Legal and Extra-legal Issues in Joint Venture Negotiations

TIMOTHY A. GELATT*

I. INTRODUCTION

More than eight years have passed since the People's Republic of China took the first concrete step in its policy of opening to foreign business by publishing a law on Chinese-foreign joint ventures (the "Joint Venture Law").[1] The Joint Venture Law, even sketchier than the recent foreign investment guidelines issued by the Soviet Union in the footsteps of its erstwhile little brother,[2] simply provided a few basic ground rules for the establishment of equity joint venture companies between Chinese and foreign firms. In those early days, almost everything — even the tax rate to be applied to a joint venture[3] — was left to the negotiating table. The lack of legislation, as well as the

* Attorney, Paul, Weiss, Rifkind, Wharton & Garrison. Mr. Gelatt has authored many articles on investment law and practice in China drawing upon his extensive experience since 1980 in negotiating contracts in the PRC.

1. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa, in ZHONGGUO SHEWAI JINGJI FAGUI HUIBIAN, 1949-1985, at 849 [hereinafter ZSJFH] (The Law of the People's Republic of China on Chinese-Foreign Joint Ventures) (adopted July 1, 1979, promulgated July 8, 1979) [hereinafter Joint Venture Law] (trans. in 1 CHINA'S FOREIGN ECONOMIC LEGISLATION 1 (1982)) [hereinafter CFEL:1].

2. Decree of the USSR Council of Ministers on the Establishment in the Territory of the USSR and Operation of Joint Ventures with the Participation of Soviet Organizations and Firms from Capitalist and Developing Countries. Supplement to FOREIGN TRADE, No. 5, 1987, at 16.

3. For example, in the 1980 contract for the establishment of the joint venture between the Jardine Schindler (Far East) Holdings S.A. of Hong Kong, the Schindler Holding AG of Switzerland and the China Construction Machinery Corporation for the manufacture of elevators in the PRC, the rate of income tax was to be 31.5%. CHINA ECON. NEWS, Apr. 7, 1980, at 2. A few months after the approval of the Schindler contract, the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures (JVITL) (*see infra* note 11) was published, with a 33% total tax rate for equity joint ventures. The Ministry of Finance issued a notice to cover the Schindler and similar situations, providing that, in contracts approved prior to the promulgation of the JVITL, the contractually approved rate would apply for the initial term of the contract, if such rate was lower than the JVITL rate, though the statutory rate would apply to any extended period. If the contractual rate was higher than the JVITL rate, however, the latter could be used from the effective date of the JVITL. [Document] Concerning Questions Relating to the Payment of Tax for Joint Venture Contracts Approved Prior to the Promulgation of the Tax Law (Nov. 5, 1980), in Zhonghua Renmin Gongheguo Caizhengbu Shuiwu Zongju (Central Bureau of the Ministry of Finance of the People's Republic of China), ZHONGGUO DUIWAI SHUIWU SHOUCE (Handbook of China's Foreign Taxation) (1983), Vol. 1, at 11 [hereinafter TAX HANDBOOK, Vol. 1].

inexperience of Chinese and foreign businesses in dealing with each other, tended to make joint venture negotiations in the late 1970s and early 1980s protracted, difficult affairs, often characterized by considerable confusion and misunderstanding.

In 1987, the legislative picture is very different. Since 1980, in the course of crafting its legal system to govern foreign economic affairs, the PRC has devoted particular attention to the regulation of equity joint ventures, the form of investment that China has generally favored for industrial projects. In addition to the extensive detailed implementing rules for the Joint Venture Law (the "Implementing Rules"),[4] which were promulgated after much deliberation in 1983, specific rules have been issued on a national basis to cover registration of joint ventures,[5] labor issues,[6] accounting,[7] financing,[8] foreign exchange,[9] debt-equity ratios,[10] and other areas. On the taxation

4. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Fa Shishi Tiaoli, in ZSJFH, *supra* note 1, at 853 (Regulations for the Implementation of the Law of the People's Republic of China on Chinese-Foreign Joint Ventures) (promulgated Sept. 20, 1983) [hereinafter Implementing Rules] (trans. in 3 CHINA'S FOREIGN ECONOMIC LEGISLATION 1) [hereinafter CFEL:3].

5. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Dengji Guanli Banfa, in ZSJFH, *supra* note 1, at 885 (Procedures of the People's Republic of China for the Registration and Administration of Chinese-Foreign Joint Ventures) (promulgated July 26, 1980) (trans. in CFEL:1, *supra* note 1, at 13).

6. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding, in ZSJFH, *supra* note 1, at 877 (Provisions of the People's Republic of China for Labor Management in Chinese-Foreign Joint Ventures) (promulgated July 26, 1980) (trans. in CFEL:1, *supra* note 1, at 20) [hereinafter JV Labor Provisions]; Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding Shishi Banfa, in ZSJFH, *supra* note 1, at 880 (Provisions for the Implementation of the Regulations on the Labor Management of Joint Ventures Using Chinese and Foreign Investment) (promulgated Jan. 19, 1984) (trans. in CHINA ECON. NEWS, Mar. 12, 1984, at 2).

7. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Kuaiji Zhidu, in ZSJFH, *supra* note 1, at 902 (The Accounting Regulations of the People's Republic of China for Joint Ventures Using Chinese and Foreign Investment) (promulgated Mar. 4, 1985) [hereinafter Accounting Regulations] (trans. in CHINA LAWS FOR FOREIGN BUSINESS, ¶ 35-500 (CCH Australia Limited Ed.)) [hereinafter CLFB]; Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Caiwu Guanli Guiding, in FAGUI XINXI 34 (1987) (Provisions of the People's Republic of China for Financial Management in Chinese-Foreign Joint Ventures) (promulgated Aug. 5, 1986).

8. Zhongguo Yinhang Dui Waishang Touzi Qiye Daikuan Banfa (Procedures of the Bank of China for Loans to Enterprises with Foreign Investment) [hereinafter BOC Loan Procedures], in ZHONGHUA RENMIN GONGHEGUO GUOWUYUAN GONGBAO (1987) 359 (STATE COUNCIL GAZETTE OF THE PEOPLE'S REPUBLIC OF CHINA) [hereinafter STATE COUNCIL GAZETTE] (adopted Apr. 24, 1987) (trans. in E. ASIAN EXEC. REP., Sept. 1987, at 24), superseding Zhongguo Yinhang Banli Zhongwai Hezi Jingying Qiye Daikuan Zanxing Banfa, in ZSJFH, *supra* note 1, at 751 (Interim Procedures for the Handling of Loans by the Bank of China to Chinese-Foreign Joint Ventures) (adopted Mar. 13, 1981) (trans. in CFEL:1, *supra* note 1, at 27).

9. Zhonghua Renmin Gongheguo Waihui Guanli Zanxing Tiaoli, in ZSJFH, *supra* note 1, at 744 (Interim Regulations on Foreign Exchange Control of the People's Republic of

front, the 1980 Joint Venture Income Tax Law and its implementing regulations[11] have been supplemented by an ever expanding body of detailed notices and rulings by the central and local tax authorities concerning specific joint venture tax issues.[12]

In addition to national legislation governing joint ventures, various local authorities in provinces, major cities, special economic zones and economic and technological development zones have issued their own rules covering such areas as labor,[13] registration,[14] land use,[15]

China) (adopted Dec. 5, 1980, promulgated Dec. 18, 1980) (trans. in CFEL:1, *supra* note 1, at 118); Dui Qiaozi Qiye, Waizi Qiye, Zhongwa Hezi Jingying Qiye Waihui Guanli Shixing Xize, in ZSJFH, *supra* note 1, at 772 (Rules for the Implementation of Foreign Exchange Controls Relating to Overseas Chinese Enterprises, Foreign Enterprises and Chinese-Foreign Joint Ventures) (adopted July 19, 1983, promulgated Aug. 1, 1983) (trans. in 2 CHINA'S FOREIGN ECONOMIC LEGISLATION 230) [hereinafter CFEL:2]; Guowuyuan Guanyu Zhongwai Hezi Jingying Qiye Waihui Shouzhi Pingheng Wenti de Guiding, in STATE COUNCIL GAZETTE 66 (1986) (Provisions of the State Council on the Question of the Balance of Foreign Exchange Receipts and Expenditures of Chinese-Foreign Joint Ventures) (promulgated Jan. 15, 1986) (trans. in E. ASIAN EXEC. REP., Feb. 1986, at 26) [hereinafter Foreign Exchange Provisions].

10. Guanyu Zhongwai Hezi Jingying Qiye Zhuce Ziben Yu Touzi Zonge Bili de Zanxing Guiding, in STATE COUNCIL GAZETTE 215 (1987) (Interim Provisions Concerning the Ratio between Registered Capital and Total Amount of Investment of Chinese-Foreign Equity Joint Ventures) (promulgated Mar. 1, 1987) (trans. in E. ASIAN EXEC. REP., Mar. 1987, at 22) [hereinafter Debt-Equity Ratio Provisions].

11. Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa, in ZSJFH, *supra* note 1, at 619 (Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (adopted Sept. 10, 1980) (trans. in CFEL:1, *supra* note 1, at 36) [hereinafter JVITL]; Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa Shishi Xize, in ZSJFH, *supra* note 1, at 622 (Rules for the Implementation of the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (adopted Dec. 10, 1980, promulgated Dec. 14, 1980) (trans. in CFEL:1, *supra* note 1, at 45).

12. A large number of such tax documents are published in TAX HANDBOOK, Vol. 1, *supra* note 3; ZHONGHUA RENMIN GONGHEGUO CAIZHENGBU SHUIWU ZONGJU (Central Bureau of Taxation of the Ministry of Finance of the People's Republic of China), ZHONGGUO DUIWAI SHUIWU SHOUCE (Handbook of China's Foreign Taxation) (1984), [hereinafter TAX HANDBOOK, Vol. 2]; Ministry of Finance's monthly ZHONGGUO SHUIWU (China's Taxation). For a discussion of how the numerous published tax notices have fleshed out China's tax system for joint ventures and other foreign business projects, see Gelatt, *Tax Guide*, CHINA BUS. REV., Nov.-Dec. 1987, at 18.

13. *See, e.g.*, Beijing Shi Shishi Zhongwai Hezi Jingying Qiye Laodong Guanli Guiding de Buchong Guiding (Supplementary Provisions of Beijing Municipality for the Implementation of the Provisions for Labor Management in Chinese-Foreign Joint Ventures) (promulgated Mar. 3, 1986) [hereinafter Beijing Labor Provisions]; Shanghai Shi Zhongwai Hezi Jingying Qiye Laodong Guanli Shishi Banfa (Shixing) (Shanghai Municipality Rules for the Implementation of Labor Management in Chinese-Foreign Joint Ventures (for Trial Implementation)) SHANGHAI OVERSEAS INVESTMENT UTILIZATION MANUAL 164 (trans. at 464) (1985) (effective Nov. 1, 1984) [hereinafter SHANGHAI HANDBOOK] (also trans. in E. ELIASOPH, LAW AND BUSINESS PRACTICE IN SHANGHAI 97 (1987)). The above cited Shanghai trial regulations have been effectively superseded by Shanghai Shi Zhongwai Hezi Jingying Qiye Laodong Renshi Guanli Tiaoli (Shanghai Municipality Regulations for Labor and Personnel Management in Chinese-Foreign Equity Joint Ventures) (promulgated Dec. 31, 1987).

