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Joint Ventures in the Republic of China: A Study in International Business Cooperation

Keywords

Joint Venture, Foreign Investment, Investment, Comparative Law, Equity

JOINT VENTURES IN THE REPUBLIC OF CHINA: A STUDY IN INTERNATIONAL BUSINESS COOPERATION

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The authors wish to dedicate this article to the memory of Mr. James M. Lee.

I. INTRODUCTION

Economically, the Republic of China has been and will remain an extremely attractive country for foreign investors. Since the government launched its first four-year economic development plan in 1953, the gross national product has increased remarkably.

In 1952, the gross national product was \$0.43 billion¹ and in 1971 the gross national product jumped to \$6.24 billion, representing an average annual increase since 1953 of 15.1 percent.² Prospects for the future are even more optimistic. With a sound currency and an extremely congenial attitude towards foreign investors, continuing rapid growth is certain.

From 1952 to 1971 there have been 631 instances of foreign investment approval by the government, aggregating over \$521.36 million.³ In 1971 alone, foreign investments approved by the government totalled \$125 million, of which 80 percent represented new investment projects while the remaining 20 percent went to expansion projects carried out by existing enterprises.⁴

What is the role of the joint venture⁵ in this recent influx of foreign investment into the Republic of China? Some statistics paint a clear picture. In 1968, a total of 122 cases of foreign investments were approved by the government for various privileges under the statutes passed for the encouragement of investments were approved by the government.⁶ Over 63 percent of this total involved joint ventures between foreign investors and local business. In 1969, with 116 cases, over 65 percent involved joint ventures. During the first six months of 1970, this dual interest still constituted the major portion of foreign investments.⁷ Evidently, the majority of for-

¹ COUNCIL FOR INTERNATIONAL COOPERATION AND DEVELOPMENT (CIECD), TAIWAN STATISTICAL DATA BOOK (1972).

² *Id.*

³ *Id.*

⁴ *Id.*

⁵ It is worth noting that to many American-trained attorneys the term "joint-venture" applies only to associations between two or more parties which are limited as to time as well as purpose. The definition we have adopted in this article is that which is widely used in the international business community. Under this definition joint-ventures may be temporary as well as long-lasting associations and are usually incorporated. See generally, W. FRIEDMANN & G. KALMANOFF, *JOINT INTERNATIONAL BUSINESS VENTURES* (1961); Miranda, *Problems of Joint International Business Ventures*, 4 *INT'L. LAWYER* 550 (1970); Ross, *The Foreign Joint Venture Corporation: Some Legal and Business Considerations*, 45 *DENVER L.J.* 4 (1968); Meek & Feltham, *Foreign Sales, Distribution, Licensing and Joint Venture Agreements*, 17 *DEPAUL L. REV.* 46 (1967).

⁶ This statistical data is furnished through the courtesy of the Industrial Development & Investment Center (IDIC), Republic of China.

⁷ *Id.*

eign investors has decided upon the joint venture corporation as opposed to the 100 percent wholly owned subsidiary as the method of doing business in Taiwan, the Republic of China. Many factors affect this decision; we shall discuss them in detail in various sections of this article. We begin our discussion with a general picture of Taiwan's economy and the government's attitude toward foreign investments and joint ventures. After putting the background into proper focus, we continue with some basic considerations in setting up a joint venture agreement and specifically the mechanics of such an agreement. The conclusion is a brief discussion of problems faced by joint venture operations in the Republic of China and offers some examples of how they have worked out.

The general environment for joint ventures

During the early stages of economic development, the government passed the Statute for Investment by Foreign Nationals in order to attract foreign investors to Taiwan Province.⁸ This statute and those following represent the effort of the government and business community to ease unnecessary government controls, to modify and amend obsolete and obstructive legislation, to simplify administrative procedures and to improve the credit system. In addition, subsequent steps were taken to improve labor-management relations and to provide various incentives (tax holidays in particular) for the encouragement of investments from domestic as well as overseas sources.⁹ All such developments were made in the wake of the realization that traditional institutional and legal frameworks, designed for or developed by a rural society, could no longer serve the needs of a modern developing economy and, in fact, have become obstacles in the path of successful development.

