



Company Establishment in China Wholly Foreigner Owned Enterprises

Consideration of Framework, Forms, Structure
and Related Law for Company Establishment

PREFACE

China has traditionally had very good trade and investment relations with many regions of the world, and the world continues to take a great interest in China's economy.

The investment conditions for foreign firms in China are excellent, and there is a large potential that remains to be tapped. The China economy is the driving force in the Asia. China stands for an open and transparent economic policy at the heart of Asia. Foreign companies in China are granted the same access to public institutions and funding as China firms and can make use of highly skilled labor and a good infrastructure. In addition, they have access to the whole China market.

The Guide is a very good means for foreign enterprises to get some first information about mergers and acquisitions. Ministry of Commerce of the People's Republic of China (MOFCOM), provides active support to foreign investors for projects in China. MOFCOM works hand in hand with associations, business promotion companies and policy makers to help foreign firms enter the China market. MOFCOM offers a broad range of information and advice on individual sectors, taxation, legislation to companies that want to expand their business activities to the China market.

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1. Investment Climate

China regularly enjoys the praise of foreign companies in international markets. Since China as one of the most attractive investment location in the world. It is important to highlighted China's strengths as the stability and transparency of the political, legal environment and characteristics repeatedly mentioned for China.

2. Industrial Policy

China's large, medium and small industrial companies provide a strong foundation for a robust macroeconomic development. Their innovative capacity and strong export performance are making a substantial contribution to growth and prosperity. A forward-looking industrial policy has been developed to boost the competitiveness of China's industrial enterprises in a sustainable manner.

In this endeavor, the China industrial policy follows the principles of the social market economy. The government creates a policy environment that promotes innovation and investment to ensure a dynamic economic development and fair competition ("level playing field"). Moreover, the government intervenes in the competitive economy only as far as is necessary to ensure a stable, transparent and predictable regulatory framework. In particular, private monopolies and cartels are prohibited. Moreover, the market mechanism, i.e. the balancing of supply and demand, is largely essential for entrepreneurial activity.

Competitiveness and competition are interdependent.



3. Foreigner Investment History

Only as recently as the mid-1990s has Foreigner Investment played a major role in China's economic processes as well as rapidly developed into quite a common business practice of market participation.