14. *See, e.g.*, Guangzhou Jingji Jishu Kaifaqu Qiye Dengji Guanli Shixing Banfa, in

procurement of materials,[16] and the procedures for negotiation and approval of projects.[17] Most recently, the October 1986 Provisions of the State Council for the Encouragement of Foreign Investment,[18] together with various national and local implementing regulations thereunder,[19] have added to the complexity of the legislative picture.

ZSJFH, *supra* note 1, at 1101 (Provisional Procedures for the Registration and Administration of Enterprises in the Guangzhou Economic and Technological Development Zone) (adopted Mar. 6, 1985, promulgated Apr. 9, 1985) (trans. in CHINA ECON. NEWS, July 22, 1985, at 3); Tianjin Jingji Jishu Kaifaqu Qiye Dengji Guanli Guiding, in ZSJFH, *supra* note 1, at 1135 (Regulations on the Registration and Administration of Enterprises in the Tianjin Economic and Technological Development Zone) (adopted July 20, 1985) (trans. in CHINA ECON. NEWS, Aug. 26, 1985, at 1); Xiamen Jingji Tequ Qiye Dengji Guanli Guiding, in ZSJFH, *supra* note 1, at 1014 (Regulations on the Registration of Enterprises in the Xiamen Special Economic Zone) (adopted July 14, 1984) (trans. in CHINA ECON. NEWS, Mar. 25, 1985, at 1).

15. *See, e.g.*, Guangzhou Jingji Jishu Kaifaqu Tudi Guanli Shixing Banfa, in ZSJFH, *supra* note 1, at 1081 (Tentative Procedures of the Guangzhou Economic and Development Zone for Land Management) (adopted Mar. 6, 1985, promulgated Apr. 9, 1985) (trans. in CHINA ECON. NEWS, June 24, 1985, at 1); Tianjin Jingji Jishu Kaifaqu Tudi Guanli Guiding, in ZSJFH, *supra* note 1, at 1144 (Provisions of the Tianjin Economic and Technological Development Zone on Land Management) (adopted July 20, 1985) (trans. in CHINA ECON. NEWS, Sept. 2, 1985, at 5); Xiamen Jingji Tequ Tudi Shiyong Guanli Guiding, in ZSJFH, *supra* note 1, at 1017 (Regulations on the Use of Land in the Xiamen Special Economic Zone) (adopted July 14, 1984) (trans. in CHINA ECON. NEWS, Apr. 15, 1985, at 1).

16. *See* Shanghai Shi Zhongwai Hezi Jingying Qiye Wuzi Gongxiao he Wujia Guanli Guiding (Shixing), in SHANGHAI HANDBOOK, *supra* note 13, at 160 (Provisions Concerning the Supply and Marketing of Materials and Commodity Price Control for Chinese-Foreign Equity Joint Ventures in Shanghai Municipality (for Trial Implementation)) (promulgated Dec. 5, 1984) (trans. in ELIASOPH, *supra* note 13, at 113).

17. *See* Shanghai Shi Zhongwai Hezi Jingying Qiye, Zhongwai Hezuo Jingying Qiye, Waizi Qiye de Shenqing he Shenpi Guiding (Shanghai Municipality Regulations on the Application for and Examination and Approval of Chinese-Foreign Equity Joint Ventures, Chinese-Foreign Cooperative Ventures and Wholly Foreign-owned Ventures) (adopted June 20, 1986) (trans. in ELIASOPH, *supra* note 13, at 40); Shanghai Shi Zhongwai Hezi Jingying Qiye, Zhongwai Hezuo Jingying Qiye, Waizi Qiye de Shenqing he Shenpi Guiding Shishi Banfa (Implementing Measures for the Provisions of Shanghai Municipality on the Application for and Examination and Approval of Chinese-Foreign Joint Ventures, Chinese-Foreign Cooperative Ventures and Wholly Foreign-owned Enterprises) (effective Nov. 1, 1986) [hereinafter Shanghai 1986 Implementing Measures].

18. Guowuyuan Guanyu Guli Waishang Touzi de Guiding, in STATE COUNCIL GAZETTE 757 (1986) (Provisions of the State Council of the People's Republic of China for the Encouragement of Foreign Investment) (promulgated Oct. 11, 1986) (trans. in E. ASIAN EXEC. REP., Nov. 1986, at 22) [hereinafter 22 Articles].

19. As of December 1987, eleven implementing regulations have been issued under the 22 Articles, with more expected: Guanyu Waishang Touzi Qiye Yongren Zizhuquan he Zhigong Gongzi, Baoxian Fuli Feiyong de Guiding, in STATE COUNCIL GAZETTE 959 (1986) (Provisions Concerning the Right of Autonomy of Enterprises with Foreign Investment in Hiring Personnel and the Wages, Insurance and Welfare Costs of Staff and Workers) (promulgated Nov. 10, 1986) (trans. in E. ASIAN EXEC. REP., Jan. 1987, at 25) [hereinafter 1986 Labor Provisions]; Zhonghua Renmin Gongheguo Haiguan Dui Waishang Touzi Qiye Luxing Chanpin Chukou Hetong Suoxu Jinkou Liaojian Guanli Banfa, in STATE COUNCIL GAZETTE 960 (1986) (Procedures of the Customs of the People's Republic of China for the Administration of Materials and Parts that Enterprises with Foreign Investment Need to Import in order to Carry Out Product Export Contracts) (promulgated Nov. 24, 1986) (trans. in E. ASIAN

These Provisions, popularly known as the "22 Articles," and the implementing regulations, provide incentives and preferential treatment to joint ventures that in many cases have the effect of amending the provisions of previous legislation.

To be sure, China has not produced legislation on every point of concern in the negotiation of equity joint ventures. Nonetheless, the statutes catalogued above, other laws that specifically govern joint ventures and numerous pieces of general legislation[20] that affect joint

---

EXEC. REP., Jan. 1987, at 23); Zhongguo Renmin Yinhang Guanyu Waishang Touzi Qiye Waihui Diya Renminbi Daikuan Zanxing Banfa, STATE COUNCIL GAZETTE 25 (1987) (Interim Procedures Concerning Renminbi Loans to Enterprises with Foreign Investment Secured by Foreign Exchange) (promulgated Dec. 12, 1986) (trans. in E. ASIAN EXEC. REP., Jan. 1987, at 25); Caizhengbu Guanche Guowuyuan Guanyu Guli Waishang Touzi de Guiding Zhong Shuishou Youhui Tiaokuan de Shishi Banfa, in STATE COUNCIL GAZETTE 93 (1987) (Implementing Measures of the Ministry of Finance to Implement the Tax Preference Articles of the Provisions of the State Council for the Encouragement of Foreign Investment) (promulgated Jan. 31, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 25); Duiwai Jingji Maoyibu Guanyu Waishang Touzi Qiye Goumai Guonei Chanpin Chukou Jiejue Waihui Shouzhi Pingheng de Banfa, in STATE COUNCIL GAZETTE 118 (1987) (Measures of the Ministry of Foreign Economic Relations and Trade for Enterprises with Foreign Investment to Solve the Balance of Foreign Exchange Receipts and Expenditures by Purchasing Domestic Products for Export) (promulgated Jan. 20, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 24) [hereinafter Product Export Measures]; Duiwai Jingji Maoyibu Guanyu Waishang Touzi Qiye Shenqing Jinchukou Xukezheng de Shishi Banfa, in STATE COUNCIL GAZETTE 119 (1987) (Implementing Measures on the Application by Enterprises with Foreign Investment for Import and Export Licenses) (promulgated Jan. 24, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 24); Duiwai Jingji Maoyibu Guanyu Queren he Kaohe Waishang Touzi de Chanpin Chukou Qiye he Xianjin Jishu Qiye de Shishi Banfa, in STATE COUNCIL GAZETTE 120 (1987) (Implementing Measures of the Ministry of Foreign Economic Relations and Trade for the Confirmation and Examination of Export Enterprises and Technologically Advanced Enterprises with Foreign Investment) (promulgated Jan. 27, 1987) (trans. in E. ASIAN EXEC. REP., Feb. 1987, at 26); Debt-Equity Ratio Provisions, *supra* note 10; BOC Loan Procedures, *supra* note 8; Jingnei Jigou Tigong Waihui Danbao de Zanxing Guanli Banfa, in STATE COUNCIL GAZETTE 157 (1987) (Interim Measures for the Administration of the Provision of Foreign Exchange Guaranties by Domestic Institutions) (promulgated Feb. 20, 1987) (trans. in E. ASIAN EXEC. REP., Mar. 1987, at 21); Guanyu Zhongwai Hezi, Hezuo Jingying Qiye Chanpin Yi Chan Dingjin Banfa (Measures Concerning the Use of Products of Chinese-Foreign Equity and Cooperative Joint Ventures for Import Substitution) (promulgated Oct. 19, 1987) (trans. in Ta Kung Pao, Nov. 5, 1987) [hereinafter Import Substitution Measures]. For examples of local regulations implementing the 22 Articles, see Shanghai Shi Guanyu Guli Waishang Touzi de Ruogan Guiding (Provisions of Shanghai Municipality for the Encouragement of Foreign Investment) (effective Nov. 1, 1986) (trans. in ELIASOPH, *supra* note 13, at 6) [hereinafter Shanghai Provisions]; Beijing Shi Renmin Zhengfu Guanyu Shishi Guowuyuan Guanyu Guli Waishang Touzi de Guiding de Ruogan Guiding (Certain Provisions of the Beijing Municipal People's Government Concerning the Implementation of the Provisions of the State Council for the Encouragement of Foreign Investment) (promulgated Oct. 11, 1986) [hereinafter Beijing Provisions]; Guangzhou Shi Guli Waishang Touzi de Shishi Banfa (Provisions of the Municipal Government of Guangzhou for the Encouragement of Foreign Investment); Guangzhou Jingji Jishu Kaifaqu Guli Waishang Touzi de Shishi Banfa (Implementing Measures of the Guangzhou Economic and Technological Development Zone for the Encouragement of Foreign Investment) (promulgated Dec. 15, 1986).

20. *See, e.g.*, Zhonghua Renmin Gongheguo Shewai Jingji Hetong Fa, in ZSJFH, *supra*

ventures as well as other types of foreign business projects, constitute a rich body of law to which foreign investors may refer in planning and negotiating joint venture projects in China. It certainly is no longer fair to say that the biggest difficulty of negotiating joint ventures in the PRC is the lack of a legal structure.

