire automatically if the foreign investor has failed to apply to the administration for industry and commerce for registration within a full 30 days from the date of issuance of the approval certificate.

A wholly foreign-owned enterprise shall carry out tax registration with the tax authorities within 30 days after the date of its establishment.

Article 13. Foreign investors may entrust Chinese service organizations for foreign investment enterprises or other economic organizations with handling on their behalf the matters set forth in Article 8, the first paragraph of Article 9 and Article 10 hereof, provided that they enter into a contract of entrustment.

Article 14. Written applications for the establishment of a wholly foreign-owned enterprise shall include the following:

(1) the name, address and place of registration of the foreign investor and the name, nationality and position of its legal representative;

(2) the name and address of the wholly foreign-owned enterprise to be established;

(3) the scope of business, types of product and scale of production;

(4) the total amount of investment, registered capital and sources of funds of, and the method and time limit of contribution of capital to, the wholly foreign-owned enterprise to be established;

(5) the form of organization, structure and legal representative of the wholly foreign-owned enterprise to be established;

(6) the main equipment to be used and the age of such equipment; and the level and source of the production technology and production process to be used;

(7) the targeted buyers and areas of sale of the products and the sales channels and methods;

(8) the arrangements for the receipt and expenditure of foreign exchange;

(9) the establishment and staffing of the relevant structure, and arrangements for the employment, training, wages, welfare benefits, insurance, labor protection, etc. of staff and workers;

(10) the possible degree of environmental pollution and the measures to solve such problem;

(11) the selection and area of the land to be used;

(12) the funds, energy and raw materials for capital construction, production and operation, and the methods for obtaining the same;

(13) the schedule of implementation of the project; and

(14) the term of operation of the wholly foreign-owned enterprise to be established.

Article 15. The articles of association of a wholly foreign-owned enterprise shall cover the following matters:

(1) the name and address;

(2) the purpose and scope of business;

(3) the total amount of investment, registered capital and time limit for contribution of capital;

(4) the form of organization;

(5) the internal organizations and their powers and rules of procedure; and the duties and limits of authority of such personnel as the legal representative, the general manager, the chief engineer and the chief accountant;

(6) the principles and systems for financial affairs, accounting and auditing;

(7) labor management;

(8) the term of operation, termination and liquidation; and

(9) the procedure for amendment of the articles of association.

Article 16. The articles of association of a wholly foreign-owned enterprise, and any amendments thereto, shall become effective upon approval by the Examination and Approval Authorities.

Article 17. If a wholly foreign-owned enterprise is divided or merged or if a major change in its capital occurs due to any other reason, approval must be obtained from the Examination and Approval Authorities, and a Chinese registered accountant shall be engaged to verify the event and to issue a capital verification certificate. Upon approval by the Examination and Approval Authorities, the change shall be registered with the administration for industry and commerce.

Chapter 3. Form of Organization and Registered Capital

Article 18. The form of organization of wholly foreign-owned enterprises shall be a limited liability company. Upon approval, they may also have other forms of liability.

In wholly foreign-owned enterprises that are limited liability companies, the liability of the foreign investors vis-à-vis the enterprises shall be limited to the amounts of capital contributed by them.

In wholly foreign-owned enterprises with other forms of liability, the liability of the foreign investors in respect of the enterprises shall be as specified in the laws and regulations of China.

Article 19. The term "total amount of investment of a wholly foreign-owned enterprise" means the total amount of funds required to set up a wholly foreign-owned enterprise, i.e. the sum of the capital construction funds and the working capital required to be invested in order to realize its scale of production.

Article 20. The term "registered capital of a wholly foreign-owned enterprise" means the total amount of capital for the establishment of a wholly foreign-owned enterprise as registered with the administration for industry and commerce, i.e. the total amount of capital subscribed by the foreign investor.

The amount of the registered capital of a wholly foreign-owned enterprise shall correspond to its scale of business. The ratio between the registered capital and the total amount of investment shall conform to the relevant regulations of China.

Article 21. Wholly foreign-owned enterprises may not reduce their registered capital during their term of operation. If such reductions are truly necessary as a result of changes in the total amount of investment, the scale of production and business, etc., approval must be obtained from the Examination and Approval Authority.

Article 22. The increase or assignment of the registered capital of a wholly foreign-owned enterprise must be approved by the Examination and Approval Authorities. Upon approval, such change shall be registered with the administration for industry and commerce.