It is difficult to compare the investment environment in Japan with that of the Republic of China. On the one hand, Japan has long been ready for the sophisticated types of joint ventures found in modern business. On the other hand, Japan

⁸ The Statute For Investment by Foreign Nationals was first promulgated on July 14, 1954, as amended, December 14, 1959 and as amended, January 8, 1968.

⁹ Such as Statute for Investment by Foreign Nationals, *supra* note 8; Statute for Encouragement of Investment as promulgated September 10, 1960, as amended, on January 4, 1965 and on December 30, 1970; Enforcement Rules of the Statute for Encouragement of Investment as promulgated on January 11, 1961, as amended, on February 22, 1966; Revised Criteria of Encouragement by Way of Reduction or Exemption of Profit-Seeking-Enterprise Income Tax as promulgated on April 22, 1969; Statute for Investment by Overseas Chinese as promulgated on November 19, 1955, as amended, on March 26, 1950 and on January 8, 1968; and many others.

is protectionist-oriented. The current Japanese policy toward foreign investments requires government validation, regardless of whether the investor wishes to obtain the right to repatriate capital and earnings in foreign currency or to operate a wholly-owned or majority-owned Japanese corporation in Japanese currency only.¹⁰

The Chinese government adopts a similar policy for validating a foreign investment only if the investor wishes to enjoy the rights and privileges provided in the Statute for Investment by Foreign Nationals. These rights and privileges include the right to repatriate capital and earnings in foreign currency.¹¹ However, if the foreign investor does not care to enjoy such rights and privileges, no special government validation is required. Of course, this latter sort of investor must still apply to the proper governmental authority for incorporation pursuant to the Company Law and must satisfy any other laws and regulations relevant to comparable domestic companies.

In this connection, it is important to note that Japan has adopted a basic policy of not validating even a minority equity owned by a foreign investor in a Japanese enterprise unless the investor possesses essential technical knowledge which he will not make available to Japanese industry by straight patent, know-how, or other licensing arrangement.¹² The Chinese policy is far more liberal. During the early stage of encouragement of foreign investments, the prime concern of the government was the importation of foreign capital in hard currencies, although the emphasis is shifting to the importation of modern, sophisticated technology.¹³

*Economic development policies of the Republic of China
affecting joint ventures*

The government has laid down two general principles for the promotion of new industries: 1) establishment of new industries to fulfill domestic needs in order to cut down the outflow of foreign exchange; and 2) the establishment of export industries in order to earn foreign exchange. To comply with these two principles, emphasis was placed on the development of light industries, manufacturing consumer products, rather than

¹⁰ Henderson, *Contract Problems in U.S.—Japanese Joint Ventures*, 39 WASH. L. REV. 489 (1964) [hereinafter cited as Henderson].

¹¹ Statute for Investment by Foreign Nationals, Article 12, as amended January 8, 1968.

¹² Henderson, *supra* note 10, at 480.

¹³ China Times (Taipei), Sept. 1, 1970, at 4.

heavy industries, the results of which can only be seen after a considerable time.

Therefore, the type of business weighs heavily in the government's decision to grant approval in each case of foreign investment, whether it occurs in the form of a wholly-owned subsidiary or joint venture.

In addition to the type of business, other policy considerations are taken into account before government approval is granted.

These policy considerations usually include the following:

- (1) After considering the national interest and the public welfare, one consideration is whether the business ought to be government owned or privately operated. The conflict often encountered is between the government's recognition of the importance of encouraging private enterprise and the necessity of exercising direct control of certain categories of industry.
- (2) Another consideration relevant to those industries run by the private sector is whether the business ought to be run by local investors or by foreign investors. This is usually a protectionist consideration. The government feels that certain local industries should be protected from the competition of foreign capital, management, and technical know-how. Of course, such policy considerations change from time to time according to circumstances. For instance, the latest trend is to expand and develop basic industries including certain heavy industries, and also to encourage and develop the highly sophisticated technical industries. In other words, the government is becoming more selective with regard to the approval of foreign investment.¹⁴

In approving a foreign venturer's application under the investment statutes, the government is actually granting certain concessions out of its sovereign rights, authorities and privileges. The foreign investor uses various attractive terms and conditions to induce the government to grant these con-