4. The Form, Structure and Regulated Law of Chinese Company

4.1 Company Forms

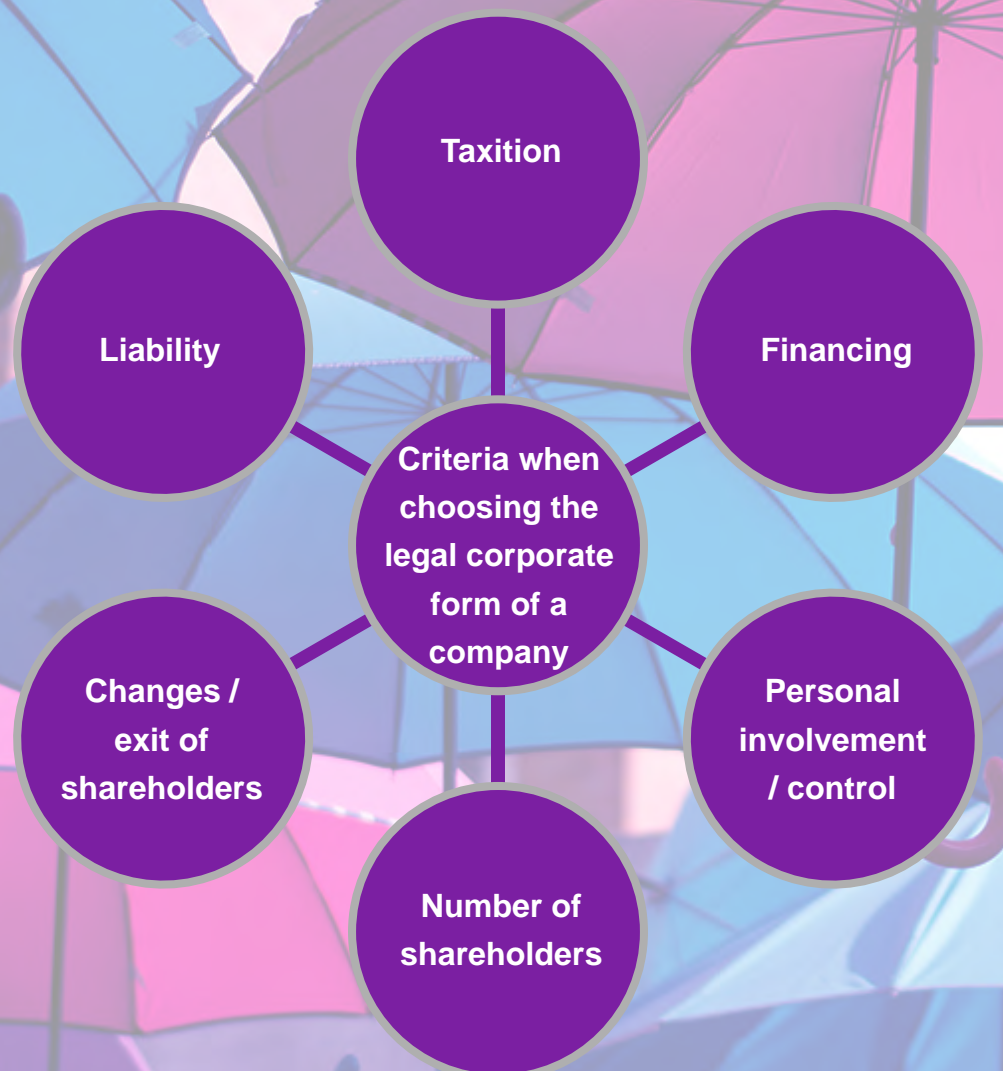
4.1.1 Introduction

Any private individual, partnership or corporation, irrespective of nationality or place of residence, can set up a company in the People's Republic of China or acquire shares in an existing company in the People's Republic of China. The People's Republic of China does not have any specific investment legislation.

Some restrictions and/or specific requirements may apply with regard to businesses acting in certain sectors, including the following sectors:

- defense;
- pharmacy, and
- offering of financial services and banking.

The choice of the corporate form usually depends on various factors such as e.g.



4.1.2 Limited Company

Generally, corporations are the best choice for larger businesses. China law offers, amongst others, the following forms of corporations:

- Limited Liability Company , and
- Stock Corporation.

One of the main advantages of corporations is the limited liability of its shareholders.

Whereas Limited Liability Company usually have a one-tier structure (consisting of at least one managing director), Stock Corporation have a two-tier structure (consisting of at least two directors and of a Supervisory Board formed by at least three members), a minimum share capital of RMB 5,000,000 and are subject to more formal requirements compared to a Limited Liability Company.

4.1.3 Limited Partnerships

The corporate form of the Limited Partnership of the Commercial Law can primarily be recommended for smaller enterprises where some partners are actively involved in the business and others participate in the profits without being involved in the management. The corporate form of a Limited Partnership is, among other reasons, used for tax purposes. From a corporate law perspective, the main feature is the personal commitment of the partners. Each Limited Partnership requires at least two partners, the general partner and the limited partner. The general partner assumes unlimited liability for the debts and liabilities of the Limited Partnership. On the other hand, no minimum share capital is required for setting up a Limited Partnership and running its business. Accounting obligations and publication requirements tend to be less extensive as compared to corporations.

4.2 Company Structure

4.2.1 Limited Liability Company

4.2.1.1 Structure of the Limited Liability Company

The Limited Liability Company (being the most frequently used corporate form in the People's Republic of China) is a corporation and as such a separate legal entity which is liable towards its creditors with its assets. It can have one or more shareholder(s) (private individuals or legal entities) whose liability is limited to the duty to pay in the respective capital contributions either in cash or in kind.

In general, the Limited Liability Company has two corporate bodies: the shareholders' meeting and the managing directors. A supervisory board is, in general, not mandatory, its establishment may, however, be provided for in the articles of association.