Article 23. The mortgage or assignment by a wholly foreign-owned enterprise to a foreign party of its property or interest must be approved by the Examination and Approval Authorities and reported to the administration for industry and commerce for the record.

Article 24. The legal representative of a wholly foreign-owned enterprise shall be the responsible person who, pursuant to the enterprise's articles of association, has the power to represent the enterprise.

If the legal representative is unable to exercise his powers, he shall appoint an agent, in writing, to exercise his powers on his behalf.

Chapter 4. Methods and Time Limits for Contribution of Capital

Article 25. Foreign investors may make their capital contributions in freely convertible foreign currencies, and also by valuating and contributing machinery, equipment, industrial property, proprietary technology, etc.

Upon approval by the Examination and Approval Authorities, foreign investors may also use as capital contribution Renminbi profits derived by them from other foreign investment enterprises established in China.

Article 26. Machinery and equipment valuated and used as capital contribution by a foreign investor must be machinery and equipment that are indispensable to the wholly foreign-owned enterprise's production.

The amounts at which such machinery and equipment are valuated may not exceed the current normal prices on the international market for the same kind of machinery and equipment.

With respect to valuated machinery and equipment to be contributed, a detailed list of valuated contributions shall be made. Such list shall include the descriptions, types, quantities, valuation, etc. of the machinery and equipment. The list shall be annexed to, and submitted to the Examination and Approval Authorities along with, the application for establishment of the wholly foreign-owned enterprise.

Article 27. Industrial property and proprietary technology valuated and used as capital contribution by a foreign investor must be owned by the foreign investor.

The valuation of such industrial property and proprietary technology shall be consistent with common international principles of valuation, and the amount at which they are

valuated shall not exceed 20 percent of the registered capital of the wholly foreign-owned enterprise.

Detailed information shall be prepared with respect to the valuated industrial property and proprietary technology to be contributed. Such information shall include copies of certificates pertaining to ownership and details of their validity, information on the technical performance and practical value, the basis and standards of valuation, etc. The said information shall be annexed to, and submitted to the Examination and Approval Authorities along with, the application for establishment of the wholly foreign-owned enterprise.

Article 28. When valuated machinery and equipment contributed as capital have arrived at the Chinese port, the wholly foreign-owned enterprise shall request a Chinese commodity inspection organization to inspect the same. Such commodity inspection organization shall issue an inspection report.

In the event of discrepancies between the kinds, quality and quantities of valuated and contributed machinery and equipment and the kinds, quality and quantities of the machinery and equipment specified on the list of valuated contributions submitted by the foreign investor to the Examination and Approval Authorities, the Examination and Approval Authorities shall have the power to demand the foreign investor to rectify such discrepancies within a specified period of time.

Article 29. The Examination and Approval Authorities shall have the power to conduct an inspection after valuated industrial property and proprietary technology contributed as capital have been put in use. In the event of discrepancies between such industrial property and proprietary technology and the information originally supplied by the foreign investor, the Examination and Approval Authorities shall have the power to demand the foreign investor to rectify such discrepancies within a specified period of time.

Article 30. The time limit within which foreign investors are to contribute their capital shall be stated in the applications for establishment of a wholly foreign-owned enterprise and the enterprise's articles of association. Foreign investors may contribute their capital in installments, provided that the final installment is contributed within three years from the date of issuance of the business license. The first of such installments may not account for less than 15 percent of the amount of capital to be contributed by the foreign investor and shall be contributed in full within 90 days from the date of issuance of the business license of the wholly foreign-owned enterprise.

If a foreign investor fails to contribute the first installment of its capital contribution within the time limit set forth in the preceding paragraph, its approval certificate shall automatically expire upon the expiration of such time limit. In such event, the wholly foreign-owned enterprise shall cancel its registration with, and turn over its business license for cancellation to, the administration for industry and commerce. If the wholly foreign-owned enterprise fails to cancel its registration and to turn over its business license for cancellation, the administration for industry and commerce shall revoke its business license and make a public announcement.

Article 31. Foreign investors shall contribute according to schedule all installments following the first installment of their capital contributions. If and when a capital contribution is 30 days overdue without legitimate reason, the matter shall be handled pursuant to the second paragraph of Article 30 hereof.

If a foreign investor requests an extension of the time limit for its capital contribution for legitimate reasons, such extension shall be agreed to by the Examination and Approval Authorities and reported to the administration for industry and commerce for the record.

Article 32. After a foreign investor has contributed all installments of its capital contribution, the wholly foreign-owned enterprise shall engage a Chinese registered accountant to verify the contribution and to issue an investment verification report, which shall be submitted to the Examination and Approval Authorities and the administration for industry and commerce for the record.