¹⁴ In the early 1950's, therefore, the emphasis was placed on items such as cement, sheet glass, bagasse board, metals, machinery and electrical appliances, textiles, flour milling and edible oil industries, etc. In the subsequent years, due to the government's encouragement and economic needs, new emphasis was placed on products such as PVC resin, viscose rayon, new chemical fertilizers, detergents, antibiotics and other new drugs, dry yeast, monosodium glutamate, automobile tires and tubes, aluminum foil and extrusions, wire and cable, industrial instruments, power tillers, motor vehicles, telephones, transistor radios, TV sets, refrigerators and other electrical appliances. During the mid-1960's, significant amounts of foreign capital began to flow into Taiwan for setting up electronics plants. As of the end of April 1970, about 60 out of a total of 83 approved electronics plants with foreign investment had been put into operation. During the same general period, the other type of industry to receive official blessing from the government was the chemical industry, especially the petrochemical industries. Along this line, items such as ethylene, acrylonitrile, ethylene dichloride, acetylene, propylene and styrene were produced to supply the building blocks of the growing synthetic and plastics industries.

cessions. Therefore, in preparing an investment application, the investor usually tries to convince the government that the proposed investment will be beneficial to the economy of the Republic of China.

During this "bargaining" process, the governments approval depends on its evaluation of the technical know-how to be introduced into Taiwan, the existing or potential export market for the products in question, the extent to which the manufacturing of the product might generate growth in related industries, and the number of job opportunities contributed by such an investment (presently a somewhat minor factor). The foreign investor's bargaining position usually involves the amount of capital to be imported, the value of the technical know-how, and the extent of the product market. The likelihood of favorable consideration usually increases when the proposed product is entirely for export and diminishes when the foreign investor wishes to have a bigger share of the domestic market. Many foreign investors, realizing their favorable bargaining position if they intend to solely export their products, ask for monopolistic status for their specific investments. For example, they might request restriction of further foreign investments in their field. Such requests can be granted since no antitrust legislation exists in the Republic of China.

In addition to the above basic policy considerations, one of the Chinese government's most generalized policy guidelines concerning foreign investments was announced by Deputy Minister Chang of the Ministry of Economic Affairs on December 9, 1970. The new guidelines for approval are more selective, and the following types of investments have a better chance for approval:

- (1) Those which utilize local raw materials, spare parts, or semi-finished products to manufacture products for export;
- (2) Those which use specialized techniques and know-how to manufacture their products, where such products are needed domestically and also have an export market;
- (3) Those which involve joint operation by foreign and local investors to explore natural resources;
- (4) Those which need large amounts of capital and advanced production technology;
- (5) Those which will be involved in research and development;
- (6) Any other industry which will better the economy of the Republic of China.¹⁵

Some modification of these conditions is permitted if such

¹⁵ Economic Daily News, December 10, 1970, at 2.

modification will better the economy of the Republic of China. For instance, local sale of products is permitted under certain circumstances.

As far as the sixth four-year economic plan (1973-1977) is concerned, these conditions will continue to be effective. Moreover, foreign investment in capital-intensive enterprises will be preferred to foreign investment in labor-intensive enterprises.

Of course, the principle of protecting local industries or of giving the local investors some priority consideration will be continued even in light of the above mentioned guidelines.

These policy considerations affect joint ventures. The most significant policy shift is the recent trend on the part of the Chinese government to approve joint venture enterprises over wholly-owned foreign subsidiaries, showing a tendency to approve those foreign investment applications which permit some degree of local participation.

Another recent trend is the encouragement of larger foreign investments. This trend is evidenced by an increase in the total cash value of foreign investments, accompanied by a decrease in the number of cases.¹⁶ The government has adopted a stricter policy in selecting those cases to be approved. In addition, the emphasis in the future will be placed upon capital-intensive rather than labor-intensive industries. Of course, industries with highly advanced technology as well as those which have already obtained a sizable export market will continue to be welcomed.

The role played by the FCN Treaty and other relevant treaties

As a general principle, any foreign national may organize a company under the laws of the Republic of China provided he does not conflict with those provisions prohibiting foreign nationals from engaging in certain activities.¹⁷ This principle is reinforced by the Treaty of Friendship, Commerce and Navigation between China and the United States.¹⁸ Although it is

¹⁶ Data furnished by the Industrial Department & Investment Center (IDIC).