While the emergence of this increasingly complete legal system has eliminated the need to "reinvent the wheel" on numerous basic issues, it has by no means made the negotiation of joint ventures a smooth or routine process. Nor has it necessarily shortened the average time required to bring a project from the initial letter of intent or other preliminary document through to the final contract. This article offers a practitioner's reflections on some of the key legal and extra-legal issues that continue to affect the process of negotiating joint ventures between Chinese and foreign companies, notes recent developments and progress with respect to some of these issues, and suggests ways both Chinese and foreign negotiators might attempt to deal with them.

II. THE NEGOTIATION AND APPROVAL PROCESS

Before raising some specific problems, a few words about the process of negotiation and approval of joint ventures are in order. Once the Chinese and foreign parties have passed the essential stage of what the Chinese call *lixiang* — the preliminary approval of the project by central or local investment officials based normally on a letter of intent or similar preliminary document and a project report by the Chinese party — they may begin negotiation of the joint venture contract documents and the joint feasibility study.[21]

A. Feasibility Study

The feasibility study is a subject about which considerable confusion exists in the minds of both Chinese and foreign negotiators. Foreign lawyers tend to regard a "feasibility study" as something with which only technical and financial people need concern themselves — a collection of numbers and projections, which has no legal significance. The Chinese themselves also gave short shrift to feasibility

note 1, at 1205 (Foreign Economic Contract Law of the People's Republic of China) (promulgated Mar. 21, 1985) (trans. in CLFB, *supra* note 7, ¶ 5-570) [hereinafter FECL]; Zhonghua Renmin Gongheguo Jishu Yinjin Hetong Guanli Tiaoli, in ZSJFH, *supra* note 1, at 1218 (Regulations on Administration of Technology Import Contracts of the People's Republic of China) (promulgated May 24, 1985) (trans. in CLFB, *supra* note 7, ¶ 5-570) [hereinafter Technology Regulations].

21. For a useful discussion of the typical progression of investment projects through the various phases of negotiation and official approval, see ELIASOPH, *supra* note 13, at 31-36.

studies until the Baoshan Steel debacle[22] drove home their importance in the minds of China's leadership. Foreigners involved in negotiations in China soon discover that the Chinese now tend to treat feasibility studies as having quasi-contractual significance. The joint feasibility study prepared by the two parties is required by law to be submitted for approval together with the contractual documents for the project.[23] Indeed, although practice is not uniform, some investment officials request that the feasibility study be attached as an appendix to the joint venture contract, thereby making it an integral part of the contract under Chinese contract law.[24] As a result of this Chinese approach, the only sound advice a foreign company can be given with respect to the feasibility study is to make liberal use of qualifying language that makes it clear that sales, foreign exchange balances and other projections are just that and not legal commitments.

The Implementing Rules provide that the feasibility study is to be submitted together with the joint venture contract documents as a package to the approval authorities.[25] The Implementing Rules do not require that the feasibility study be fully negotiated and agreed to before the contracts may be discussed. Although some local investment regulations state that the feasibility study must be concluded before the contracts are negotiated,[26] practice often deviates from this requirement; during many joint venture negotiations the parties work on two tracks at the same time with a technical and financial team developing the feasibility study while a group of business people and lawyers work through the contract documents.

---

22. In 1981, the PRC cancelled a $1.4 billion contract with the Japanese Nippon Steel Corporation for the importation of a major steel plant. One factor behind the cancellation was the fact that the site planned for the plant was discovered to be marshland. The experience of the Baoshan project is cited by Chinese officials as an important impetus for China's emphasis on feasibility studies for investment and other major foreign business projects. *See* Sneider, *The Baoshan Debacle: A Study of Sino-Japanese Contract Dispute Settlement*, 18 N.Y.U. J. INT'L L. & POL. 541 (1986).

23. Implementing Rules, *supra* note 4, art. 9(2).

24. FECL, *supra* note 20, art. 8.

25. *See supra* note 23 and accompanying text.

26. *See* Shanghai Shi Guanyu Kaiban Zhongwai Hezi Jingying Qiye he Jieshou Waishang Touzi Kaishi Ziying Qiye de Qiaotan Gongzuo he Shenpi Changsu Guiding (Shixing) de Shishi Banfa, in SHANGHAI HANDBOOK, *supra* note 13, art. 1(ii), at 149 (Implementing Measures for the Provisions Concerning the Negotiation of and Examination and Approval Procedures for the Establishment of Chinese-Foreign Equity Joint Ventures and the Acceptance of Foreign Investment for the Establishment of Wholly Foreign-owned Ventures in Shanghai Municipality (for Trial Implementation)) (trans. in ELIASOPH, *supra* note 13, at 51) [hereinafter Shanghai Implementing Measures].

B. Battle of the Forms

Once the contract negotiations begin, one of the most vexing problems that has plagued investment discussions even before substantive issues are reached is the "battle of the forms."[27] The Ministry of Foreign Economic Relations and Trade ("MOFERT"), China's leading foreign investment authority, has developed a form joint venture contract and articles of association that it provides to Chinese negotiators as their starting point for discussions with foreign parties.[28] Chinese negotiators often refer to the MOFERT model as if it were binding law. In fact, the MOFERT model, which in many respects is heavily skewed toward the Chinese position and provides inadequate coverage of a number of important issues,[29] is recognized by investment officials for what it is — a starting point.

Upon reviewing the draft contract based on the MOFERT model presented by the Chinese party, many foreign lawyers tend to cast it aside and counter with their own draft based on joint ventures their client has undertaken elsewhere in the world, reflecting its own ideal set of terms and conditions. A protracted debate often results as to whose draft will be used as the starting point for negotiations.

The time spent on the battle of the forms may be eliminated or substantially reduced if the foreign company drafts its proposed contract in English and Chinese using at least the form of the MOFERT model, even though the substance may deviate in numerous respects. For all its defects, the MOFERT model has the virtue of reflecting the basic legal and procedural structure of the Chinese foreign investment system. A contract organized in a way familiar to the Chinese party will be much less threatening and is more likely to be accepted as a starting point for negotiations than one that looks completely different.[30]

Contrary to some popular belief, length is not the major issue with which foreign lawyers should concern themselves in drafting joint venture contracts for use in China. The Chinese no longer think that it is possible or desirable to conclude major investment projects

27. *See* ELIASOPH, *supra* note 13, at 35; Chang, *The Great Battle of the Forms*, CHINA BUS. REV., July-Aug., 1987, at 7, 9-10.

28. For an English translation of the MOFERT model contract and articles of association, see ELIASOPH, *supra* note 13, at 178-90, 199-208.

29. *See, e.g., infra* notes 84, 89, 98 and accompanying text.

30. For a similar view see ELIASOPH, *supra* note 13, at 35. Chinese negotiators are typically urged by their superior agencies to put their own draft on the table and strive to have it used as a starting point. *See* Shanghai Implementing Measures, *supra* note 26, art. 12. However, they are clearly at liberty, having gone through the motions of presenting their draft, to agree to work from the foreign side's draft, while incorporating provisions from the Chinese draft as appropriate.

with a five page contract. To be sure, Chinese negotiators and their lawyers often offer suggestions, in many cases constructive ones, for the simplification of complex legal provisions drafted by the foreign side. But as a general matter, the experience of the Chinese over the past several years has convinced them of the need for detailed documentation for major investment and other business contracts.[31]

C. *The Role of Approval Authorities*

A final aspect of the joint venture negotiation process that is relevant to all the substantive issues discussed in this article relates to the requirement that all joint venture contracts and related documents be approved by MOFERT or by its provincial counterparts.[32] A point that appears obvious to the schooled China hand, but that many foreign business people and their lawyers do not fully appreciate, is that Chinese enterprises negotiating joint ventures with foreign companies are to a large extent not negotiating on their own behalf. From the face of the legislation, it would appear that the approval authorities only review and comment on the documents after they have been signed by the parties. In fact, the Chinese party reports frequently on the progress of the negotiations to the authorities that will ultimately approve the project and receives instructions from those agencies about how to proceed.[33] In addition to the MOFERT model contract and other public indicia of the Chinese position on joint ventures, Chinese negotiating parties have access to numerous internal memoranda issued by the agencies in charge of foreign investment, which provide guidance on the preferred way to resolve issues that commonly arise in negotiations.

This direct and indirect contact with the investment authorities gives the Chinese party a good sense of the type of provisions likely to be readily approved and of those likely to cause difficulty. Not sur-

31. For instance, investigations of contracts with foreign and Hong Kong parties conducted in the Shenzhen Special Economic Zone between 1983 and 1985 revealed that inadequately drafted contracts were among the important causes for disputes between the parties. Huang Sungyou, *Analysis of Disputes in Economic Contracts in Shenzhen Involving Foreign and Hong Kong Interests*, 4 FAXUE JIKAN (Legal Studies Quarterly) 61-62 (1985).

32. Implementing Rules, *supra* note 4, art. 9. MOFERT's branches in different provinces and cities are granted the right to approve investment contracts up to certain monetary limits set by the State Council, which vary from time to time as well as from place to place. However, even though a project may fall within the relevant monetary amount, central MOFERT approval will still be required if materials, foreign exchange or other resources for the project need to be allocated from outside the province or city in question. *See* Implementing Rules, *supra* note 4, art. 8.

33. In Shanghai, for example, Chinese negotiators are required to submit a report to the investment authorities as to the progress of the negotiations within one week after the end of each negotiating session. Shanghai 1986 Implementing Measures, *supra* note 17, art. 12.

prisingly, Chinese negotiators generally try to avoid rocking the boat. In some cases, it appears to foreign negotiators that their Chinese counterparts have not even consulted the approval authorities on a given problem, but are simply insisting to the foreign party that its demand will never be approved in order to avoid confronting their supervisors and risking rebuke.

The existence in China of an administrative system for the approval of investment contracts is a reality that will not change in the foreseeable future. But steps could be taken on both the Chinese and foreign sides to make this system less of an obstacle to the negotiation process. First, foreigners entering into joint venture negotiations in China should do their homework. In addition to being familiar with the legal system governing foreign investment, the MOFERT contract and other public documents, they should attempt to learn as much as possible from other companies that have successfully negotiated investment projects in China. An awareness of what terms have been accepted in other transactions can often be useful in countering Chinese assurance that a particular provision is out of the question and in convincing them at least to attempt to seek its approval. On the Chinese side, greater direct participation in the negotiations by the authorities in charge of a project when particularly difficult issues are being debated would in many cases be highly useful, affording foreign companies the opportunity to exchange views directly with the people who will make the final decision.