Chapter 5. Use of Land and Fees Therefor

Article 33. The land to be used by wholly foreign-owned enterprises shall be arranged for by the local People's Governments at or above county level of the locations of the enterprises upon examination in the light of local circumstances.

Article 34. Within 30 days from the date of issuance of their business licenses, wholly foreign-owned enterprises shall carry out land use procedures with and obtain a land certificate from the land administration department of the local People's Governments at or above county level of the places where they are located, on the strength of their approval certificates and business licenses.

Article 35. The land certificates shall be the legal certificates on the strength of which wholly foreign-owned enterprises may use land. Without approval, wholly foreign-owned enterprises may not assign their land use rights during their terms of operation.

Article 36. When collecting their land certificates, wholly foreign-owned enterprises shall pay land use fees to the land administration departments of the places where they are located.

Article 37. Wholly foreign-owned enterprises using developed land shall pay land development fees.

The land development fees mentioned in the preceding paragraph shall include the requisitioning, demolition, removal and resettlement expenses and the construction expenses incurred when linking the wholly foreign-owned enterprise to

the existing infrastructure. Land developers may charge the land development fees as a lump sum or in annual installments.

Article 38. Wholly foreign-owned enterprises using undeveloped land may develop the land themselves or entrust relevant Chinese units with such development. The construction of infrastructure facilities shall be centrally arranged by the local People's Governments at or above county level of the places where the wholly foreign-owned enterprises are located.

Article 39. The rates for the land use fees and land development fees charged to wholly foreign-owned enterprises shall be set in accordance with the relevant regulations of China.

Article 40. The term of the use of land by a wholly foreign-owned enterprise shall be the same as its approved term of operation.

Article 41. In addition to obtaining land use rights in accordance with this Chapter, wholly foreign-owned enterprises may obtain such rights pursuant to other laws and regulations of China.

Chapter 6. Purchases and Sales

Article 42. Wholly foreign-owned enterprises shall have the right to decide on their own on the purchase of machinery, equipment, raw materials, fuel, parts, accessories, components, devices, means of transportation, office articles, etc. for their own use ("Supplies").

When purchasing Supplies in China, wholly foreign-owned enterprises shall be granted terms equal to those granted to Chinese enterprises, given that conditions are equal.

Article 43. Wholly foreign-owned enterprises may sell their products on the Chinese market. The state encourages wholly foreign-owned enterprise to export their products.

Article 44. Wholly foreign-owned enterprises shall have the right to export their own products, and they may also entrust Chinese foreign

trade companies or companies outside China with selling their products on their behalf.

Wholly foreign-owned enterprises may sell their own products in China, and they may also entrust commercial organizations with selling their products on their behalf.

Article 45. For those of the machinery and equipment contributed as capital by foreign investors for which China requires an import license, the wholly foreign-owned enterprises shall, either directly or through an appointed agency, apply for import licenses to and obtain the same from the licensing authorities, on the strength of the enterprises' approved lists of imported equipment and Supplies.

With respect to the Supplies imported by wholly foreign-owned enterprises within their approved scopes of business which are required for use in their own production and for which China requires an import license, the enterprises shall draw up annual import plans and, once every six months, apply for import licenses to and obtain the same from the licensing authorities.

For those of the products exported by wholly foreign-owned enterprises for which China requires an export license, the enterprises shall draw up annual export plans and, once every six months, apply for export licenses to and obtain the same from the licensing authorities.

Article 46. The prices of the Supplies and technical services imported by wholly foreign-owned enterprises may not exceed the arm's length prices of the same Supplies and services on the international market at that time. The prices of products exported by wholly foreign-owned enterprises shall be set by wholly foreign-owned enterprises themselves by reference to the prices on the international market at that time, provided that they may not be lower than reasonable export prices. The tax authorities shall have the power to investigate pursuant to the tax laws the legal liability of wholly foreign-owned enterprises

evading taxes by such means as importing at high prices and exporting at low prices, etc.

Article 47. Wholly foreign-owned enterprises shall provide statistical information and submit statistical statements in accordance with the *Statistics Law of the People's Republic of China* and China's regulations concerning the system for statistics on the use of foreign investment.

Chapter 7. Taxation

Article 48. Wholly foreign-owned enterprises shall pay taxes in accordance with the laws and regulations of China.