¹⁷ Article 12 of Law Governing the Application of the General Principles of the Civil Code provides: "Within the limits prescribed by law and ordinances, a recognized foreign juristic person has the same capacity of enjoying rights as a Chinese juristic person." Two of the areas in which a foreign national is prohibited from engaging are real estate and mining. In the observation of Chinese law, a foreign juristic person mentioned in the foregoing paragraph is under the same obligations as a Chinese juristic person.

¹⁸ Treaty with the Republic of China on Friendship, Commerce, and Navigation, Nov. 4, 1946[1948] 63 Stat. 1299, T.I.A.S. No. 1871. FCN treaties are a unique feature in U.S. foreign relations; the Republic of China has only concluded such a treaty with the United States.

no problem for foreign investors to organize companies under Chinese law and to own majority interests in these companies, they must operate as would any ordinary Chinese company. They are unable to take advantage of the privileges afforded under the Foreign Investment Encouragement Statute.¹⁹ A foreign investor must receive the approval of the Chinese government in order to be able to enjoy these rights and privileges as provided by the Statute for Investment by Foreign Nationals, including, the right to repatriate earnings and capital.²⁰

Therefore, without the privilege of remitting foreign currency, the profit of the company will remain in the Republic of China. In addition, foreign capital staying within the country for more than six months will not be permitted to be repatriated.²¹ Consequently, foreign investors who have not obtained

¹⁹ The two principal articles in the Statute for Investment by Foreign Nationals are Article 11 and Article 12 dealing with the repatriation of invested capital as well as exchange settlement of profits or interest. Article 11:

The investor shall be entitled to apply for exchange settlement in accordance with provisions of this Statute. This privilege is not transferable except to his legitimate heir or to other foreign nationals or overseas Chinese to whom he has assigned his investment.

Article 12:

The investor may apply for exchange settlement against the yearly income of net profit or interest accruing from his investment.

The investor may each year apply for exchange settlement against 15% of the total amount of his invested principal two years after the completion of the approved investment plan.

The percentage for exchange settlement provided in the preceding paragraph may be raised with the approval of the Executive Yuan upon recommendation by the authority-in-charge according to the situation prevailing at the time the annual foreign exchange settlement application is made.

Applications by investors for exchange settlement against payments on bonds or loans shall be governed by the agreed terms and conditions as approved.

When the investment is made in accordance with sub-paragraph 2 or Article 3, the value of the total amount of such investment shall be determined by the Ministry of Economic Affairs at the request of the investor after such machinery, equipment, raw materials or commodities for sale have been imported.

When the investment is made in accordance with sub-paragraph 3 or Article 3, the value of the total amount of such investment shall be determined by the Ministry of Economic Affairs at the time of application for investment. Statute for Investment by Foreign Nationals, Art. 11 and 12 *as amended*, January 8, 1968.

²⁰ *Id.*

²¹ Regulation Governing the Limitation on the Amount of Gold, Silver, Foreign Currency and New Taiwan Dollars Carried by Inbound and Outbound Passengers.

Article 7:

1. Passengers entering into Taiwan must declare to the customs the amount of gold, silver, and foreign currency they are carrying. The foreign currency may be converted into New Taiwan dollars in accordance with the prevailing rates. However, the gold and silver are not convertible and may be stored with the Cus-

the privileges under the Foreign Investment Encouragement Statute are reluctant to invest, even though under Chinese law, as well as the FCN Treaty, they are permitted to do so.

Most of the Treaties of Amity and Commerce were concluded in the 1920's and 1930's between China and a few other nations.²² These treaties now have very little effect on a joint venture situation since the situation in the field of international investment and trade was quite different forty years ago. The Agreement between the Republic of China and the United States relating to investment guaranties enables certain American investments in Taiwan to be eligible to apply for AID's guaranties.²³ Another type of treaty affecting a joint venture situation involving a Chinese party and a foreign party from a specific nation is a tax treaty. It is anticipated that such a treaty will be concluded between the Republic of China and the United States in the foreseeable future.²⁴

Since there exist relatively few treaties which have any effect on joint ventures, the treaty factor bears little significance for the joint venture situation.