One of the most frustrating experiences some companies have encountered in their investment negotiations has been concluding a protracted and difficult series of negotiations with the Chinese party and signing a mutually acceptable contract, only to receive extensive objections from the approval authority that require substantial renegotiation on important issues. In the technology transfer area, Chinese legislation has provided a pre-approval mechanism under which the parties can submit the draft contract on which they have agreed for preliminary comment. Changes may then be made to accommodate the approval authorities' requests before the parties formally execute the contract and resubmit it for what should then be a smooth final approval process.[34]

34. Jishu Yinjin Hetong Shenpi Banfa, art. 7, in ZSJFH, *supra* note 1, at 1221 (Procedures for Examination and Approval of Technology Import Contracts) (adopted Aug. 26, 1985, promulgated Sept. 18, 1985) (trans. in CLFB, *supra* note 7, ¶ 5-573) [hereinafter Technology Approval Procedures]. The Technology Approval Procedures have been superseded by Zhonghua Renmin Gongheguo Jishu Yinjin Hetong Guanli Tiaoli Xize (Rules for the Implementation of the Regulations of the People's Administration of Technology Import Contracts) (adopted Dec. 30, 1987, promulgated Jan. 20, 1988) [hereinafter 1988 Technology Contract

Although not explicitly provided for in the investment legislation, a similar approach has been used in some joint venture negotiations. Its utility in some cases has been severely limited by the failure of the approval authorities to provide written comments on the preliminary documents, on the basis of which the parties could revise the contracts. In one recent transaction, the approval agency's comments on the drafts were relayed orally by the Chinese party. It was later discovered that in many instances the comments were relayed inaccurately; when the contract was signed and submitted for final approval, numerous new important objections surfaced. If properly administered, however, the pre-approval process could serve a time-saving role in investment negotiations. The Chinese should seriously consider making it systematically available in joint venture as well as in other projects.

III. Issues Arising in Negotiations

A. The Applicable Law and Subsequent Legislation

An issue that pervades the entire negotiation process is the scope of the legal regime that governs joint venture contracts. Not surprisingly, all equity joint venture and other investment contracts are legally required to be governed by PRC law.[35] As the above introductory remarks indicate, that proposition is not nearly as daunting as it might have been in earlier days, before the advent of laws specifying basic contractual principles, as well as of those providing needed details on tax, accounting and other problems. However, two important concerns remain.

First, what is the effect of future laws on preexisting contracts? China clearly has far from completed the work of providing a legislative system for foreign investment, and the existing structure is still evolving. More laws and regulations are expected on a variety of topics affecting joint ventures from insurance to price control. Investors and their lawyers are justifiably concerned that changes in the law occurring after the approval of their contract will significantly affect the terms of the deal.

In an effort to insulate their contracts from any changes in the legal regime, many foreign companies have attempted to negotiate clauses that "freeze" the law applicable to the contract as of the date of signature. Chinese investment officials and negotiators generally

Rules], of which article 17(4) provides for the same preliminary review as the Technology Approval Procedures.

35. FECL, *supra* note 20, art. 5.

have taken the position that these clauses are unacceptable.[36] Their argument — hard to refute — is that a Chinese unit negotiating an investment contract cannot bind the lawmaking bodies of China as to what legislation will be promulgated, nor to how it will be applied. China, however, has by no means ignored the concern of foreign investors about changes in law. The Foreign Economic Contract Law, promulgated in 1985, provides that where there is a conflict between the provisions of laws promulgated after an investment contract's approval and those of the contract, the contract "may" continue to be implemented according to its terms.[37]

Foreign lawyers and their clients are obviously dissatisfied with the conditional wording of the Foreign Economic Contract Law, which seems to leave room for official discretion as to whether or not the original contract will be upheld when a subsequent law conflicts. One interpretation, supported by some Chinese lawyers close to the legislative drafting process, is that the best of both worlds will obtain: if a new law is more favorable than the provisions applying at the time of the contract, the parties may apply the new provisions. If, on the other hand, the new rule is detrimental to the parties' interests, the position at the time of the contract will continue to prevail.[38] In the tax area, China has indeed adopted this approach in some cases.[39]

The promulgation of this provision of the Foreign Economic Contract Law, however inadequate it may appear to foreigners, has made Chinese negotiators more reluctant than ever to accept contractual clauses dealing with changes in the law. The Chinese argue that the issue has been covered by law and need not be referred to in the contract. Not infrequently, however, it is possible to obtain Chinese agreement to a provision that would allow the parties, subject to approval of the original approval authorities, to renegotiate the con-

36. For a reflection of this view, see Zhang Yuejiao, *Several Problems to be Noted in the Use of Foreign Investment*, ZHONGGUO FAZHI BAO (China Legal Gazette), Nov. 1, 1985, at 3.

37. FECL, *supra* note 20, art. 40.

38. Author's conversations with the drafters of FECL, 1986.

39. *See supra* note 3. In 1983, the periods of tax exemption and reduction for joint ventures were extended from one and two years, respectively, provided under the JVITL, *supra* note 11, art. 5, to two and three years, respectively, and preexisting joint ventures that had not yet used up their tax exemption and reduction periods were allowed to enjoy the extended periods. Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui Guanyu Xiougai Zhonghua Renmin Gongheguo Zhongwai Hezi Jingying Qiye Suode Shui Fa de Jueding, in STATE COUNCIL GAZETTE 866 (1983) (Decision of the Standing Committee of the National People's Congress Concerning Revision of the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures) (adopted Sept. 2, 1983); Notice of the Ministry of Finance Regarding the Earnest Implementation of the Decision of the Standing Committee of the National People's Congress Regarding Amendment of the Income Tax Law of the People's Republic of China Concerning Chinese-Foreign Joint Ventures (Oct. 12, 1983), 12 CAIZHENG (Finance) 51 (1983).

tract in the event a change in the law significantly affects the economic position the parties contemplated when they signed the contract.[40]

Foreign companies often try to cast this renegotiation provision in a one-sided way by making it apply only to changes that negatively impact the foreign party. Of course, there are numerous potential changes in the laws governing joint ventures that could also affect the interests of the Chinese party to a joint venture.[41] Foreign companies stand a better chance of having a renegotiation provision accepted if they draft it in a reciprocal fashion.

In light of the clear position of investment authorities and the language of the Foreign Economic Contract Law, foreigners should realize that the Chinese party is not in a position to accept the "freezing" clause. By the same token, the Chinese should recognize that the change in law issue still concerns foreign investors. Consequently, the parties should accept a reciprocal renegotiation clause as a less than perfect, but best possible, solution that can serve the interests of both sides.

B. Internal Regulations

One skeleton that needs to be brought out of the closet and buried once and for all if foreign negotiators and their lawyers are to feel comfortable in negotiating investment contracts in China is the phenomenon of "internal" regulations. In earlier years, when little investment legislation had been promulgated, Chinese negotiators frequently made reference to draft laws and regulations that, though they had not been officially published, were being circulated among Chinese investment officials for comment and used as guidelines for Chinese parties in negotiations. The almost comical scene of a Chi-

40. The Implementing Rules seem to require any amendments to a joint venture contract to be approved by the agency that originally approved the contract before the amendments may become effective. Implementing Rules, *supra* note 4, art. 17. The FECL, which applies to joint venture contracts, requires only "major" amendments to approved contracts to be approved. FECL, *supra* note 20, art. 33. China has yet to develop a rule as to whether laws of general applicability (in this case, the FECL) or laws specifically governing the type of contract or transaction involved (in this case, the Implementing Rules) should apply in the event of a difference between the two. It is likely, in any event, that an amendment to deal with a change in law would be considered "major" and would thus require approval even if the FECL, and not the Implementing Rules, were determinative.

41. Obvious examples are adverse changes in income tax rates or the rates of the Consolidated Industrial and Commercial Tax, a sales and turnover tax applied to gross receipts of joint ventures. *See* Gelatt & Pomp, *Tax Aspects of Doing Business with the People's Republic of China*, 22 COLUM. J. TRANSNAT'L L. 421 (1984). Since these taxes are paid by the joint venture, they impact both the foreign and Chinese parties in proportion to their respective investment ratios.

nese negotiator peering down into his lap to consult a document he was not allowed to show to his foreign counterpart was frequently replayed. Indeed, at least one piece of early investment legislation, relating to the thorny issue of land valuation for purposes of the Chinese equity contribution[42] explicitly stated that the Chinese parties should consult it in negotiations but not show it to the foreign investor.[43]

As the body of published investment legislation has grown richer, reliance by Chinese negotiators on internal rules has diminished. In addition, certain Chinese organizations are making a commendable effort to publish interpretive documents, implementing rules, and other legal documents to which foreigners previously had no access.[44] Nevertheless, all too often the Chinese party in joint venture negotiations still refers to "regulations" as a basis for its position on a particular point, but refuses the foreign party's request to see the rule in question on the ground that it is "internal."

In some cases, one suspects that this approach may be simply a negotiating tactic on the Chinese part. But foreign lawyers involved in the China practice often do in fact learn of "internal" documents that elaborate on, and in some cases significantly change, the provisions of published investment legislation. Despite the ever increasing body of publicly issued law, the suspicion that not all the rules of the game are accessible continues to frustrate foreign business people and their lawyers.[45]

In a society where law has always been a particularly sensitive subject and where the government's notion of "state secrets" is exceedingly broad,[46] the historical and political background for the existence of internal regulations is not hard to understand. After liv-

42. *See infra* notes 57, 58 and accompanying text.

43. On file with the author.

44. The Ministry of Finance is the leading example. *See supra* note 12 and accompanying text.

45. One internal regulation whose existence was recently revealed in the PRC press would be of great interest to foreign investors. In a statement to U.S. businessmen in December 1987, Vice Minister Zhu Rongji of the State Economic Commission (soon to be mayor of Shanghai) mentioned a regulation on political work within joint ventures. Zhu said that these regulations had not been published, but he "personally" believed they should be. China Daily, Dec. 14, 1987, Business News, at 4.

46. *See* Baoshou Guojia Jimi Zanxing Tiaoli, Zhongyang Renmin Zhengfu Faling Huibian (1951), art. 7, at 28 (Provisional Regulations for the Preservation of State Secrets) (adopted June 1, 1951, promulgated June 8, 1951), in which weather reports are among the specific items listed as "state secrets." For a discussion and English translation of the state secrets law, see Hsia, Hambley & Johnson, *Introduction to the State Secrets Laws of the People's Republic of China*, 2 CHINA L. REP. 267 (1983). As of January 1988, a new law on state secrets was under discussion by the Standing Committee of the National People's Congress. China Daily, Jan. 11, 1988, at 1.

ing through an era when telling a foreigner the size of a city's grain supply in a given year was grounds for years of solitary confinement,[47] Chinese bureaucrats naturally tend to assume much information to be secret.

In some cases, failure to issue publicly a certain document relevant to foreign investment stems not from any particularly sensitive content, but from a lack of organization. Although two gazettes periodically publish documents emanating from the State Council and the National People's Congress,[48] China has yet to develop a comprehensive system of organizing and publishing the large body of legislation that different sectors of the government produce. In particular, local legislation, which plays an increasingly important role in the foreign investment process, is generally available to foreigners only when it happens to be published in local newspapers or journals to which foreigners have access. The recent establishment of a computer bank for Chinese economic law[49] is a promising sign, though it remains to be seen how effective it will be and to what extent foreigners will be able to use it. In any event, it is clear that to eliminate the bugaboo of internal legislation, the Chinese need to work on both philosophical and administrative fronts.