Article 49. The staff and workers of wholly foreign-owned enterprises shall pay individual income tax in accordance with the laws and regulations of China.

Article 50. Wholly foreign-owned enterprises shall be granted duty and tax reductions and exemptions on the import of the following Supplies, in accordance with the relevant provisions of Chinese tax laws:

(1) machinery, equipment, parts and building materials, and the materials required for the installation and reinforcement of machinery, used by the foreign investors as capital contribution;

(2) machinery, equipment, parts, means of transportation for use in production and production management equipment imported by wholly foreign-owned enterprises using funds within their total amounts of investment and required for their own production;

(3) raw materials, auxiliary materials, components, parts and packaging materials imported by wholly foreign-owned enterprises for the production of export products.

Duties and tax shall be paid or made up in accordance with China's tax laws on those of the Supplies mentioned in the preceding paragraph which are, upon approval, diverted for sale domestically in China or diverted to the production of products to be sold domestically in China.

Article 51. Tax and duty reductions, exemptions or refunds shall be granted in accordance with the relevant provisions of Chinese tax laws on export products produced by joint ventures other than products the export of which is restricted by China.

Chapter 8. Exchange Control

Article 52. The foreign exchange matters of wholly foreign-owned enterprises shall be handled in accordance with the relevant exchange control regulations of China.

Article 53. On the strength of the business license issued by the administration for industry and commerce, wholly foreign-owned enterprises may open accounts with banks in China allowed to engage in foreign exchange business. The payments into and out of such accounts shall be supervised by the banks with which they have been opened.

The foreign exchange revenue of wholly foreign-owned enterprises shall be deposited in the foreign exchange accounts with their banks. Foreign exchange disbursements shall be paid out of their foreign exchange bank accounts.

Article 54. Wholly foreign-owned enterprises which wish to open foreign exchange accounts with banks outside China for reasons of production and business needs must obtain approval from China's exchange control authorities and regularly report details of the foreign exchange receipts and payments and provide the banks' account statements in accordance with the regulations of China's exchange control authorities.

Article 55. Upon payment of tax in accordance with China's tax laws, the wages and other legitimate foreign exchange income of the expatriate, Hong Kong, Macao and Taiwan staff and workers of wholly foreign-owned enterprises may be freely remitted out of the country.

Chapter 9. Financial Affairs and Accounting

Article 56. Wholly foreign-owned enterprises shall establish financial and accounting systems in accordance with the laws and regulations of China and the regulations of China's finance authorities and shall submit such system to the finance and tax authorities of the place where they are located for the record.

Article 57. The fiscal year of wholly foreign-owned enterprises shall commence on January 1 of the Gregorian calendar and end on December 31 of the same year.

Article 58. Wholly foreign-owned enterprises shall make allocations to a reserve fund and a bonus and welfare fund for staff and workers from their profits after paying income tax in accordance with China's tax laws. The rate of allocations to the reserve fund may not be lower than 10 percent of the after-tax profits; once the cumulative amount of allocations equals 50 percent of the registered capital, no further allocations need be made. The rate of allocations to the bonus and welfare fund for staff and workers shall be determined by the wholly foreign-owned enterprises themselves.

Wholly foreign-owned enterprises may not distribute profits until the losses from preceding fiscal years have been made up. Retained profits from preceding fiscal years may be distributed together with the distributable profits of the current fiscal year.

Article 59. Accounting vouchers, books and statements printed by wholly foreign-owned enterprises themselves shall be written in Chinese. Those written in a foreign language shall include notes in Chinese.

Article 60. Wholly foreign-owned enterprises shall keep independent accounts.

The annual accounting statements and liquidation accounting statements of wholly foreign-owned enterprises shall be prepared in accordance with the regulations of China's finance and tax authorities. If accounting statements are prepared in a foreign currency, Renminbi accounting statements shall be prepared simultaneously by translating such foreign currency amounts into Renminbi.

Chinese registered accountants shall be engaged to verify the annual accounting statements and liquidation accounting statements of wholly foreign-owned enterprises and to issue a report thereon.

The annual accounting statements and liquidation accounting statements of wholly foreign-owned enterprises described in the second and third paragraphs, together with the reports issued by the Chinese registered accountants, shall be submitted within the prescribed time limits to the finance and tax authorities and, for the record, to the Examination and Approval Authorities and the administration for industry and commerce.

Article 61. Foreign investors may engage at their own expense Chinese or foreign accounting staff to inspect the accounting books of their wholly foreign-owned enterprises.