II. BASIC CONSIDERATIONS IN SETTING UP A JOINT VENTURE OPERATION

What constitutes a joint venture

Lawyers have made many efforts to define the term "joint

toms authority by the passenger. The passenger then is permitted to bring those declared and stored gold and silver with him when he departs. As to the foreign currency, only the difference of the amount declared and the amount converted into New Taiwan dollars is permitted to be carried out.

2. When the above mentioned passenger departs after remaining in this country for over six months, he is still allowed to carry the stored gold and silver with him. But the amount of foreign currency permitted to be carried out shall be limited in accordance with the restriction applying to the ordinary passengers (i.e. he is allowed to carry 400 U.S. dollars only when he departs).

²² For example, Treaty of Amity and Commerce between Belgium and China signed on February 28, 1928; between Portugal and China signed on March 27, 1929; between Spain and China signed on December 31, 1929. MINISTRY OF FOREIGN AFFAIRS (Republic of China), TREATIES BETWEEN THE REPUBLIC OF CHINA AND FOREIGN STATES (1927-1961) (1963).

²³ Exchange of Notes, Amendment to the Agreement relating to Investment Guaranties between the Republic of China and the United States, signed June 8, 1964, effective August 6, 1965.

²⁴ The officials of the Republic of China and the United States of America had several preliminary sessions on the drafting of a Tax Treaty between the two countries. The Republic of China and the United States signed an agreement for the Mutual Exemption for Taxes on Income Derived from Sea and Air Transport in March 1972, announced in 66 DEP'T STATE BULL. 493 (1972). Furthermore, the Republic of China is a member of the Convention on the Settlement of Investment Disputes between States and Nationals of other States.

venturee" since there are few, if any, statutory provisions which attempt to do so. Some say a "joint venture" is a "contract and more."²⁵ Others define it as "a special combination of two or more persons, where, in some specific venture, a profit is jointly sought without any actual partnership or corporate designation."²⁶

A joint venture is often thought to be limited in duration and purpose. In the international commercial community this usage has all but been abandoned. Today, the term joint venture covers practically any type of formal cooperation between two or more parties.

The meaning of joint venture was well put by Judge Cardozo when he wrote:

Joint adventures, like copartners, owe to one another, while the enterprise continues, the duty of the finest loyalty. Many forms of conduct permissible in a work-a-day world for those acting at arm's length, are forbidden by those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the disintegrating erosion of particular exception.²⁷

It is established that the so-called joint venture always commences pursuant to the concluding of a joint venture agreement.²⁸ However, it has been frequently questioned whether the agreement which gives the joint venture its existence automatically terminates when the enterprise is incorporated.²⁹ Will it terminate even though the incorporation was for the purpose of carrying out the joint venture, the rights of third parties were not affected thereby, and the act of forming the corporation has been undertaken in conformity with the contractual agreements of the parties to the undertaking? It seems reasonable to assume that if the parties to the agreement intend that the original contract shall continue after incorporation,

²⁵ Taubman, *What Constitutes a Joint Venture*, 41 CORNELL L. Q. 640, 643 (1956) [hereinafter cited as Taubman].

²⁶ Annot., 63 A.L.R. 909, 910 (1929). See also 46 Am. Jur. 2d., *Joint Adventures*, § 1-6 (1969).

²⁷ *Meinhard v. Salmon*, 249 N.Y. 458, 164 N.E. 545 (1928).

²⁸ Broden & Scanlan, *The Legal Status of Joint Venture Corporations*, 11 VAND. L. REV. 673, 678 (1958); Taubman, *supra* note 25.

²⁹ Note, *Joint Adventures — Contracts Creating Joint Adventures — Whether Terms of a Joint Venture Survive in Event Enterprise is Later Incorporated*, 34 CHI.-KENT L. REV. 161 (1956) [hereinafter cited as *Joint Adventures*].

which serves merely to provide a convenient mode to carry out the purposes of the joint venture, there should be no reason why the corporate form and the joint venture agreement could not co-exist.³⁰

