

THE APPLICATION OF LAW ABOUT THE CONTRACT OF CHINA'S JOINT VENTURE

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SUMMARY: I. *The Joint Venture of China and the Joint Venture Contract.* II. *The application of law about the contract of "Joint Venture" in China.* III. *Brief Summary.*

I. THE JOINT VENTURE OF CHINA AND THE JOINT VENTURE CONTRACT

1. *The Joint Venture of China*

Under the legal system of China, the foreign-invested enterprise in China has three kinds of types and two of them are Joint Ventures:

1. Chinese-foreign Equity Joint ventures. According with the Law of the People's Republic of China on Chinese-foreign Equity Joint Ventures,¹ the foreign companies, enterprises, other economic organizations or individuals joint with Chinese companies, enterprise or other economic organizations in establishing joint ventures in the People's Republic of China in accordance with the principle of equality and mutual benefit and subject to approval by the Chinese Government.²

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¹ Adopted by the Second Session of the Fifth National People's Congress on July 1, 1979 and revised in accordance with "Resolution on Revision of the Law of the People's Republic of China on Chinese-Foreign Joint Venture" of the Third Session of the Seventh National People's Congress on April 4, 1990, the foreign companies, enterprises, other economic organizations or individuals (hereafter referred to as "foreign joint ventures").

² Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, article 1.

2. Chinese-Foreign Contractual Joint Ventures. According with the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures,³ on the principle of equality and mutual benefit, by foreign enterprises and other economic organizations or individuals and Chinese enterprises or other economic organizations of Chinese-foreign contractual joint ventures within the territory of the People's Republic of China.⁴

3. Foreign-funded Enterprises. According with the Law of the People's Republic of China on Foreign-funded Enterprises,⁵ the foreign enterprises, other foreign economic organizations and individuals to set up foreign-funded enterprises in China and protects the legitimate rights and interests of such enterprises.⁶

Those laws and regulations which about the Joint Venture in China mainly including the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, the Law of the People's Republic of China on Foreign-funded Enterprises, the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment, the Detailed Regulations for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures and the Provisions on Guiding the Orientation of Foreign Investment. On the other hand, General Principles of the Civil Law of the People's Republic of China, Contract Law of the People's Republic of China and the Company Law of the People's Republic of China etc. are also the parts of the law which protect the foreign-invested enterprise (including joint venture). The number the foreign-invested enterprise in China is in-

³ Adopted at the First Session of the Seventh National People's Congress, and revised according to the Decision on Modifying the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures adopted at the 18th Session of the Standing Committee of the Ninth National People's Congress on October 31, 2000, and promulgated by Order No. 40 of the President of the People's Republic of China on October 31, 2000.

⁴ Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, article 1.

⁵ Adopted at the 4th Meeting of the Sixth National People's Congress on April 12, 1986, amended in accordance with the Decision on Modifying the Law of the People's Republic of China on Foreign-funded Enterprises adopted at 18th Meeting of the Standing Committee of the Ninth National People's Congress on October 31, 2000, and promulgated by Order No. 41 of the President of the People's Republic of China on October 31, 2000.

⁶ Law of the People's Republic of China on Foreign-funded Enterprises, article 1.

creasing very rapid. For example, up to the beginning of 2000, the number of the foreign-invested enterprise more than 340,000, by the end of May, 2003, the number of the foreign-invested enterprise are 439,371.⁷ The contract of Joint Venture is very important in the activities of establishment a Joint Venture. But before discussing the Joint Venture's contract, we must solve a problem: the relation between Equity Joint venture and Contractual Joint Venture. From the features of them, we could know their difference. In general, the features of Equity Joint Venture are:

1. One party of the Equity Joint Ventures is a foreign Joint Venture, and the other party is a Chinese Joint Venture. Both of them establish an economic unit according with the law of China. Joint Ventures using Chinese and foreign investment established within China's territory in accordance with the Law on Chinese-Foreign Joint Ventures are Chinese legal persons, and in the same time, they are subject to the jurisdiction and protection of Chinese law.

2. A Joint Venture is an Equity Joint Venture. Chinese and foreign Joint ventures make the investment together. They are the co-administrator and the co-operator of the Equity Joint Venture. The parties to the venture shall share the profits, risks and losses in proportion to their respective contributions to the registered capital.

3. A Joint Venture is a limited liability company. The highest authority of the joint venture shall be its board of director.