Article 62. Wholly foreign-owned enterprises shall submit annual balance sheets and profit and loss statements to the finance and tax authorities and, for the record, to the Examination and Approval Authorities and the administration for industry and commerce.

Article 63. Wholly foreign-owned enterprises shall maintain their accounting books in the place where they are located. Such accounting books shall be subject to supervision by the finance and tax authorities.

If a wholly foreign-owned enterprise violates the provisions of the preceding paragraph, the finance and tax authorities may impose a fine on it and the administration for industry and commerce may order it to suspend business or revoke its business license.

Chapter 10. Staff and Workers

Article 64. Wholly foreign-owned enterprises shall enter into labor contracts with the staff and workers they employ in China, in accordance with the laws and regulations of China. Such contracts shall specifically cover such matters as employment, dismissal, remuneration, benefits, labor protection, labor insurance, etc.

Wholly foreign-owned enterprises may not employ children as laborers.

Article 65. Wholly foreign-owned enterprises shall be responsible for the vocational and technical training of their staff and workers and establish an assessment system, in order that the production and management skills of their staff and workers are sufficient to meet the enterprises' production and development requirements.

Chapter 11. Labor Union

Article 66. The staff and workers of wholly foreign-owned enterprises have the right to establish basic-level labor unions and carry on labor union activities in accordance with the *Labor Union Law of the People's Republic of China*.

Article 67. The labor union of a wholly foreign-owned enterprise shall represent the interests of the staff and workers. It shall have the right to enter into a labor contract with the enterprise on behalf of the staff and workers and to supervise the implementation thereof.

Article 68. The basic tasks of the labor union of a wholly foreign-owned enterprise shall be to protect the lawful rights and interests of the staff and workers in accordance with the laws and regulations of China, to assist the enterprise in arranging and using the bonus and welfare fund for staff and workers in a rational way; to organize the staff and workers to engage in political, scientific, technological and vocational study; to organize cultural and athletic activities; and to teach the staff and workers to observe labor discipline and make efforts to accomplish the various economic tasks of the enterprise.

When a wholly foreign-owned enterprise studies and decides on matters such as rewards, punishment, the wage system, benefits, labor protection, labor insurance, etc., of staff and workers, a representative of its labor union shall have the right to attend the meeting as a non-voting attendee. The wholly foreign-owned enterprise shall listen to the opinions of its labor unions and obtain its cooperation.

Article 69. Wholly foreign-owned enterprises shall actively support the work of their labor unions and, in accordance with the *Law of the People's Republic of China on Labor Unions*, provide them with the necessary premises and equipment for office work and meetings and for use in organizing collective welfare, cultural and athletic activities for staff and workers. Wholly foreign-owned enterprises shall each month allocate labor union funds at the rate of 2 percent of the total take-home pay of their staff and workers. Such funds shall be used by their labor unions in accordance with the measures for the use of labor union funds formulated by the All-China Federation of Trade Unions.

Chapter 12. Term, Termination and Liquidation

Article 70. The term of operation of wholly foreign-owned enterprises shall be set forth by the foreign investors in their applications for the establishment of a wholly foreign-owned enterprise, on the basis of the specific circumstances of the industries and enterprises

in question, and shall be approved by the Examination and Approval Authorities.

Article 71. The term of operation of wholly foreign-owned enterprises shall be reckoned from the date of issuance of their business licenses.

If the term of operation of a wholly foreign-owned enterprise needs to be extended upon expiry, a written application for extension of the term of operation shall be submitted to the Examination and Approval Authorities 180 days prior to expiry. The Examination and Approval Authorities shall decide whether to approve or reject the application within 30 days from the date of receipt thereof.

Wholly foreign-owned enterprises which have obtained approval to extend their term of operation shall register the change with the administration for industry and commerce within 30 days from the date of receipt of the approval document for such extension.

Article 72. A wholly foreign-owned enterprise shall be terminated in any of the following circumstances:

(1) its term of operation has expired;

(2) it suffers heavy losses due to mismanagement and the foreign investor decides to dissolve it;

(3) it suffers heavy losses due to an event of force majeure such as a natural disaster, war, etc.;

(4) it becomes bankrupt;

(5) it is lawfully closed because it has violated the laws and regulations of China, thereby harming the public interest; or

(6) another reason for dissolution as specified in the wholly foreign-owned enterprise's articles of association has arisen.

In any of the circumstances mentioned under items (2), (3) and (4) of the preceding paragraph, the wholly foreign-owned enterprise shall voluntarily submit a written application for termination to the Examination and Approval Authorities for approval. The date of the Examination and Approval Authorities' approval shall be the date of the enterprise's termination.