4.2.1.2 Shareholders' Meeting

The shareholders' meeting is the supreme body of the Limited Liability Company. Unless otherwise provided for by statutory law or the articles of association, its powers cover all business matters. These include, in particular, the approval of the annual financial statements, the use of profits, the appointment and removal of managing directors as well as the control and approval of their management performance.

4.2.1.3 Management / Representation of the Limited Liability Company

One or more managing directors who do not need to be shareholders are in charge of the management and represent the Limited Liability Company towards third parties. The scope of such statutory power of the managing director(s) to represent the Limited Liability Company cannot be limited with legal effect towards third parties. Internally, however, the shareholders' meeting is entitled to give instructions to the managing directors. The competencies of the managing director(s) may be restricted by internal regulations (set forth e.g. in rules of procedure).

The managing director(s) grant upon respective instructions by the shareholders' meeting a commercial limited statutory power of representation, to employees of the company, entitling them to represent the company with regard to the daily business.

Duties and Liability of Managing Director(s)

Apart from being responsible for the overall management of the Limited Liability Company, managing director(s), inter alia, have the following duties:

General Duties

Prepare and convene shareholders' meetings

Provide information relating to the Limited Liability Company to shareholders on demand

Maintain and update the shareholders' list

Duties relating to Finances of the Limited Liability Company

Set up proper accounts in accordance with GAAP

Prepare the annual financial statements

Ensure that the Limited Liability Company files tax Returns timely and correctly

Duties relating to the Protection of the Share Capital of the Limited Liability Company

Confirm that the initial contributions of the shareholders were made correctly and are at the disposition of the Limited Liability Company

Undertake all measures necessary to protect the share capital and prevent the share capital being paid back to the shareholders

Call a shareholders' meeting in case 50 % of the share capitalist lost

Duties in case of Insolvency of the Limited Liability Company

Make sure that a petition for the opening of insolvency proceedings in case of over-indebtedness or insolvency is filed timely and correctly in accordance with statutory law

Prevent certain payments in case of over-indebtedness or insolvency of the Limited Liability Company

Liability and Sanctions

A breach of the aforementioned duties of managing director(s) may give rise to a claim for damages of the Limited Liability Company, shareholders, and/or third parties against the managing director(s) personally and may justify a dismissal of the managing director(s) for cause. In addition, non-compliance with certain duties may lead to further sanctions, e.g. authorize the courts or governmental authorities to impose fines in order to enforce compliance with statutory law. The Limited Liability Company may also be subject to administrative and/or criminal penalties. A conviction of a managing director for certain crimes relating to breaches of the duties of the managing director(s) (e.g. the duties relating to the insolvency of the Limited Liability Company, fraud or embezzlement) leads to a disqualification to exercise the office of a managing director.

4.2.1.4 Setting up a Limited Liability Company or Purchasing a Limited Liability Company

The Limited Liability Company (being the most frequently used corporate form in the People's Republic of China) is a corporation and as such a separate legal entity which is liable towards its creditors with its assets. It can have one or more shareholder(s) (private individuals or legal entities) whose liability is limited to the duty to pay in the respective capital contributions either in cash or in kind.

In general, the Limited Liability Company has two corporate bodies: the shareholders' meeting and the managing directors. A supervisory board is, in general, not mandatory, its establishment may, however, be provided for in the articles of association.

4.2.2 Stock Corporation

4.2.2.1 Structure of the Stock Corporation

The Stock Corporation (being used for rather large or listed companies) is a corporation and as such a separate legal entity which is liable towards its creditors with its assets. It can have one or more shareholder(s) (private individuals or legal entities) whose liability is (apart from exceptional cases) limited to the duty to pay in the respective capital contributions either in cash or in kind. The share capital of an AG is divided into par value or non-par value shares (in the form of either registered or bearer shares).

In general, there are no restrictions of the transfer of shares (exceptions if the articles of association provide for transfer restrictions). Stock Corporations can thus approach a large investing public, including the stock market. Share transfers are not subject to notarization.

Unlike the law governing the Limited Liability Company, the Stock Corporation Act is relatively inflexible and to a large extent mandatory. The articles of association can deviate from the Stock Corporation Act in limited cases only. The Stock Corporation Act is rather formal concerning administration compared to the Limited Liabilities Company Act.

