



China's Contractual Joint Ventures (CJVs)

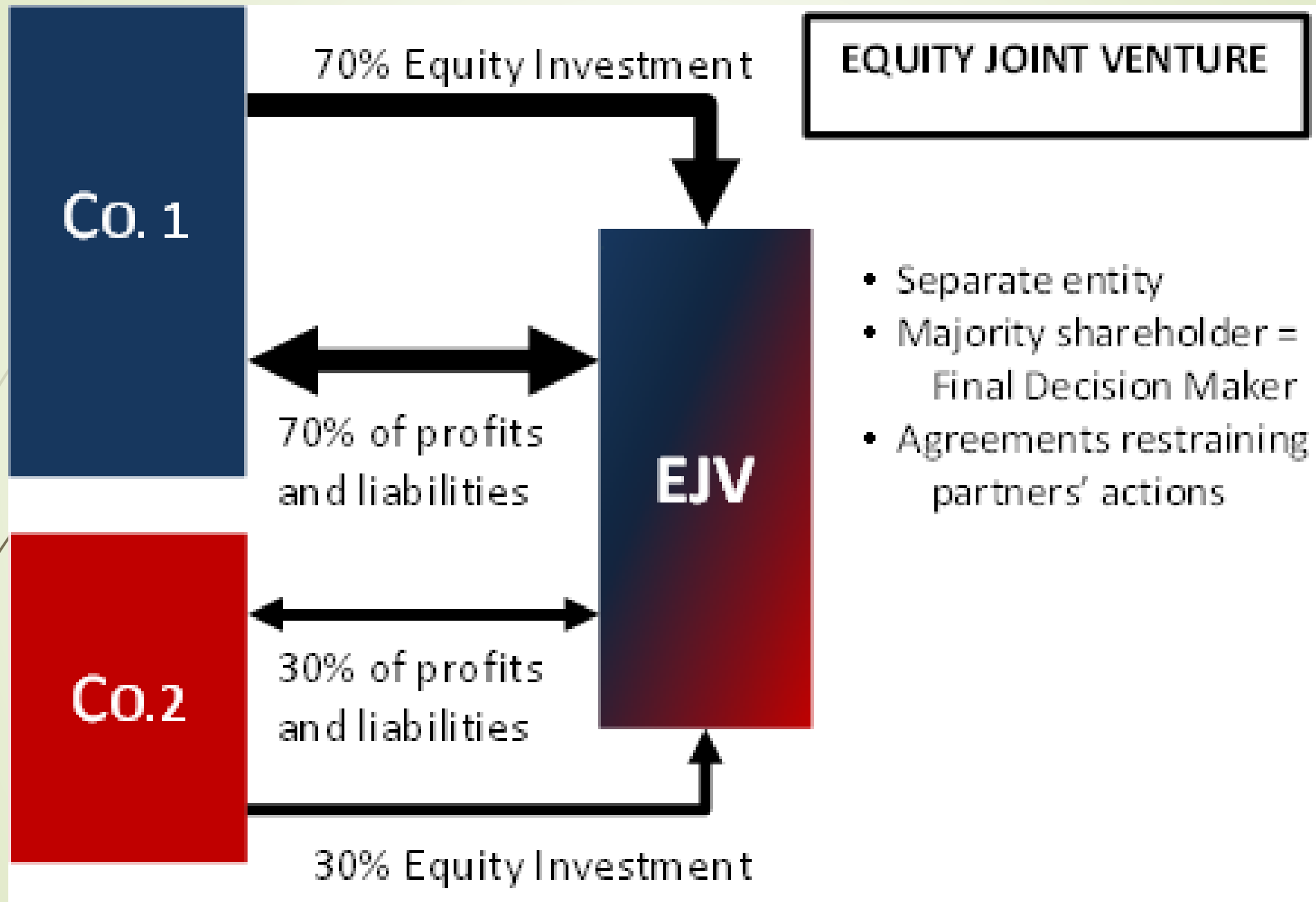
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- **China's MSMEs**: the importance of MSMEs to the Chinese economy is clear.
 - They account for **more than 50% of government tax revenue**
 - more than **60% of GDP**
 - more than **70% of technological innovation**
 - and more than **80% of urban employment**.
Employment is the key to people's livelihood.
- **SMEs Promotion Law** (2003, revised in 2017).
- Promotion of SMEs Development Plan (2016-2020, the Ministry of Industry and Information Technology, **MIIT**)
 - Definition, classification (labor intensive in China)