Article 73. A wholly foreign-owned enterprise which has been terminated pursuant to items (1), (2), (3) or (6) of Article 72 hereof shall make a public announcement and notify its creditors within 15 days from the date of termination. In addition, it shall, within 15 days from the date of issuance of the public announcement of termination, submit a proposal to the Examination and Approval Authorities concerning the procedure and principles of liquidation and the candidates for the liquidation committee, and implement the same upon examination and approval by the Examination and Approval Authorities.

Article 74. A liquidation committee shall be composed of the legal representative of the wholly foreign-owned enterprise, representatives of its creditors and representatives of the relevant competent authorities. In addition, accountants, lawyers, etc. registered in China shall be invited to serve on the committee.

The liquidation expenses shall be paid out of the property currently held by the foreign-owned enterprise on a priority basis.

Article 75. A liquidation committee shall exercise the following powers:

(1) convene creditors' meetings;

(2) take over the management of and sort out the enterprise's property, and prepare a balance sheet and a property list;

(3) valuate the property and state the basis for the calculation of the values assigned;

(4) prepare the liquidation plan;

(5) redeem the enterprise's claims and satisfy its debts;

(6) recover any amounts to be contributed by the shareholders which have not yet been contributed;

(7) distribute the balance of the property; and

(8) represent the wholly foreign-owned enterprise when it sues or is being sued.

Article 76. Prior to completion of the liquidation of a wholly foreign-owned enterprise, the foreign investor may not remit or carry the enterprise's funds out of China and may not dispose of the enterprise's property on its own authority.

Upon completion of the liquidation of a wholly foreign-owned enterprise, if the sum of the net amount of its assets and the balance of its property exceeds its registered capital, the portion in excess shall be regarded as profit, and income tax shall be paid thereon in accordance with China's tax laws.

Article 77. Upon conclusion of the liquidation of a wholly foreign-owned enterprise, de-registration procedures shall be carried out with, and its business license shall be returned for cancellation to, the administration for industry and commerce.

Article 78. When wholly foreign-owned enterprises liquidate and dispose of their property, Chinese enterprises or other organizations shall have a preemptive right to purchase the same, provided that conditions are equal.

Article 79. A wholly foreign-owned enterprise which is terminated pursuant to item (4) of Article 72 hereof shall be liquidated by reference to the relevant laws and regulations of China.

A wholly foreign-owned enterprise which is terminated pursuant to item (5) of Article 72 hereof shall be liquidated in accordance with the relevant regulations of China.

Chapter 13. Supplementary Provisions

Article 80. All items of insurance of wholly foreign-owned enterprises shall be taken out from insurance companies in China.

Article 81. Contracts between wholly foreign-owned enterprises and other companies, enterprises, economic organizations and individuals shall be governed by the *Contract Law of the People's Republic of China*.

Article 82. Matters concerning wholly-owned enterprises established in Mainland China by companies, enterprises, or other economic organizations and individuals from Hong Kong, Macao and Taiwan or by Chinese citizens resident abroad shall be handled by reference to these Detailed Implementing Rules.

Article 83. Expatriate, Hong Kong, Macao and Taiwan staff and workers of wholly foreign-owned enterprises may bring in reasonable quantities of means of transportation and daily necessities for their own use. Such staff and workers shall carry out customs formalities for such goods in accordance with the regulations of China.

Article 84. These Detailed Implementing Rules shall be implemented as from the date of publication.

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Baker & McKenzie has long been acknowledged as having the pre-eminent China practice. The Firm has maintained a presence in China since the late 1970s and is one of the pioneers in the area of China law. With over 30 years' experience in advising on doing business in China, we bring an in-depth understanding of China's cultural, political and legal structure. We partner with clients, taking into account their commercial objectives and work to manage and resolve issues through innovative solutions tailored to their business needs.

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Our long-standing involvement in China has allowed us to become a highly respected and recognized legal advisor to central and local governmental bodies in China. Over the course of the last few years, we have had the privilege of advising the Legislative Affairs Committee of the National People's Congress and key Chinese Ministries on a platform of legislative reforms. More recently, our Chairman participated in the 2004 International Business Leaders Advisory Council meetings organized and hosted by the Beijing Mayor's office. As a testament to our acknowledged expertise, we were one of the first foreign law firm to represent the Chinese government in foreign legal proceedings in the early 1980s.

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