Contractual Joint Venture is very different from the Equity Joint Venture. The features of Contractual Joint Venture are:

1. This kind of Joint Venture is a Contractual Joint Venture. The right and liability of the Chinese and foreign parties shall prescribe in their contractual joint venture contract such matters as the investment or conditions for cooperation, the distribution of earnings or products, the sharing of risks and losses, the manners of operation and management and the ownership of the property at the time of the termination of the contractual joint venture. These are different from equity joint venture.

2. A Contractual Joint Venture which meets the conditions for being considered a legal person under Chinese law, shall acquire the status of a

⁷ <http://www.chinafair.org.cn/cn/recn/captal-20030722.htm>

Chinese legal person in accordance with law. That means, a contractual joint venture may be not a Chinese legal person. Although the Chinese law are not require that a Contractual Joint must has the status of a Chinese legal person, but according with the Chinese law, a Contractual Joint Venture has the ability to independently bear liability.

3. If, upon the expiration of the period of a venture's operation, all the fixed assets of the Contractual Joint Venture, as agreed upon by the Chinese and foreign parties in the Contractual Joint Venture contract, are to belong to the Chinese party, the Chinese and foreign parties may prescribe in the Contractual Joint Venture contract the ways for the foreign party to recover its investment ahead of time during the period of the venture's operation. If the foreign party, as agreed upon in the contractual joint venture contract, is to recover its investment prior to the payment of income tax, it must apply to the financial and tax authorities, which shall examine and approve the application in accordance with state provisions concerning taxes.

If the foreign party is to recover its investment ahead of time during the period of the venture's operation, the Chinese and foreign parties shall, as stipulated by the relevant laws and agreed in the Contractual Joint Venture contract, be liable for the debts of the venture.

4. The management organization of a Contractual Joint Venture much more than one type. A contractual joint venture shall establish a board of directors or a joint managerial institution which shall according to the contract or the articles of association for the contractual joint venture, decide on the major issues concerning the venture.

Although Contractual Joint Venture is one type of joint venture in China, but equity joint venture is still a major type. In general, "Joint Venture" in China usually refers to Equity Joint Venture. So this article will mainly discuss the application of law about the contract of equity joint venture.

2. The Joint Venture Contract in China

"Joint Venture contract" in China refers to a document agreed upon and concluded by the parties to the joint venture on their rights and obligations. The main items of it are:⁸

⁸ Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment. Promulgated by the State Council

1. The names, the countries of registration, the legal address of parties to the joint venture, and the names, professions and nationalities of the legal representatives thereof.
2. Name of the joint venture, its legal address, purpose and the scope and scale of business.
3. Total amount of investment and registered capital of the joint venture, investment contributed by the parties to the joint venture, each party's investment proportion, forms of investment, the time limit for contributing investment, stipulations concerning incomplete contributions, and assignment of investment.
4. The ratio of profit distribution and losses to be borne by each party.
5. The composition of the board of directors, the distribution of the number of directors, and the responsibilities, powers and means of employment of the general manager, deputy general manager and high-ranking management personnel.
6. The main production equipment and technology to be adopted and their source of supply.
7. The ways and means of purchasing raw materials and selling finished products.
8. Principles governing the handling of finance, accounting and auditing.
9. Stipulations concerning labor management, wages, welfare, and labor insurance.
10. The duration of the joint venture, its dissolution and the procedure for liquidation.
11. The liabilities for breach of contract.
12. Ways and Procedures for settling disputes between the parties to the joint venture.
13. The language used for the contract and the conditions for putting the contract into force.

The annex, for example, the articles of association of the Joint Venture, to the contract of a joint venture shall be equally authentic with the contract itself.

on Sep. 20, 1983 Amended by the State Council on Jan.15 1986, Dec. 21, 1987 Amended by the State Council according to the Decision of the State Council on Amending the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment on July 22, 2001.

“Joint venture contract” is different from the “joint venture agreement”. The “joint venture agreement” mentioned in these Regulations refers to a document agreed upon by the parties to the joint venture on some main points and principles governing the establishment of a joint venture. If the joint venture agreement conflicts with the contract, the contract shall prevail. If the parties to the joint venture agree to sign only a contract and articles of association, the agreement can be omitted.