It is well established in practice that a joint venture possesses the following basic attributes: the existence of an agreement, the existence of a joint interest, the sharing of profits and losses, the recognition of joint control and the existence of a fiduciary relationship.³¹ We can therefore say that a joint venture before its incorporation is nothing more than a partnership relationship. Article 667 (1) of the Chinese Civil Code Book of Obligation states that “[p]artnership is a contract whereby two or more persons agree to put contributions in common for a collective enterprise.”³²

The question now is: can partnership as defined by the Civil Code coexist with one of the entities as provided by the Company Law? The logical answer seems to be that a partnership agreement can exist among individual investors (or joint venturers) even after the incorporation of the new company. In other words, there is no restriction in Chinese law prohibiting shareholders or directors from continuing or reaching an agreement among themselves. Therefore, when a joint venture is concluded, it can continue in existence long after the new company is incorporated. It is said in the note referred to above, that

[s]ince joint venturers are involved in a fiduciary relationship, owing obligations of loyalty and are expected to conduct themselves, in relation to one another, with the utmost of good faith, they, when parties to an original contract, should be denied an opportunity to use the corporate entity as a shield to perpetrate wrong. For the corporate veil is not so sacred that a court would not look through the form to discover the substance, even though this would require a disregard of the corporate fiction.³³

In reality, the establishment and registration of a company often involves various types of contractual relationships among the promoters, shareholders, and directors; these contractual relationships cannot be terminated simply because the joint venture has launched into a new phase, namely, the incorporation of a joint venture company.³⁴

³⁰ *Id.*, at 162.

³¹ *Id.*

³² Civil Code—Book of Obligation Article 667 (1), promulgated on November 22, 1929, effective from May 5, 1930.

³³ Joint Adventures, *supra* note 29, at 164; see also *Mirabito v. San Francisco Dairy Co.*, 8 Cal. App. 2d 54, 47 P.2d 530 (Dist. Ct. App. 1935).

³⁴ Joint Adventures, *supra* note 29; partnership, Title XVIII. Civil Code—Book of Obligation.

In determining the existence of a joint venture under Chinese law, the following criteria are of vital importance: (1) *The conclusion of a joint venture agreement.* Although such an agreement represents a partnership among the joint venturers, it goes beyond being a mere contract since the joint venture agreement also serves as a prerequisite to the formation of a joint venture corporation. In addition to being a contract, it is also "a form and method of business organization and of doing business."³⁵ (2) *Dual interest.* In a joint venture arrangement, there should be a clear understanding of the existence of joint interest as well as the sharing of profits and losses. (3) *Degree of control.* There should also be a specific arrangement as to what degree of control each joint venturer possesses.

There is neither a provision of law nor a court decision attempting to define joint venture or to classify a joint venture as a unique type of contract under Chinese law. It would seem most reasonable, therefore, to classify a joint venture agreement as a form of partnership agreement. In other words, before the incorporation all juristic acts are conducted in the name of partnership and thus, all partners bear obligation as joint and several obligors to each other.³⁶ Once the joint venture company is incorporated, although the joint venture agreement should not be deemed automatically terminated, all juristic acts will be conducted in the name of the company. If the company is of limited liability, then the liability will be limited to the assets of the company.³⁷ It is obvious that the enterprise would not want to conduct juristic acts in the name of the partnership at this point.

Corporate structure of a joint venture

As has been stated above, the term "joint venture" has actually been quite loosely used. The mere existence of a joint venture agreement and the fact of shared participation in a joint venture company, regardless of the percentage of shares, would in most cases be considered a joint venture. Thus, one party's interest in a joint venture can range from 1% to 99%. It might seem reasonable to the layman to consider a joint-venture as a 50-50 deal. But this is rarely the case since it would involve complicated legal problems, for example, deter-

³⁵ Taubman, *supra* note 25, at 643.

³⁶ Article 681 of the Book of Obligations of the Civil Code reads: "If the assets of the partnership are not sufficient to cover the liabilities, the partners are liable as joint debtors for the deficit."

³⁷ There are two types of limited liability companies under the Chinese Company Law: companies limited and companies limited by shares.

mining who has controlling interest. This problem is dealt with in a subsequent section.