The Stock Corporation mandatorily has three corporate bodies: the General Assembly of Shareholders, the Board of Directors and the Supervisory Board.

4.2.2.2 General Assembly of Shareholders

The General Assembly of Shareholders has limited powers such as, in particular, amending the articles of association and modifying the corporation's capital basis, discharging members of the Board of Directors and of the Supervisory Board, appointing the members of the Supervisory Board etc. Resolutions of the General Assembly of Shareholders must be notarized to a large extent.

4.2.2.3 Board of Directors

The Board of Directors is in charge of the management of the Stock Corporation. The members of the Board of Directors have the statutory right to jointly represent the Stock Corporation, unless the articles of association provide the power of sole representation. The Board of Directors is not subject to any instructions from the Supervisory Board and/or the General Assembly of Shareholders.

Accordingly, the statutory powers of representation of the Board of Directors are unlimited and its management authority is generally not subject to any resolutions of the other corporate bodies. The approval of the General Assembly of Shareholders may, however, be required for decisions of fundamental importance. Some decisions are subject to prior approval of the Supervisory Board pursuant to mandatory statutory law. The members of the Board of Directors can be appointed for a maximum term of three years.

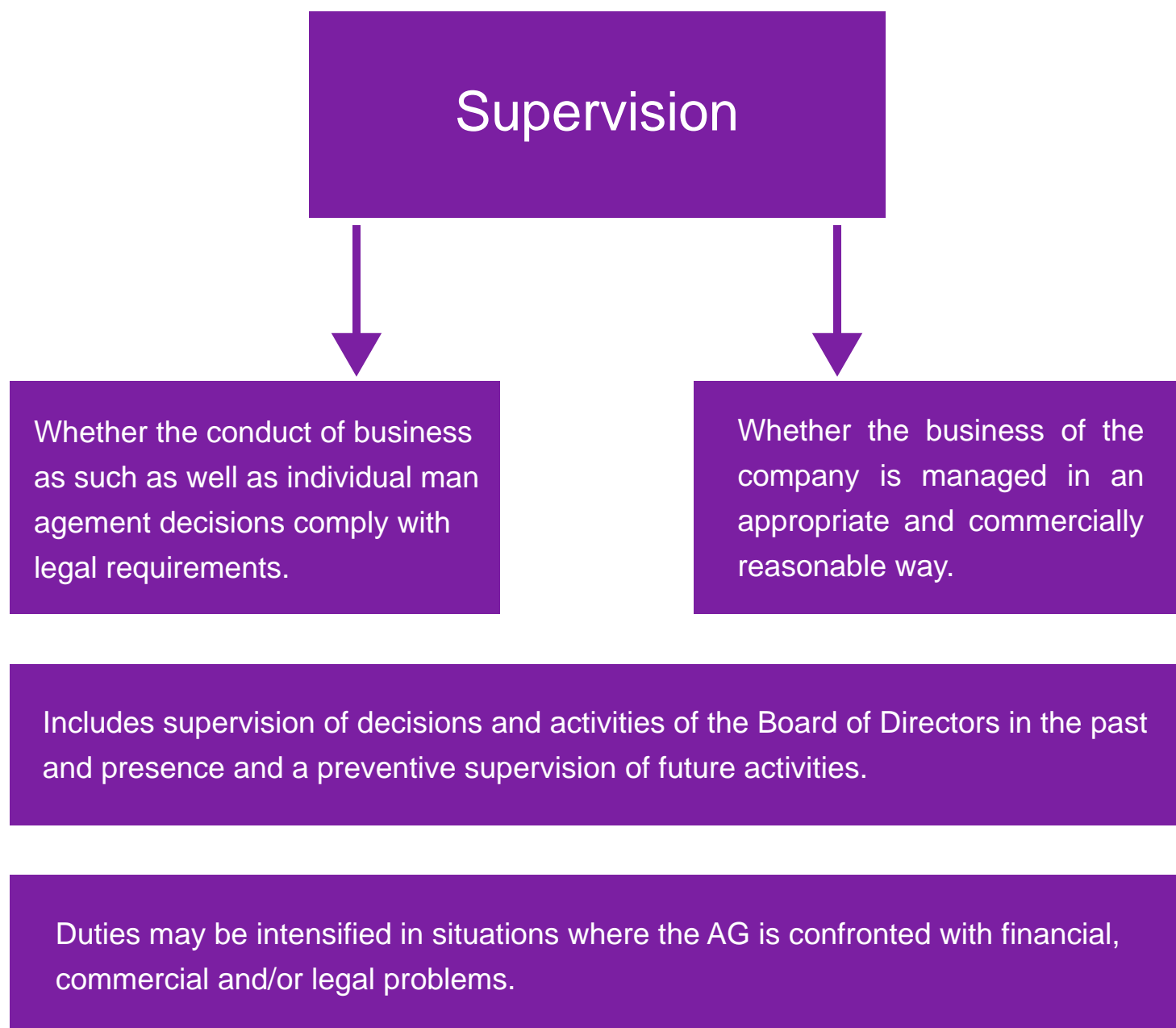


4.2.2.4 Supervisory Board

Certain types of management decisions usually internally require a prior approval of the Supervisory Board. The Supervisory Board must consist of at least three members. The members of the Supervisory Board can be appointed for a maximum term of three years.

Duties and Liability of Members of the Supervisory Board

The main duty of the Supervisory Board and each of its members is the supervision of the management activities of the Board of Directors:



4.2.3 Limited Partnership with a Limited Liability Company as General Partner

4.2.3.1 Structure

The Limited Partnership with a Limited Liability Company as general partner Limited Liability Company is a special form of a Limited Partnership.

The advantage is that none of the private individuals participating in the Limited Partnership has unlimited liability. As the general partner is responsible for the management of the Limited Partnership, the managing directors of the Limited Liability Company are also the managing directors or managing body of the Limited Partnership. The disadvantage of this corporate form of enterprise is its comparatively complicated structure due to the interlocking of two legal entities of different corporate forms.

4.2.3.2 Limited Partner