When a contract of a joint venture shall be signed, the parties of it should mention the Provisions on Guiding the Orientation of Foreign Investment.⁹ In the provision, stipulate that foreign-funded projects fall into 4 categories, namely encouraged, permitted, restricted and prohibited ones:

A. Encouraged projects

A project in any of the following situations shall be listed as the encouraged foreign-funded projects:

1. Being of new agriculture technologies, agriculture comprehensive development, or energy, transportation and important raw material industries.
2. Being of high and new technologies or advanced application technologies that can improve the product performance and increase the technology economic efficiency of the enterprises or those that can produce the new equipments and new materials which the domestic production capacity fails to produce.
3. Meeting the market needs and being able to improve the product level, develop new markets or increase the international competitive capacity of the products.
4. Being of new technologies and new equipments that can save energy and raw material, comprehensively utilize resources and regenerate resources, and prevent environment pollutions.
5. Being capable of bring into the advantages of human power and resources of the mid-west region into full play and being in conformity to the industrial policies of the State.
6. Other situations as provided for by laws and administrative regulations.

⁹ The Provisions on Guiding the Orientation of Foreign Investment came into force on April 1, 2002.

Most of the joint venture in China now are encouraged foreign-funded projects, the government of China always attach great importance to the encouraged projects. These joint ventures act a very important rule in the economic field of China.

B. Restricted projects

1. Being of technology lagged behind.
2. Being adverse to saving resources and improving environment.
3. Engaged in the prospecting and exploitation of the specific type of mineral resources to which the State applies protective exploitation.
4. Falling into the industries that the State opens step by step.
5. Other situations as provided by laws and administrative regulations.

C. Prohibited projects

1. Harming the State safety or impairing the public interests.
2. Polluting the environment, damaging natural resources or harming human health.
3. Occupying too much farmland and being adverse to the protection and development of land resources.
4. Harming the safety and usage of military facilities.
5. Using the particular techniques or technologies of China to produce products.
6. Other situations as provided for by laws and administrative regulations.

D. Permitted projects

The foreign-funded projects that don't fall into the categories of encouraged, restricted or prohibited projects shall be the permitted foreign-funded projects.

The foreign-funded projects that are encouraged, restricted and prohibited shall be listed in the Catalog of Foreign-funded Industry Guidance.¹⁰

¹⁰ Promulgated on March 11, 2002, and effective as of april 1, 2002.

For the reason that the article 12 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment stipulate: The formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by the Chinese law. So it needs to consider and obey those project rules when one signs a contract of joint venture.

II. THE APPLICATION OF LAW ABOUT THE CONTRACT OF "JOINT VENTURE" IN CHINA

As stated above, the article 12 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment stipulates: the formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by the Chinese law. But how we understand this article? It needs to know the following aspects.

1. *The basic principle of application of law of the article 12 is as the same as the Company Law of the People's Republic of China*¹¹

The article 18 of the Company Law of the People's Republic of China stipulate: the foreign-invested limited liability company governed by this law. And the article 4 of the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures is: A joint venture shall take the form of a limited liability company. So the contract of joint venture also governed by the Company Law of the People's Republic of China.

Analysis the relation of The Company Law of the People's Republic of China and the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures. Based on the basic principle of law in China, the Company Law is belong to common law, and the joint venture law is belong to special law. When the Company Law has no stipulations to adopt

¹¹ Adopt at the Fifth meeting of the Fifth National People's Congress on December 29, 1993, amended in accordance with the Decision on the Company Law of the People's Republic of China at 13th Meeting of the Standing Committee of the Ninth National People's Congress on December 25, 1999, and promulgated by Order No. 29 of the President of the People's Republic of China, and effective as of the date of promulgation.

some situation of a contract of joint venture, and the joint venture law has some special rules can adopt the contract, those special rules of the joint venture law shall be applicable. If the joint venture law had no rules to adopt some situation of a contract of joint venture, but the Company Law has definite stipulations, these definite stipulations of the Company Law should be used. If the stipulations of the Company law and the joint Venture law have conflicts, the stipulations of the Joint venture shall be applied.

There are many articles about the limited liability company in The Company Law of the People's Republic of China. For example, those articles about the name of a company, articles of association and registered capital etcetera, all of them are applicable to the contract of joint venture because "a joint venture is a limited liability company". And the name of a company, articles of association and registered capital etc. are the main items of a Joint Venture contract of China. The article 9 of the Company law of PRC stipulates: A limited liability company established according to this law must clearly indicate the words "limited liability company" in its name. The article 11 is: articles of association must be formulated in accordance with this law when a company is incorporated. A company's articles of association shall have binding force on the company, its shareholders, directors, supervisors and managers. A company's scope of business shall be defined in its articles of association and registered in accordance with the law. Items within the company's "scope of business" that are subject to restrictions under laws, administrative rules and regulations shall be approved in accordance with the law. The article 23 is about the registered capital: The registered capital of a limited liability company shall be the amount of the paid-up capital contributions of all its shareholders as registered with the Company Registration Authority. The registered capital of a limited liability company shall be no less than the following minima (1) RMB 500 000 yuan for a company engaged mainly in production and operation; (2) RMB 500 000 yuan for a company engaged mainly in commodity wholesale; (3) RMB 300 000 yuan for a company engaged mainly in commercial retailing; and (4) RMB 100 000 yuan for a company engaged mainly in science and technology development, consultancy or services. Where the minimum registered capital of a limited liability company in specified trades needs to be higher than those stipulated in the preceding paragraph, it shall be stipulated by the laws and administrative rules and regulations separately. On the other hand, the Company law of PRC also