- ▶ Chinese SMEs face unique institutional obstacles during the country's current period of **economic transition**, such as **unfair business environment**, **difficulty financing** and **heavy tax burden**.
- ▶ The Chinese government's emphasis is on supporting smaller businesses through **financing and tax reform** while producing less effects than expected.
- ▶ There has long been **a gap between the government's perception of its policies and the actual experience of businesses**.
- ▶ China's ability to stabilize and continue growing its economy depends largely on **whether MSMEs can surmount obstacles and increase their intrinsic dynamism**.
- ▶ Ultimately, SMEs should be the judges of how policies are promoted and improved.



CONTRACTUAL JOINT VENTURE



Co.1

The diagram illustrates the formation of a Contractual Joint Venture (CJV). On the left, two vertical bars represent the parent companies: a dark blue bar labeled 'Co.1' and a red bar labeled 'Co.2'. A large, dark grey circular arrow with a white center points from the space between these two bars towards a grey vertical bar on the right labeled 'CJV'. An orange arrow points from the left edge of the slide towards the 'Co.1' bar.

Co.2

CJV

- Separate Entity Non-necessary
- JV Agreement states how to solve dispute
- Agreements restraining partners' actions



➤ Legal Status: CJVs as a form of enterprises

- The Chinese and foreign parties cooperate on the basis of a joint venture contract, became common in the early 1980s.
- Co-operative joint venture is another term for CJVs.
- The Law of the People's Republic of China on Chinese-Foreign Cooperative Joint Ventures (the "Contractual Joint Venture Law"), promulgated in 1988 and amended on October 31, 2000, 2017, essentially confirmed the established practice.
- An Update: China promulgated Foreign Investment Law on March 15, 2019. The CJV Law is to be repealed on Jan. 1, 2020.



- Overall, CJVs in China have been **under-studied** despite their historic importance as one of the three major forms of FDI prescribed by the Chinese Law.
- However, the nature of CJVs is deemed as a **relational subcontracting arrangement** rather than a form of FDI.
- Formed mainly between **Hong Kong SAR and Chinese firms** in the South China province of Guangdong, CJVs display **quasi-market and quasi-hierarchy** features, sitting between Processing and Assembling arrangements (P&As) on the one hand and Equity Joint Ventures (EJVs) and Wholly Foreign Owned Enterprises (WFOEs) on the other.



➤ Advantages of CJVs

- **Shared risks and costs** when expanding to Chinese market
- Market Access: only way to invest in **closed industries**
- If a JV is formed as a Chinese Ltd. Co. : higher chance in **government procurement** biddings
- Simplifies dealing with government authorities
- Benefits from Chinese partner's **network** and local business practices (**cost control**).



➤ Two forms of CJVs

- In a CJV, the parties involved may operate as **separate legal entities** and **bear liabilities independently** rather than as a single entity.
- a “**pure**” CJV in which no legal entity separate from the contracting parties is established and the parties make their contributions to the project and bear the risk of profit and loss directly; and
- A CJV may also be registered as **a limited liability entity** resembling an EJV in operation, structure, and status as a Chinese legal entity.
- a “**hybrid**” CJV in which a separate business entity is established and registered and the parties’ liabilities are generally limited to their capital contributions to the entity.



- ▶ The CJVs Law does not explicitly distinguish between these two types of ventures, it provides that CJVs that meet the relevant legal requirements may qualify as “legal persons” under Chinese law.
- ▶ The CJVs Regulations make further distinctions concerning the treatment of CJVs with legal person status and those without.
- ▶ A hybrid form CJV would generally qualify as a legal person, while a pure form CJV would not.