From the date of registration with the commercial register the liability of the limited partner is determined by the amount of their partnership interest registered with the commercial register. Generally, the limited partner have fewer rights (in particular with regard to management, participation in profits and voting rights) than the general partner.

Usually the limited partners are shareholders of the Limited Liability Company in which case the Limited Partnership is a Limited Partnership with a Limited Liability Company as General Partner.

4.2.3.3 General Partner

The general partner of a Limited Partnership has unlimited liability for the debts and liabilities of the Limited Partnership. If the Limited Partnership is set up in a form that the only General Partner is a Limited Liability Company, the - unrestricted—liability of the general partner is limited to the assets of the Limited Liability Company due to the corporate form as a Limited Liability Company.

The general partner is responsible for the management of the Limited Partnership.

5. Regular Law

Company Investment or M&A activities in China are regulated by a framework of laws related to corporate, tax and merger control.

The relevant corporate regulations, are primarily:

- the Company Law;
- the Commercial Law and

The most important laws in tax matters are the Corporate Income Tax Law, the Individual Income Tax Law, and related laws and implementation regulations.

Most aspects of merger control are regulated by the Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors.



6. Assistance to Foreign Investors

There are many service providers in China, public and private, which may assist foreign investors who intend to enter the China market through Investment or M&A. Which one to approach will mainly depend on the investor's own capabilities, the status of preparatory work and his corresponding needs.

Often sought sources of information and assistance include:

- Ministry of Commerce of the People's Republic of China;
- The business development associations of China;
- Foreign banks in China, in particular their Investment departments;
- China banks in the respective country and in China, in particular their Investment departments;
- Investment banks in China;
- Accounting firms in China;
- Corporate finance and Investment advisors in China;
- Law or CPA firms in China.

Though the China market is a unified one, there is a tendency that certain industries concentrate in certain regions ("industry clusters"). In many cases this is due to the location of resources and infrastructure.

It therefore may well be reasonable for investors to first get an overview and investigate where to invest and what aid may be received from the relevant locations. Without intimate knowledge of the market, it is difficult to identify and approach suitable targets. Professional service providers may facilitate the target search, negotiations and implementation of the Company Investment process.

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