stipulates about the registered capital: A shareholder may make its capital contributions to a company in currency or by contributing material objects, industrial property rights, non-patented technology or land-use rights to be contributed as capital must undergo an asset valuation and verification, and shall not be overvalued or undervalued. The appraisal and valuation of land-use rights shall be handled in accordance with the laws and administrative rules and regulations. The investment in the form of industrial property rights and non-patented technology at their appraised value shall not exceed twenty percent of the registered capital of a limited liability company, except where special State regulations in respect of the application of high and new technological achievement provide otherwise.

2. *The Contract Law of the People's Republic of China¹² has the same stipulation as the article 12 of the Regulations for the Implementation of the Law of the People's Republic of China*

About the application of law of the joint venture of China, the Contract Law of the People's Republic of China has the same stipulation as the article 12 of the Regulations for the Implementation of the Law of the People's Republic of China. The article 126 of the Contract Law of the People's Republic of China stipulated: The parties to a contract involving foreign interests may choose the law applicable to the settlement of their contract disputes, except as otherwise stipulated by law. If the parties to a contract involving foreign interests have not made a choice, the law of the country to which the contract is most closely connected shall be applied. The contracts for Chinese-foreign equity joint ventures, for Chinese-foreign contractual joint ventures and for Chinese-foreign cooperative exploration and development of natural resources to be performed within the territory of the People's Republic of China shall apply the laws of the People's Republic of China.

In the article 126 of the Contract Law of the People's Republic of China contains two principles: principle of autonomy of will and principle of the

¹² Adopt at the Fifth meeting of the Fifth National People's Congress on December 29, 1993, amended in accordance with the Decision on the Company Law of the People's Republic of China at 13th Meeting of the Standing Committee of the Ninth National People's Congress on December 25, 1999, and promulgated by Order No. 29 of the President of the People's Republic of China, and effective as of the date of promulgation.

closest connection. Based on the principle of autonomy of will, the parties to a contract involving foreign interests may choose the law applicable to the settlement of their contract disputes, but except as otherwise stipulated by law. The contracts for Chinese-foreign Equity Joint Ventures to be performed within the territory of the PRC shall apply the laws of the People's Republic of China. As the same, according with the principle of the closest connection, if the parties to a contract involving foreign interests have not made a choice, the law of the country to which the contract is most closely connected shall be applied. But the contracts for Chinese-foreign Equity Joint Ventures to be performed within the territory of the PRC shall apply the laws of the People's Republic of China.

3. *The principle of application of law about the joint venture contract is in the General Principles of the Civil Law of the People's Republic of China*¹³

First, the General Principles of the Civil Law of the People's Republic of China defined the state of the joint venture: A Chinese-foreign Equity Joint Venture, Chinese-foreign contractual shall be qualified as a legal person in China, if it has the qualifications of a legal person and has been approved and registered by the administrative agency for industry and commerce in accordance with the law. In the territory of the People's Republic of China, the legal person of PRC (including the contract of establishment the legal person) governed by the law of PRC is definitely.

Second, the General Principles of the Civil Law of the People's Republic of China has the same principle with the Contract Law of the People's Republic of China. Let's see the article 145 of the General Principles of the Civil Law of the People's Republic of China: The parties to a contract involving foreign interests may choose the law applicable to settlement of their contractual disputes, except as otherwise stipulated by law. If the parties to a contract involving foreign interests have not made a choice, the law of the country to which the contract is most closely connected shall be applied.

¹³ Adopted at the Fourth Session of the Sixth National People's Congress, and promulgated by Order No. 37 of the president of the People's Republic of China on April 12, 1986, and effective as of January 1, 1987.