C. Capitalization

Although it is often left to a relatively late point in the discussions, capitalization of the joint venture is one of the most basic points that needs to be resolved in any joint venture negotiation. Most foreign companies negotiating investment projects in China start out with a fairly definite idea of the ownership interest they want in the joint venture, and the question of the investment ratio itself[50] is normally resolved early in the discussions of a project. Assuming the parties have agreed on a split, the problem is to arrive at an agreement as to what assets each party will contribute to establish its equity interest and how those contributions will be valued.

In some negotiations, problems are avoided by the parties' agree-

47. *See* N. CHENG, LIFE AND DEATH IN SHANGHAI 353 (1987).

48. These are the STATE COUNCIL GAZETTE, *supra* note 8, and ZHONGHUA RENMIN GONGHEGUO QUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI GONGBAO (People's Republic of China National People's Congress Standing Committee Gazette).

49. Renmin Ribao (People's Daily) (Overseas Edition), Oct. 13, 1987, at 1. This report indicates the data bank so far contains 1,887 economic laws and regulations passed by the National People's Congress, the State Council and their subordinate departments, as well as provincial legislation.

50. The Joint Venture Law is flexible on the ratio of Chinese and foreign investment, providing only that "generally" the foreign interest must be at least 25%. Joint Venture Law, *supra* note 1, art. 4.

ing for each side simply to contribute an equal amount of cash — typically, the Chinese party in Renminbi, and the foreign party in foreign currency. Many investors, however, both Chinese and foreign, prefer to minimize cash contributions and contribute assets that the joint venture will need as at least a significant portion of their equity contributions. The Joint Venture Law permits equity contributions in the form of equipment and machinery, technology and know-how.[51] The Chinese party may contribute the right to use a piece of land[52] as well as an existing factory building as part of its equity stake,[53] eliminating the need for the joint venture to rent land or buildings from the local authorities.

Machinery and equipment with an ascertainable market value may be relatively easily assessed, but intangibles like technology pose more problems. The Chinese are suspicious of the value foreign companies place on their know-how.[54] Exacerbated by a certain amount of negative experience with undercapitalized Hong Kong and foreign investors, this suspicion has resulted in a general Chinese policy that discourages capitalizing a joint venture in large part by intangibles. In the Shenzhen Special Economic Zone and the Guangzhou Economic and Technological Development Zone, negotiating flexibility is constrained by a rule that restricts technology or know-how to a total of twenty percent of a joint venture's total registered capital. The rule also requires that the foreign investor match any technology contributions with an equivalent amount of cash or hard assets.[55] In Shanghai and other cities, foreign companies have sometimes been told of inter-

51. Joint Venture Law, *supra* note 1, art. 5.

52. All land in the PRC belongs to the State or collectives. *See* Zhonghua Renmin Gongheguo Xian Fa, art. 10 (Constitution of the People's Republic of China) (adopted Dec. 4, 1982) (trans. in CLFB, *supra* note 7, ¶ 4-500). Individuals may only enjoy the right of land use.

53. Joint Venture Law, *supra* note 1, art. 5.

54. Local regulations in some of the special economic zones give the Chinese party the right to demand that foreign companies in joint venture and other transactions involving technology provide copies of past technology transfer contracts, in part as a basis for demonstrating the value of the technology. Xiamen Jingji Tequ Jishu Yinjin Guiding, art. 12, in ZSJFH, *supra* note 1, at 1026 (Regulations on Technology Imports to the Xiamen Special Economic Zone) (adopted July 14, 1984) (trans. in CHINA ECON. NEWS, Apr. 22, 1985, at 3); Guangzhou Jingji Jishu Kaifaqu Jishu Yinjin Zanxing Guiding, art. 22, in ZSJFH, *supra* note 1, at 1078 (Interim Regulations of the Guangzhou Economic and Technological Development Zone Concerning the Introduction of Technology) (promulgated Apr. 9, 1985) (trans. in CHINA ECON. NEWS, June 17, 1985, at 2) [hereinafter Guangzhou Technology Regulations]; Shenzhen Jingji Tequ Jishu Yinjin Zanxing Guiding, art. 11, in ZSJFH, at 998 (Interim Provisions of the Shenzhen Special Economic Zone for the Import of Technology) (adopted Jan. 11, 1984, promulgated Feb. 8, 1984) (trans. in CFEL:3, *supra* note 4, at 334) [hereinafter Shenzhen Technology Provisions].

55. Guangzhou Technology Regulations, *supra* note 54, art. 12; Shenzhen Technology Provisions, *supra* note 54, art. 23.

nal guidelines that prescribe a similar limit, though both the percentage and the strictness of application seem to vary.[56]

If the Chinese are suspicious about foreign valuation of technology, foreigners have similar concerns about the way in which the Chinese value their intangible contributions. The right to use land, including land preparation and clearing costs, has been particularly troublesome. In earlier years, when there were no public guidelines on the cost of land for joint ventures, there was no basis on which to assess the often substantial figures the Chinese quoted as the value of their land contributions. The recent emergence in some cities and provinces of local legislation that spells out in considerable detail the range of rates to be charged for land in different areas[57] provides a bench mark for foreign investors to evaluate the quotations of their Chinese counterparts.

If local regulations prescribe the land use fees that a joint venture would pay if it rented land from the local government, the value of the Chinese "contribution" of the land use right should be equal to the total of the annual fees under those standards over the life of the joint venture, on the theory that the Chinese party will pay the fee on behalf of the joint venture.[58] But even assuming local standards are available for the land use fees, foreign investors still have difficulty evaluating figures quoted by Chinese negotiators for site clearance, requisitioning land from current tenants and similar expenses.

In the end, the discussion of investment figures often ends up

56. For a discussion of the principle of limiting technology contributions to a certain percentage of registered capital, see JIANG YIHE, XU E & ZHOU JIANPING, ZHONGWAI HEZI JINGYING QIYE (Chinese-Foreign Joint Ventures) 159-61 (1984). *See also* CHU BAOTAI, FOREIGN INVESTMENT IN CHINA: QUESTIONS & ANSWERS 46-47 (1985). A recent article in an important Chinese journal recommends elimination of limitations on contributions of technology and know-how to joint ventures. JINGJI CANKAO (Economic Reference), Sept. 19, 1987, at 4 [hereinafter JJCK Article]. A newly promulgated national regulation on contributions to equity joint ventures does not prescribe any limitations on contributions in the form of technology or know-how. The regulation requires, however, that investors contributing industrial property rights, technology or other non-cash items to a joint venture provide "valid evidence" of their ownership of the item being contributed and of their right to dispose of it. Zhongwai Hezi Jingying Qiye Heying Gefang Chuzi de Ruogan Guiding (Provisions on Equity Contributions by Joint Venture Parties in Chinese-Foreign Equity Joint Ventures) (promulgated Jan. 1, 1988), art. 2 [hereinafter Contributions Provisions].

57. *See, e.g.*, Shanghai Shi Zhongwai Hezi Jingying Qiye Changdi Shiyongquan Guanli he Shiyongfei Shoufei Shixing Banfa (Shanghai Municipality Trial Measures for the Administration of the Site Use Rights of Chinese-Foreign Equity Joint Ventures and the Site Use Fees to Be Charged) (trans. in ELIASOPH, *supra* note 13, at 79).

58. *See* CHU BAOTAI, *supra* note 56, at 44-45. Contrary to the hopes of some foreign investors, the Chinese have not generally discounted in any way the land use fee to reflect present value when the land use right is contributed by the Chinese party as equity. The Implementing Rules simply provide that when the site use fee is contributed, it shall not be adjusted during the term of the contract. Implementing Rules, *supra* note 4, art. 51.

being a cat and mouse game. Each party tries to anticipate the other side's quotations and respond in such a way as to achieve its agreed percentage of interest in the venture. Both the Chinese and foreign sides could facilitate negotiations on this issue by being more forthcoming. While foreign companies are understandably reluctant to disclose details of prior technology deals, they should be prepared to break down as much as possible the way in which their technology is valued and to justify the total figure they quote. The Chinese cannot be expected to accept a lump sum figure without some backup, any more than foreigners can be expected to accept Chinese valuations without question.

For its part, China needs to continue the process of promulgating local land standards and to enforce their implementation. Chinese negotiators in Shanghai and other localities sometimes seem only vaguely aware of local land rules. In addition, the Chinese need to be more open with foreigners about the way in which they calculate such expenses as moving people off the land and preparing the land for construction. The promulgation of local rules governing these costs would be a major step forward.[59]

D. Technology Transfer

Technology transfer is, of course, one of China's primary goals in encouraging joint ventures. The foreign partner's technology and know-how may be transferred to its Chinese joint venture either through equity investment[60] or through a license from the foreign partner to the joint venture company. In some cases, a combination of the two approaches is used. A licensing agreement is drafted not only when the foreign party licenses technology to the joint venture in return for the payment of technology fees, but also in some cases when the technology is simply contributed as equity. Normally the license contract is negotiated between the two joint venture parties during the process of negotiating the joint venture contract and other documents. The license contract is not formally signed until the actual licensee (the joint venture company) has received its business license and acquired the legal capacity to sign contracts; nonetheless, the license contract forms an appendix to the joint venture contract.[61]

59. No such regulations have yet been published to the author's awareness.

60. *See supra* note 56 and accompanying text.

61. The license contract is typically initialled by the two joint venture parties at the time they sign the joint venture contract, submitted to the investment approval authorities together with the contract and other appendices, and approved by those authorities with the entire package of documents. Some Chinese lawyers seem to take the view that this approval of the initialled license contract together with the other document is sufficient to make the contract

The negotiation of joint venture license contracts presents the same issues as the negotiation of a simple license from a foreign party to a Chinese entity where no joint venture is involved and the licensor will not have a long-term presence in China. China's technology transfer legislation[62] and practice do not distinguish between the cases where the Chinese licensee is an equity joint venture partly owned by the foreign licensor, and those where the licensee and licensor are unrelated entities. Thus, the same demands that Chinese law and practice make in the ordinary licensing situation crop up in the negotiation of license contracts involving a joint venture, including broad performance guarantees,[63] penalties for late delivery of technical documentation,[64] the requirement that products produced with the transferred technology be tested and accepted[65] and others.

Foreigners often bemoan this Chinese approach to licensing to joint ventures and urge the Chinese to relax their strict, pro-licensee standpoint. They argue that the licensor will not be taking the money and running, but rather will have a long-term stake in the success of the enterprise to which it is licensing its technology. But foreign companies, in their own way, are guilty of the same sin. Most foreign companies licensing their technology to Chinese joint ventures in which they are investors tend to use the same type of license agreement they would use with a completely unrelated foreign licensee, including extensive disclaimers and indemnification provisions, strict controls on the use of the technology, requirements that the technology be returned at the end of the license and other standard provisions.