Despite the fact that under the Chinese Company Law there are five different forms of companies,³⁸ almost all joint ventures are organized in the form of a "Company Limited by Shares" for reasons not always evident in the Company Law. Considering only the Company Law, the most satisfactory form is probably the so-called "Limited Company"³⁹ for the following reasons: (1) The liability of shareholders to the company is limited to the extent of the capital contributed by each of them;⁴⁰ (2) the required shareholders can be as few as two;⁴¹ (3) the minimum capital requirement is considerably less than that of a company limited by shares;⁴² (4) shareholders who do not conduct business may from time to time exercise power of control;⁴³ (5) the shareholders may not, without the agreement of a majority of all the other shareholders, transfer all or a part of their contribution to the capital of the company to other persons; and (6) the shareholders who conduct the business of the company, or directors and supervisor, may not, without the unanimous agreement of all other shareholders, transfer all or a part of their contribution to the capital of the company to other persons.⁴⁴

Such an internal corporate arrangement does, to a great extent, simplify the complicated nature of a joint venture, and under normal circumstances will be a satisfactory arrangement for setting up a joint venture company. The only drawback is that if the joint venturer desires to enjoy all the privileges and benefits provided by the Statute for Encouragement of Investment, he must organize a "Company Limited by Shares" since the Statute recognizes only the "Company Limited by Shares" as a "productive enterprise" within the meaning of the Statute.⁴⁵ In other words, a "Limited Company" is not a

³⁸ Company Law, Article 2 *as amended*, September, 1970.

³⁹ Company Law, Chapter 3 Limited Company, *as amended*, September, 1970.

⁴⁰ *Id.*, Article 99.

⁴¹ *Id.*, Article 98.

⁴² *Id.*, Article 100. In practice, the Ministry of Economic Affairs sets a minimum capital requirement in accordance with the economic policies at the time.

⁴³ *Id.*, Article 109.

⁴⁴ *Id.*, Article 111.

⁴⁵ Article 3 of the Statute For Encouragement of Investment reads as follows: "The term, 'productive enterprise' as used in this Statute refers to any one of the following types of operation which produces goods and/or renders services, and which is organized as a company limited by shares in accordance with the Company Law:

“productive enterprise” under the Statute for Encouragement of Investment. As a result, joint venturers are left almost no choice but to try to qualify their operation as one of the

-
- (1) Manufacturing: Any operation which makes or processes products with machinery and manual labor.
 - (2) Handicraft: Any operation which makes or processes products with manual labor and skill.
 - (3) Mining: Any operation which prospects or works mines with machinery and manual labor for the purpose of producing mineral products.
 - (4) Agriculture: Any operation which utilizes land and equipment for growing plants and producing crops.
 - (5) Forestry: Any operation which utilizes forest land and equipment for planting or replanting forests and for felling or cutting trees for forestry products and by-products.
 - (6) Fishery: Any operation which catches and cultures marine animals and plants with fishing craft or fish ponds and fishing gear.
 - (7) Animal Husbandry: Any operation which raises and breeds livestock on farm or ranch or by mechanical means.”

The Statute For Encouragement of Investment provides the following privileges and benefits: (1) five years exemption from profit-seeking-enterprise income tax (or business income tax, Article 5); (2) the maximum rate of profit-seeking-enterprise income tax, including all forms of surtax, payable by a productive enterprise shall not exceed eighteen percent of its total annual income (Article 6); (3) a productive enterprise which invests its undistributed profits for the taxable year in expansion of its machinery or equipment used for production or rendition of services, may exclude the amount of such investments from its taxable income, provided that the undistributed profits eligible for such exclusion does not exceed an amount equal to 25% of its taxable income for current taxable year (Article 7); (4) where a productive enterprise invests its undistributed profits in an expansion of its machinery or equipment, the new stocks issued to shareholders or the increased value of old stocks held by shareholders as a result of the capital increase are excludable from the shareholders' consolidated income or profit-seeking-enterprise income of the taxable year for taxation (Article 9); (5) a productive enterprise which incurs a foreign currency debt for purchase of productive equipment with government approval may set aside each year from its profits, starting from the year in which such debt is incurred, an amount not exceeding seven percent of the unpaid balance of the foreign currency debt calculated in local currency at the exchange rate prevailing at the time of closing of accounts for the current year as special reserve for foreign currency debt exchange loss to be used solely for compensating losses incident to exchange rate adjustment. Such special reserve shall not be included as taxable profit-seeking-enterprise income (Article 13); (6) a productive enterprise importing machinery or equipment for use by the enterprise for the production of goods or rendition of services may pay the duties on such machinery in installments (Article 23); (7) a productive enterprise engaged in any of the basic metal industries, electrical and electronics industries, machinery manufacturing industries, transportation equipment manufacturing industries, chemical fertilizer industries, petrochemical industries, pulp manufacturing industries, or industries for the installation of pipelines for supply of natural gas in conformity with the standards as may be prescribed by the Ministry of Economic Affairs, which has a capitalization of not less than 30,000,000 *juan* (equivalent to NT \$90,000,000), shall be exempt from the payment of import duties on machinery or equipment (Article 23); (8) a productive enterprise which renovates its machinery or equipment for the purpose of increasing its production or service may reduce the useful life of such machinery and equipment by one-third of the number of service years prescribed by the Income Tax Law for the purpose of depreciation (Article 24); (9) the deed tax on real property used by productive enterprises directly for productive purposes is imposed at half the statutory rate (Article 28).