As stated above, the Contract law of PRC and the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment have the specific stipulates: The contracts for Chinese-foreign equity joint ventures to be performed within the territory of the People's Republic of China shall apply the laws of the People's Republic of China. As above stated, according to the basic theory of law of China, the General Principles of the Civil Law of the People's Republic of China is belong to the common law, the Contract law of PRC and the Regulations for the Implementation of the Law of the People's Republic of China are belong to the specific law. Based the principle of law of PRC, when the common law, the General Principles of the Civil Law of the People's Republic of China has no some special detail stipulations to adopt some situation of a Contract of Joint Venture of China, and the Contract law of PRC and the Regulations for the Implementation of the Law of the People's Republic of China joint have some special rules can adopt the contract, those special rules of the joint venture law shall be applicable. It is obvious that the principle of applying the law of PRC for a contract of joint venture is a basic principle in the law of PRC.

For the reason that the General Principles of the Civil Law of the People's Republic of China adopted and effected in the time of planning economic in China, it is not adapt to the social and economic development of China now. But, before the Code of Civil law of PRC has been adopted and effected, it would be still governed the relations of the contract of Joint Venture of China.

4. The application of foreign law has been refused

The article 12 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment stipulates very clearly: the formation of a joint venture contract, its validity, interpretation, execution and the settlement of disputes under it shall be governed by the Chinese law. That means, the contract of joint venture of China must and only governed by the Chinese law.

In the practice of establishment a joint venture in China, some foreign enterprise consists to apply their country's law in the contract of joint venture. It violated the principle of the law of China. For example, in one joint venture contract of China have this two articles:

Article x. The joint venture shall adopt and comply with standards of conduct and business practices in conformity with the laws and regulations of the PRC and those standards applied by M International Inc. on a world wide basis, including the W International Inc.'s Business Code of Conduct, W International Inc.'s Proper Business Practices and W International Inc.'s Health Safety and Environmental Policy and Assurance System, and such laws and regulations of A country which extend to W International Inc.'s operation outside the A country, provided that they do not conflict (although they may be in addition to what is required by) with the laws and regulations of the PRC, including without limitations the A country's Foreign Corrupt Practices Act and export controls laws and anti-boycott laws.

Article y. This Contract shall be interpreted and enforced in accordance with and governed by the promulgated and publicly available laws and regulations of the PRC. If no such promulgated PRC law exists to govern a particular matter relating to this Contract, then the relevant provisions in many treaty to which the PRC is a member or signatory may be applied. If there is no such treaty applicable, then general international practices may be applied. Any contract or agreement contained in any Schedule to this Contract shall be governed by the law chosen in such contract or agreement. These two articles mainly have the following contents:

1. The joint venture contract applies the law of PRC.
2. If no such promulgated PRC law exists to govern a particular matter relating to this Contract, then the relevant provisions in many treaty to which the PRC is a member or signatory may be applied. If there is no such treaty applicable, then general international practices may be applied.
3. The contract governed by those standers which applied by M International Inc. on a world wide basis if they do not conflict with laws and regulations of PRC.
4. The contract applies and obeys the law of A country if they do not conflict with laws and regulations of PRC.

Some contents of the two articles of the joint venture contract have violated the law of PRC seriously. As this paper mentioned above, the article 12 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures Using Chinese and Foreign Investment stipulate: The formation of a joint venture contract, its validity, inter-

pretation, execution and the settlement of disputes under it shall be governed by the Chinese law. According to the article, the contract of joint venture shall be governed by the law of PRC. And in the judicial process of PRC, apply a foreign law to a joint venture (include concluding a contract of joint venture) is impossible.

First, the joint venture is a Chinese legal person which established according with the law of China. The article 2 of the Regulations for the Implementation of the Law of the People's Republic of China on Joint Ventures is: Joint ventures using Chinese and foreign investment established within China's territory in accordance with the Law on Chinese-Foreign Joint Ventures are Chinese legal persons and are subject to the jurisdiction and protection of Chinese law. That means, the contract of joint venture is also apply the law of PRC.

Second, in the law of China, there have not this content that a foreign country's law shall adopt and comply in the field of China if they do not conflict with the laws and regulations of the PRC.

III. BRIEF SUMMARY

To conclude, Chinese Joint Venture's feature and other aspects have a strong influence to the Contract of Joint Venture of China. And the contract of joint venture of PRC should governed by the Law of PRC. Any viewpoint and practice that the contract of joint venture of PRC could apply the foreign law (even if these laws are not conflict to the law of PRC) should be refused. Although sometime we could see some items about using foreign law¹⁴ in the contract of joint venture of China, but it is invalid in the judicial practice in PRC.