The license contract, although ultimately signed between the joint venture and the foreign partner, is actually negotiated between the two investors at a time when they are just getting to know one

valid under Chinese law. Support for this proposition might be derived from the FECL, *supra* note 20, art. 8, providing that appendices are integral parts of the contract. Under the relevant technology transfer legislation, however, all technology contracts, including those signed between an equity joint venture and its foreign partner, must themselves be submitted for approval after being signed *by the parties — i.e.*, in the joint venture case, by the venture and the foreign party. 1988 Technology Contract Rules, *supra* note 34, art. 4. Thus, to be certain that the technology license contract is fully valid and binding, foreign investors are well advised to insist that the contract be submitted by itself for formal approval after it is signed between the joint venture and the foreign party. For a discussion of this issue, see JJCK Article, *supra* note 56.

62. Technology Regulations, *supra* note 20; 1988 Technology Contract Rules, *supra* note 34.

63. *See* Technology Regulations, *supra* note 20, art. 6; 1988 Technology Contract Rules, *supra* note 34, art. 18(6).

64. *See, e.g.*, sample "Know-How Contract" used by some PRC corporations, in THEROUX, LEGAL ASPECTS OF DOING BUSINESS WITH CHINA 70 (Contract § 8.4) (1985).

65. *Id.* at 69 (Contract § 7).

another and do not know how their joint venture will pan out. It is thus not surprising that both the Chinese and foreign sides adopt a "we-they" mentality toward the license of technology. Nonetheless, negotiation on this typically most crucial aspect of a major industrial joint venture could be rendered less acrimonious and more conducive to a smooth joint venture relationship if both the Chinese and foreigners were willing somewhat to let down their guard. Both parties should recognize that the full litany of protections may not always be essential in the context of a joint venture, where a tremendous incentive exists on both sides to make the license successful. Chinese investment and technology transfer officials should be willing to consider applying standard policies somewhat less rigorously when a joint venture is involved; policy makers in foreign companies should also give their negotiators the discretion, as appropriate, to modify substantially some of their typical positions.

E. Corporate Governance

A major question in the discussion of any joint venture project is the composition of the venture's board of directors and its management structure. Foreign companies and their lawyers often place great importance on having a majority interest in a Chinese joint venture on the theory that this will ensure the foreign partner a "controlling" position on the board. This Western approach to company control does not necessarily translate well, either legally or practically, into the Chinese context.[66] First, the Implementing Rules arguably do not automatically give the majority partner in a joint venture a majority position on the board; they provide only that the composition of the board be determined by reference to the ratio of the parties' equity contributions.[67] Second, even assuming that a foreign company succeeds, as some have, in obtaining both a majority interest in the venture and a majority position on the board of directors, the Chinese party, in negotiating the provisions of the contract and the articles of association, will inevitably require that many issues be

66. Interestingly, the "control" analysis of board membership is used in a recent treatise on Chinese-Foreign joint ventures by two leading PRC investment officials. CHU BAOTAI & DONG WEIYUN, ZHONGWAI HEZI QIYE JIANGHUA (Equity Joint Ventures In China) 87 (1987) [hereinafter CHU & DONG].

67. Implementing Rules, *supra* note 4, art. 34. *See* CHU & DONG, *supra* note 66, at 87. The term "by reference to" (*canzhao*), when used in PRC legislation, is weaker than the term "according to" (*anzhao*). The use of the latter term in this provision of the Implementing Rules would have required a strict parallel between the parties' equity ratios and their representation on the board of directors. The use of "by reference," on the other hand, means that the parties' equity ratios are to be taken into account in deciding the composition of the board, but the ratios are not strictly determinative.

decided by unanimous consent of the Board. Hence, the ability to garner a majority vote will often not be determinative.[68]

In practice, therefore, foreign companies are probably best advised to concern themselves primarily with the composition of the company's day to day management as a means for exerting control and influence over the operations of their China joint venture. On this issue, the Chinese investment legislation is completely flexible. Chinese investment officials have frequently stated that they view the acquisition of foreign management expertise as one of China's primary goals in inviting foreign investment.[69] For their part, foreign companies establishing joint ventures in China are anxious to ensure that their technology is correctly implemented, that sales operations are properly conducted, and that the enterprise generally meets their worldwide standards.

The problems that arise when management provisions are negotiated in joint venture contracts result more from political sensitivities than either commercial or legal considerations. Some foreign companies want to reserve the right to have their expatriate nominee in the top management position for the entire term of the joint venture. Others encourage localization of management at an appropriate time. On the other hand, the Chinese often insist — sometimes claiming, incorrectly, that it is a requirement of Chinese law — that the position of general manager of the joint venture be turned over after a contractually fixed period of time from the foreign party's nominee to an individual selected by the Chinese party. Alternatively, they sometimes suggest a rotational system under which the foreign and Chinese parties rotate every few years filling the general and deputy general manager positions.[70]

Foreign companies normally resist both of these approaches. Even for companies that are anxious to turn over the key position as soon as possible to a nominee of their Chinese partner, a rigid sched-

68. Unanimous vote is required by law for certain major decisions: amendments of the joint venture articles of association, termination or dissolution of the joint venture, increase or assignment of the registered capital, and merger of the venture with another economic organization.

69. *See, e.g.*, CHU & DONG, *supra* note 66, at 10, 103.

70. The MOFERT model joint venture contract's management provision provides: "The management organization shall consist of one general manager recommended by Party _____ and _____ deputy general managers, among which _____ deputy general manager(s) shall be recommended by Party A and _____ deputy general manager(s) shall be recommended by Party B." ELIASOPH, *supra* note 13, at 184. This article appears to allow for the possibility of the general manager always being recommended by the foreign party of a joint venture. The MOFERT model articles on the other hand, provide: "The first general manager shall be recommended by Party _____, and the first deputy general manager(s) shall be recommended by Party _____," implying that a change is contemplated after the first term of office.

ule, which may bear no relation to the Chinese manager's readiness to take over, seems illogical and inadvisable. Chinese negotiators, however, seem to be under great pressure to avoid signing a contract under which foreign management is at least potentially in control for an indefinite period of time.

Both parties should keep in mind that under the Joint Venture Law management personnel may be appointed only by decision of the board of directors.[71] The parties may only nominate candidates for approval by the board. Thus, if a contract flexibly provides for the foreign party to nominate the general manager until both parties agree that it is appropriate for the Chinese to do so, then neither party can unilaterally dictate the length of time a foreign manager remains in command or when a Chinese manager takes over. While a provision with a fixed time period might appear cosmetically more appealing to some Chinese officials, it imposes an unnecessary constraint on the joint venture board's ability to make decisions based on business needs.

Assuming a foreign company is willing to consider giving up the top position at some stage, a flexible provision is probably the best solution. Companies that insist on nominating the general manager for the entire term of the venture have been successful in obtaining approval on a number of occasions, though generally only through protracted and difficult negotiations.

F. Personnel Costs

In addition to the obvious political undesirability of having a foreigner at the helm for an extended period, one reason foreigners face difficult negotiations on the management question is the cost of expatriate personnel. Foreign technical or managerial personnel posted to China for long assignments, even if the project happens to be in Beijing, Shanghai or another major city, expect a healthy package of hardship allowances, home leave, housing and other benefits. Typically the foreign party in a joint venture negotiation expects the joint venture to bear this cost just as the joint venture bears the full cost for all Chinese employees. Depending on their rank and the particular foreign company's policy, two expatriates can easily result in an annual joint venture expenditure of several hundreds of thousands of dollars.

The Chinese spend an inordinate amount of time in joint venture negotiations attempting to negotiate down the cost of the expatriate employees and to persuade the foreign party to bear a portion of that

71. Joint Venture Law, *supra* note 1, art. 6; Implementing Rules, *supra* note 4, art. 40.

burden out of its own pocket. The Chinese argue that the expatriate costs impose a foreign exchange burden on the venture,[72] and that, for instance, two foreign managers may cost the joint venture several times more annually than the entire Chinese work force. These arguments are undeniable, but if China means what it says when it cites the acquisition of management expertise as one of its goals in the foreign investment process, it must accept the fact that such expertise comes at a cost. While the Chinese have every right to require that foreign companies explain the components of their expatriate benefit packages, they must recognize that these packages represent real costs and not negotiating positions. In addition, the Chinese should remember that the cost of foreign management in a major investment project generally represents a relatively small percentage of the total costs involved but may provide incalculable long-term returns. While the benefits of foreign management training may be less tangible than a piece of technical documentation, such training may in many cases be the most significant contribution a foreign investor makes to its Chinese joint venture.

Tense negotiations about personnel costs are not restricted to the area of foreign management. The debate about the composition and cost of a joint venture's Chinese labor force has generally been another of the most trying aspects of investment negotiations.

First, the Chinese tendency has often been to over-staff joint ventures as they do Chinese state enterprises. Indeed, commentaries on China's joint venture law and policy reveal that China considers joint ventures as one way to help solve China's unemployment problem.[73] If a joint venture takes over the entire existing factory of the Chinese party, the latter will be under great pressure from its supervisory agencies to have all of the existing work force transferred to the joint venture. The local labor department thereby avoids the problem of reassigning workers. Foreign businesses need to be sensitive to the problems facing China's developing economy and realize that they may not be able to apply the same standards to streamlining of work forces that are relevant in other countries. On the other hand, the Chinese need to pay greater attention to foreigners' concerns about the unnecessary costs and inefficiencies caused by having a bloated staff. In some recent negotiations, encouraging progress has been observed on this issue, with Chinese parties showing greater willing-

72. See the discussion of foreign exchange issues, *infra* notes 81-88 and accompanying text.

73. *See* CHU & DONG, *supra* note 66, at 11.

ness to take responsibility for reassigning excess staff not needed by the joint venture.

In addition to paying a basic wage that includes a special premium for Chinese joint venture workers,[74] joint ventures are expected to bear various subsidies normally provided to workers by Chinese state enterprises. Foreign companies generally do not object to the principle of paying these costs. What has made negotiations difficult in the past has been the Chinese reluctance to reveal in detail the composition and use of the various supplementary amounts which often add two or more times as much again to a worker's take home pay. As in the case of land fees, until recently there was relatively little legislative guidance.

More recently, local legislation has begun setting out in some detail the composition of Chinese workers' benefit packages,[75] and Chinese parties have in some transactions become more forthcoming about explaining the way in which these subsidy systems work. Just as the Chinese party has a right to obtain a detailed explanation of the expatriate benefits a joint venture is expected to pay, foreign parties are entitled to seek detailed explanations of the Chinese workers' compensation and clarification of local labor legislation on these issues when the rules are incomplete.

Although the situation with respect to workers' compensation may have improved, a continuing source of difficulty is the compensation of Chinese management personnel. In negotiations on this politically charged issue, Chinese negotiators continue to invoke the principle of "equal pay for equal work."[76] Few negotiators still argue that a Chinese deputy general manager should be paid a salary equal to that received by the foreign general manager. Yet the Chinese party still usually insists that the Chinese management salaries be calculated as a percentage of the salary earned by expatriate personnel rather than simply being based in some fashion on Chinese wage scales. Even if the percentage is relatively small, the result is a salary for the Chinese manager that is far above what the highest level officer in a Chinese state enterprise could ever receive under current conditions.