- The foreign investor is permitted to **withdraw** their registered capital or a portion thereof from the CJV during the duration of CJV contract.
- The term of the **CJV contract** may be renewed subject to the consent of the parties involved and approval from the examination and approval authorities.
- Greater flexibility in the structuring of a CJV is also permissible including the structure of the **organization, management, and assets.**



► Parties' contributions

- One of the reasons many investors in the past have chosen to utilize a CJV structure instead of an EJV has been that the investors are able to make their contributions to the joint venture **in forms other than those allowed** for an EJV.
- There is no minimum **foreign contribution** required to initiate a CJV, allowing a foreign company to take part in an enterprise where they preferred to remain a minor shareholder.
- The **contributions** made by the investors are not required to be expressed in a **monetary value** and can include labor, resources, services, market access rights, etc.
- The Chinese party to a CJV might, e.g., be made responsible for providing the required local labor, including the payment therefor.



► Parties' contributions (Con'd)

- Foreign investors should focus on how to categorize and structure the parties' contributions to a CJV.
- **Profits** in a CJV are divided according to **the terms of the CJV contract** rather than by investment share, allowing a more **flexible schedule for investment return** in cases where one investor provides cash while the other party's investment is primarily in kind.
- Unlike the case of an EJV, a foreign party's **investment in a CJV may be repatriated prior to the expiration of the term of the joint venture**, if the joint venture contract provides that ownership of all of the fixed assets of the joint venture shall revert to the Chinese party upon expiration of the joint venture term.
- The methods by which early repatriation may be accomplished are limited, and careful planning is required before establishment of the CJV.



➤ Operation

- No binding system for voting rights (**Board of Directors or Joint Management Body**)
- Pure CJVs usually have a shorter term than EJVs, while hybrid CJVs may have longer terms similar to those of EJVs.
- CJVs are favored for **hotels and commercial complexes and in infrastructure projects** where the parties intend that the joint venture assets will stay with the Chinese party at the end of the joint venture term.



- CJVs are also commonly used for projects where the **Chinese partner lacks material assets** to contribute to the joint venture.
- CJVs in **manufacturing** are generally discouraged.
- The operational activities of CJVs are restricted in much the same way as those of EJVs.
- It is common for CJVs contracts, especially those of pure CJVs, to provide for the **reversion of all of the assets of the joint venture to the Chinese party upon termination of the venture.**
- In other cases, **the liquidation procedures** follow those applicable to EJVs.



➤ Foreign exchange

- CJVs are generally subject to the same foreign exchange rules as EJVs.

➤ Profits

- A substantial advantage of CJVs is that the parties may agree on the distribution of profits at a ratio **different from that of the parties' capital contributions.**

➤ Financial administration

- An accountant registered in China must be engaged to audit and verify accounts. The parties may engage the accountant jointly or individually.
- A CJV without legal person status must keep unified account books, and the parties must, in addition, keep their own separate account books.



➤ Foreign Investment Law of the People's Republic of China

- Adopted at the 2nd session of the 13th National People's Congress on March 15, 2019)
- *Article 42 This Law shall come into force on January 1, 2020. The Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, and the Law of the People's Republic on Sino-Foreign Contractual Joint Ventures shall be repealed simultaneously.*
- *Foreign-invested enterprises that have been established before the implementation of this Law in accordance with the Law of the People's Republic of China on Sino-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-owned Enterprises, and the Law of the People's Republic of China on Sino-Foreign Contractual Joint Ventures may continue retaining their original forms of business organizations within five years after the implementation of this Law. The detailed implementation measures of this Law shall be prescribed by the State Council.*



➤ Preliminary Observation on Contractual Networks in China to Promote MSMEs

- Concept and relevant rules in an early stage
 - All China Federation of Supply and Marketing Cooperatives (ACFSMC) represents the largest cooperative organization in China, an important force in developing the rural economy.
 - China Co-Op Group
 - Contract farming
- Technology plays a key role in driving MSMEs, e-commerce, leapfrogging
- The instruments in this area developed by UNCITRAL is of great use and help for China's MSMEs' development.



Thanks for Your Attention!