74. The premium was originally set at 20 to 50 percent over the real wages of workers in state enterprises in the locality and industry of the joint venture. JV Labor Provisions, *supra* note 6, art. 8. The exact premium between 20 and 50 percent was negotiable between the parties. In 1986, the rule was made more flexible, though not necessarily more favorable to foreign investors, by setting the premium at "no less than" 20% over the state enterprise level. 1986 Labor Provisions, *supra* note 19, art. II(1).

75. *See, e.g.*, the regulations cited in *supra* note 13.

76. *Tonggong tongchou.*

The Chinese insistence on setting the salaries of Chinese managers at levels comparable to their expatriate colleagues is not dictated by law. Rather, it reflects the political undesirability of a foreign manager earning an amount far in excess of his Chinese counterpart's salary. In fact, as some local labor legislation indirectly implies[77] and Chinese negotiators generally admit, the Chinese manager himself takes home only a small percentage of the large figure allocated for his "salary" in the joint venture feasibility study. The rest usually disappears into the state treasury.

While this practice is abhorrent to foreign investors, some encouragement can be found in the more flexible and open attitude Chinese negotiators have been exhibiting of late on the issue. Indeed, some Chinese officials have recently indicated that China may be considering a new approach to the problem of expatriate and local employee salary differentials.[78] Perhaps the ideal solution would be, as some commentators have suggested,[79] to handle Chinese managerial salaries in the same way as those of Chinese workers — in other words, require a joint venture to pay the same premium over Chinese state enterprise salaries for managers as it does for ordinary workers, with the premium going to the manager himself as an incentive for good performance.[80] In the meantime, a solution some investors have found acceptable is to provide in the personnel appendix to the joint venture contract that the amount of remuneration allocated for the Chinese manager in excess of what he can personally receive will be kept in a joint venture fund for improvement of conditions for the company's personnel and similar uses. This approach at least avoids the resentment foreigners feel at paying what is essentially an additional tax to the Chinese government.

G. Foreign Exchange

The difficulty for a joint venture to balance its receipts and

77. Beijing Labor Provisions, *supra* note 13, art. 11, which provides, in paragraph 3, "[t]he wage for Chinese and foreign senior managerial personnel . . . of a joint venture shall be determined by the board of directors of the joint venture in accordance with the principle of equal remuneration for equal ability and equal contributions and be filed with the municipal labor bureau for the record. The real wage of the Chinese senior managerial personnel shall be determined in accordance with the relevant provisions of the municipal labor bureau." The reference to "relevant provisions of the municipal labor bureau" probably refers to internal guidelines setting out what percentage of the salary "paid" to Chinese managers by a joint venture may actually go into the individual's pocket. The author has been told that such guidelines exist in Shanghai.

78. Author's conversations with investment officials in Shanghai, Aug. 1987.

79. Cohen & Harris, *Equal Pay for Equal Work*, CHINA BUS. REV., Jan.-Feb. 1986, at 10.

80. *See supra* note 74 and accompanying text.

expenditures of foreign currency is undeniably the largest obstacle facing most foreign companies investing in China. A detailed discussion of the foreign exchange problem and China's legislative and other efforts to resolve it is beyond the scope of this article.[81] But some comment is in order on how the foreign exchange issue affects the negotiation process.

First, both Chinese and foreign parties have a tendency to sweep the problem under the carpet. Many foreign companies start out in their draft contracts asking for a "guaranty" of foreign exchange availability to meet profit repatriation and other needs. Although the Implementing Rules provide for the possibility in certain cases of state intervention to make up foreign exchange deficiencies,[82] the provision has rarely been implemented. In fact, since 1986, the reality of China's foreign exchange shortage as reflected in new regulations has made that provision effectively a dead letter.[83] However, rather than explaining to foreign companies the unlikeliness of a guaranty provision being approved and suggesting alternative approaches, the parties could explore resolving the foreign exchange problem. Chinese negotiators tend to ignore the issue until the project negotiations are at an advanced stage.

When the foreign exchange question is put on the table, the Chinese negotiators are likely to suggest a contractual provision that requires the foreign investor to be responsible for achieving a fixed percentage of exports per year.[84] Chinese negotiators are not so naive as to believe that the mere inclusion of a percentage of exports in the contract is sufficient to guarantee either that those sales will be made or that the venture's foreign exchange will be balanced. Their motive for arguing strongly for such a provision is simple: it puts the foreign exchange problem in the foreign investor's lap, thereby removing from the Chinese party any responsibility either for assisting the joint venture to generate foreign exchange or for obtaining approval for special foreign currency generating measures allowed under relevant legislation. Under national legislation on joint venture foreign exchange balancing, promulgated in 1986, if a contract provides for a fixed percentage of exports and the target is not met, Chinese authori-

81. For a discussion, see Gelatt, *China's Foreign Exchange Quandary*, CHINA BUS. REV., May-June 1986, at 28.

82. Implementing Rules, *supra* note 4, art. 75.

83. The Foreign Exchange Provisions, *supra* note 9, provide for a much more limited level of government foreign exchange assistance to joint ventures than the Implementing Rules, *supra* note 4, art. 75. The Foreign Exchange Provisions arguably supersede Implementing Rules, art. 75, with respect to this point. *See* Gelatt, *supra* note 81.

84. See the MOFERT model joint venture contract, arts. 20, 21, in ELIASOPH, *supra* note 13, at 183.

ties bear no responsibility for resolving the problem.[85]

China's foreign exchange shortage and the difficulties it poses for foreign investment will not be resolved easily. Nevertheless, greater understanding and flexibility on both sides of the table could at least make the issue less of a stumbling block in the negotiation of joint venture contracts. Foreign investors should accept the fact that, unless their project is of extraordinary national importance, no form of assurance of foreign exchange availability is likely to be forthcoming. By the same token, the Chinese must realize that few if any foreign companies will be willing to accept a contractual export commitment for a long-term joint venture when market conditions, price, quality and numerous other factors are so uncertain.

The Chinese should educate their foreign counterparts about the possible approaches the Chinese government is beginning to make available to foreign investment projects to help with the foreign exchange problem: the use of import substitution,[86] swapping of currency between foreign investment ventures,[87] the use of compensation trade,[88] and others. Contractual provisions should refer to all possible approaches, subject, of course, to the approval of relevant authorities when required.

Most importantly, the Chinese should stop thinking of foreign exchange as the foreigners' problem. Chinese negotiators beg the

85. Foreign Exchange Provisions, *supra* note 9, art. 7.

86. *Id.* art. 5. Import substitution occurs when Chinese purchasers of imported products substitute products produced by a joint venture for the imported products. These domestically produced substitutes are purchased, at least in part, for foreign currency. Implementing this approach has proved difficult; Chinese units often prefer to use their foreign exchange to import products from abroad on the assumption that they are superior to those made in China. *See* Gelatt, *supra* note 81. Certain provinces and cities have for some time been experimenting with regulations to enforce import substitution by establishing lists of products produced in the locality by joint ventures and refusing import licenses for the import of such goods by local units. *See, e.g.*, Guangdong Sheng Guanyu Yi Chan Ding Jin Tidai Jinkou de Shixing Banfa (Trial Procedures of Guangdong Province Concerning the Use of Products for Import Substitution) (promulgated Dec. 8, 1986). National regulations on this subject were issued in October 1987. *See* Import Substitution Measures, *supra* note 19. In addition, specific implementing rules have been promulgated on import substitution in the machinery and electronics industry. Zhongwai Hezi Hezuo Jingying Qiye Jidian Chanpin Yi Chan Ding Jin Guanli Banfa (Measures for the Administration of the Use of Mechanical and Electrical Products of Chinese-Foreign Equity and Cooperative Joint Ventures for Import Substitution) (promulgated Oct. 1987).

87. *See* Foreign Exchange Provisions, *supra* note 9, art. 9, allowing swapping of foreign currency between joint ventures with a common foreign partner and 22 Articles, *supra* note 18, art. 14, allowing swaps between any two "enterprises with foreign investment," which are defined to include equity and cooperative joint ventures and wholly foreign-owned enterprises, *id.* art. 2.

88. *See* Foreign Exchange Provisions, *supra* note 9, art. 6; Product Export Measures, *supra* note 19.

question when they say that foreigners are the ones who want foreign exchange from the joint venture and therefore should worry about how to meet their needs themselves. Foreign exchange is not only needed for repatriation of the foreign investor's profits, but also for training costs, raw material and equipment imports and numerous other expenditures from which the joint venture, and not the foreign party, reaps the rewards. Foreign investors must of course be willing to take risks with regard to foreign exchange in the contemporary Chinese environment, but their Chinese partners must demonstrate a willingness to work with them in resolving the problem for the ultimate good of the joint venture.

H. Taxation

Just as many foreign companies have attempted to write contractual language that guarantees the foreign exchange treatment of the project, they and their lawyers have often drafted provisions, either in the body of the joint venture contract or in a contractual appendix, that purport to fix detailed tax treatment of the joint venture and the foreign party. The tax clause preferred by Chinese parties, on the other hand, simply states that the joint venture will pay tax in accordance with relevant tax laws.[89]

Prior to the development of a detailed system for the taxation of joint ventures, there was no alternative to including tax treatment in the contract. Even today, with an extensive body both of statutes and detailed interpretive documents in the tax area, the existence of numerous national and local discretionary incentives[90] makes it important to pin down the precise tax treatment of a given project. As on the foreign exchange issue, however, foreigners need to be more sensitive to Chinese realities. Chinese state enterprises with which foreign companies negotiate joint ventures have no authority to dictate tax terms in the contract, and investment approval bodies like

89. *See* MOFERT model joint venture contract, art. 42, in ELIASOPH, *supra* note 13, at 186.

90. The special economic zones and economic and technological development zones have developed their own body of tax incentives. *See* Zhonghua Renmin Gongheguo Guowuyuan Guanyu Jingji Tequ he Yanhai Shisi Ge Gangkou Chengshi Jianzheng, Mianzheng Qiye Suode Shui he Gongshang Tongyi Shui de Zanxing Guiding, in ZSJFH, *supra* note 1, at 1030 (Interim Provisions of the State Council of the People's Republic of China Concerning the Reduction of and Exemption from Enterprise Income Tax and Consolidated Industrial and Commercial Tax in the Special Economic Zones and Fourteen Coastal Port Cities) (promulgated Nov. 15, 1984) (trans. in CFEL:3, *supra* note 4, at 239) [hereinafter SEZ/14 Cities Provisions]. Most of the local investment encouragement regulations issued under the 22 Articles, *supra* note 18, contain special tax incentives. *See, e.g.*, Beijing Provisions, *supra* note 19, arts. 21, 23; Shanghai Provisions, *supra* note 19, arts. 2, 3.

MOFERT and its local counterparts have no authority to approve them.[91] To the extent that various tax benefits are available under national and local legislation, approval of the relevant tax authorities is often required before such benefits may apply.[92]

In order to have the clearest understanding possible of the profitability of the joint venture and the costs affecting it, both the Chinese and foreign parties should be interested in ascertaining the tax treatment as early as possible. But given Chinese tax law and administration, neither the foreign approach of writing tax principles into the contract, nor the completely open provision favored by the Chinese, will achieve the desired results. A new approach used recently in some joint venture negotiations in Shanghai is for the parties to execute a "memorandum," completely separate from the contract, that sets out the parties' understanding of the tax treatment available to the joint venture under relevant legislation. The memorandum makes it clear that discretionary treatment is subject to the relevant approvals, and that, in all cases, provisions of tax legislation will prevail over any inconsistent provisions of the memorandum. The idea is for this document to be submitted to the local tax authorities for review, comment and approval.

What has yet to be developed is a clear approval process for these tax documents. Although China's high level tax authorities clearly understand the need for an advance approval system to reassure investors about their tax treatment before the deal is finalized, the

91. Contrary to the understanding of some foreign parties, MOFERT is not a "superagency" with the power to approve all aspects of joint venture projects. Tax, foreign exchange, customs and other aspects require the approval of the appropriate specialized agency. The PRC has established the Administrative Bureau for Enterprises with Foreign Investment in China (Zhongguo Waizi Qiye Guanliju) whose mission will reportedly be to act as a one-stop "window" for joint ventures and other enterprises with foreign investment to assist with all types of problems encountered after establishment of the enterprise. Wen Wei Pao (Hong Kong), July 3, 1987, at 4; CHINA ECON. NEWS, Sept. 28, 1987, at 3. It remains to be seen how this new agency will function in practice.

92. For example, a 20% withholding tax is normally applied to technology fees earned by foreign companies from the PRC. Zhonghua Renmin Gongheguo Waiguo Qiye Suode Shui Fa, art. 11, in ZSJFH, *supra* note 1, at 640 (The Foreign Enterprise Income Tax Law of the People's Republic of China) (adopted and promulgated Dec. 13, 1981) (trans. in CFEL:1, *supra* note 1, at 64.) Under national tax rules, local tax authorities may grant a reduction of this tax to 10%, but only the central Ministry of Finance may approve a complete exemption. Zhonghua Renmin Gongheguo Caizhengbu Guanyu Dui Zhuanyou Jishu Shiyongfei Jianzheng, Mianzheng Suode Shui de Zanxing Guiding, art. 3, in ZSJFH, *supra* note 1, at 668 (Interim Provisions of the Ministry of Finance of the People's Republic of China Concerning the Reduction of or Exemption from Income Tax on Royalties for Proprietary Technology) (promulgated Dec. 13, 1982) (trans. in CFEL:2, *supra* note 9, at 201). In the special economic zones and fourteen open coastal cities, on the other hand, the tax rate is automatically lowered to 10%, and the local tax authorities may grant a full exemption. SEZ/14 Cities Provisions, *supra* note 90, arts. I(4), II(4), III(3).

system has yet to be put in place. In the joint venture as well as the technology transfer area,[93] an effective mechanism for securing advance tax approvals would be an enormous boon.

I. Termination and Dissolution

All the issues raised in this article thus far relate to matters that will affect a joint venture throughout its term of operation. One problem that consumes considerable time in most negotiations relates not to the life, but rather to the death, of a joint venture. This is the contractual provision that deals with the termination of a venture at the expiration of its normal term or with its early dissolution.

The Implementing Rules provide a number of general bases for the board of directors to apply to the approval authorities for dissolution in advance of the scheduled date,[94] but leave the parties complete flexibility to provide other grounds in the contract. Though there are often differences on what those grounds should be,[95] the Chinese and foreign parties are normally able to arrive at a mutually satisfactory list without undue difficulty.

More vexing in many negotiations has been the issue of what happens after the joint venture terminates — whether on or ahead of schedule. The Implementing Rules,[96] the PRC's accounting rules for joint ventures[97] and the MOFERT model contract[98] all contemplate a simple "liquidation" process in which the parties form a committee to assess the company's assets and liabilities, pay the joint venture's debts and distribute any remaining property between the parties in accordance with their original equity ratios.

Aside from the practical difficulties of assessing the value of joint venture assets and deriving funds to distribute to the parties, many foreign companies take issue with the fairness of the liquidation concept itself. In reality, while the joint venture company as such will cease to exist, its business will in all likelihood continue to be operated by the Chinese partner on its own. While it is generally not stated in such direct terms, the PRC's obvious objective in attracting foreign investment is to enable the Chinese, after a limited period of coopera-

93. For a discussion of tax approvals in the technology transfer context, see Gelatt, *supra* note 12, at 20.

94. Implementing Rules, *supra* note 4, art. 102.

95. An example of a ground for dissolution frequently suggested by foreign parties and objected to by the Chinese is effective exclusion of the foreign investor from the board of directors or management of the joint venture.

96. Implementing Rules, *supra* note 4, arts. 103-07.

97. Accounting Regulations, *supra* note 7, arts. 79-84.

98. ELIASOPH, *supra* note 13, art. 49, at 187.

tion with foreigners, to send the foreigners packing and use what they have learned to run advanced enterprises on their own. The technology, managerial know-how and other intangible contributions a foreign company makes to a Sino-foreign joint venture over the term of its existence will continue to benefit the Chinese investor in its future production and sales. Many foreign investors, therefore, take the view that joint venture contracts should require the Chinese partner upon expiration to buy out the foreign party's interest at a price that reflects the "going concern value" of the venture.

Chinese negotiators are no longer as prone as they were in the past to dismiss the buy-out idea and insist on the simple liquidation formula as the sole possible way to handle a joint venture's termination. A relatively common solution in recent negotiations has been for liquidation and buy-out to be provided for in the contract as alternatives with liquidation occurring if neither party offers to buy the other party's interest. This type of provision, of course, does not protect foreign companies against the Chinese party declining to buy the foreign company's interest, thereby triggering a legal "liquidation," but continuing to run the business in any event. But Chinese negotiators are loathe to avoid the liquidation concept altogether, since the relevant legislation seems to make it a *sine qua non*. Since both Chinese negotiators and investment officials[99] seem generally to recognize the logic of the buy-out notion, revision of both the legislation and the MOFERT contract, to make it clear that this approach to joint venture termination is acceptable, would seem to be in order.

IV. CONCLUSION

As the foregoing sampling of issues affecting the negotiation of Sino-foreign joint ventures demonstrates, significant progress has been made on many fronts, but the road to business partnership between Chinese and foreign investors is still in many respects a tortuous one. As one sums up the general themes that run through the above reflections, the conclusion emerges that both the progress and the continuing difficulties can be attributed to the same basic factors.

First, as this article has indicated in numerous contexts, the legal system governing joint ventures in the PRC has reached an impressive level of sophistication in a comparatively short period of time. While lacunae certainly remain to be filled, foreign investors no longer feel, as they did in the first few years of China's open door policy, that they are entering the arena with blindfolds, the rules of the game a complete mystery.

99. *See* CHU & DONG, *supra* note 66, at 123.

As this article has demonstrated, the Chinese legal system is not without its drawbacks for foreign investors. But the most important overall legislative problem that hampers the foreign investment negotiation process lies not so much in the substance of the laws as in their implementation and dissemination. In a sense, the Chinese may have let their lawmaking get ahead of them; they have produced the rules before establishing an effective system for making them known and accessible to both the Chinese and foreign entities to which they apply. It is not uncommon for Chinese negotiators to be unaware of an important local regulation affecting a key point in the discussions; nor is it rare for the Chinese party to refer to a regulation crucial to the issue being negotiated but unknown to the foreign party. The lack of comprehensive, systematic and timely publication of legislation and the continuing existence of vitally important internal rules all demand the urgent attention of the Chinese authorities. These problems must be solved if the legal infrastructure that the PRC is developing for foreign investment is to achieve its aims of inspiring confidence in investors and facilitating the negotiation process.

Second, great steps forward have been taken since the early days when the Chinese wanted to conclude complex transactions on the basis of a sketchy statement of principles, and when both foreign and Chinese lawyers were unwelcome visitors to the table. But while a certain level of basic mutual understanding has developed about the need for detail and precision in joint venture documents, both Chinese and foreign investment partners continue to spend far too much time on unproductive attempts to impose their respective standard forms on one another. On the Chinese side, MOFERT needs more effectively to inform Chinese negotiators that its reference form is not the law and that they may depart from the model and adopt foreign investors' suggestions so long as the Chinese party protects its interests and complies with Chinese investment legislation. Foreign companies need to abandon the notion that, if it was good enough for Japan, Brazil and Saudi Arabia, it is good enough for China; they need to make a greater effort to adapt their contract drafting to the Chinese investment environment.

Finally, and most critically, as the survey of selected substantive issues arising in investment negotiations indicates, Chinese and foreign investors need to spend more time improving the basic attitudinal premises that underlie their negotiating postures.

In 1979, when they first published the Joint Venture Law after a long period of isolation from the foreign business community, the Chinese could not really have been expected to understand or apply

the words they used in their laws and public pronouncements with such apparent ease — mutual benefit, cooperation, profitability and the like. Nor could foreigners have been unduly criticized for being highly suspicious and defensive of their own interests when undertaking business negotiations in a country where a few short years earlier a foreign business firm was about as welcome as a poisonous snake.

Few would deny that things have improved since those early years. Mutual familiarity and confidence have grown, and the catch phrases are slowly beginning to acquire some genuine meaning. But both sides must work a lot harder if the negotiation of Sino-foreign joint ventures is to become significantly easier. The Chinese must give up the notion that foreign investors' purpose in life is to bring their cash and technology to China, teach the Chinese with minimal time and cost to run a modern enterprise, use their insuperable marketing ability to open world markets to Chinese products and then go quietly home. The Chinese must recognize that while many foreign companies are anxious to be involved in China's modernization, it is a means, not an end. The end is making money.

Foreign companies must stop assuming that China is a monolith in which every state enterprise it negotiates with can engineer guarantees of foreign currency, raw material supplies at a favorable price, tax exemptions and the like. They must learn as much as they can about the Chinese system and past experience before they start negotiations. They must approach their discussions with due regard, to be sure, for securing the best possible deal, but also for the necessity of adapting their demands and their expectations to China's realistic capabilities at this stage in its legal and economic development.

Whether the Chinese or foreigners are more to blame for the troubled atmosphere that seems all too often to pervade investment negotiations probably varies from case to case and, in any event, is unimportant. The long and the short of it is that both sides need to devote a lot more reflection to the meaning of the term "joint venture" — a common undertaking in which benefits and risks are shared. Otherwise, Chinese and foreign companies can spend painstaking hours crafting joint venture contracts that contain consistently drafted provisions in English and Chinese, but they will never speak the same language.