“productive enterprises” in order to obtain the privileges under the Statute.

It is important to note that, in theory, any of the five corporate forms as provided by the Chinese Company Law can be chosen for a joint venture operation provided that the joint venturers decide to forego some of the privileges and benefits of the Statute. There is no law restricting a joint operation involving foreign investors. In fact, there are some foreign-owned or joint venture companies operating in the Republic of China which have never applied under the Statute for Encouragement of Investment and the Statute for Investment by Foreign Nationals and therefore do not enjoy the privileges and benefits provided therein. These companies operate as would any Chinese company. The incentives provided by the Statute are sufficiently valuable, however, as to nullify any internal advantages which might be obtained by forming a company other than a “Company Limited by Shares.”⁴⁶

III. PREPARATION OF THE JOINT VENTURE AGREEMENT

In preparing a joint venture agreement to form a joint venture company, the primary consideration is the conformity of the agreement to the relevant Chinese laws regulating contracts. Contracts are regulated by the civil code which, to a great extent, corresponds to the Japanese and German Civil Codes. The Civil Code Book of General Principles covers juristic acts including the formation of contracts.⁴⁷ Book II of the Civil Code — Obligations, Chapter I Title (1) Part (1) — deals specifically with contracts.⁴⁸ There is no separate commercial

⁴⁶ Lawyers trained in Anglo-American law are often curious as to the extent to which Chinese Company Law differs from the corporate law of common law countries. The Chinese Company Law is, of course, based on civil law concepts, but some recent revisions are markedly influenced by Anglo-American legal concepts. For instance, it is well established that in the civil law tradition, it is the shareholders, not the board of directors, who make managerial decisions, but the revised Chinese Company Law has placed the managerial decision making power in the hands of the board of directors. Nevertheless, the Chinese Company Law still remains basically different from Anglo-American corporate concepts. Under the Anglo-American legal system, the power of corporate directors is limited by the objects of the corporation as set forth in the articles of incorporation. Where directors act beyond these corporate powers, their act is void; where directors act within the corporate powers but beyond the scope of the powers granted to them as directors in the articles of incorporation, their act is invalid unless and until it is ratified by the shareholders. Under Chinese law, a company is a juristic person whose powers are those of any individual and thus are not limited by the objectives specified in the articles of incorporation.

⁴⁷ Civil Code — Book of General Principles, Chapter 4, promulgated May 1929, effective as of October 1929.

⁴⁸ Civil Code — Book of Obligations, Chapter I, promulgated November 22, 1929, effective May 5, 1930.

code in Chinese law and commercial matters are primarily covered by the Civil Code. Of course, a joint venture agreement usually involves many other juristic acts and therefore, other provisions of the Civil Code are applicable as well.⁴⁹

*Various means for corporate control*⁵⁰

One of the main concerns in drafting a joint venture agreement is corporate control, assuming control is desired. Under the Chinese Company Law, the board of directors represented by the chairman, the shareholders, and the general manager are those relevant in the control of the company.⁵¹ The chairman of the board is elected from among the directors by a majority at a meeting attended by over two-thirds of the directors; directors are elected by the meeting of shareholders from among shareholders with disposing capacity and any of their designated representatives.⁵² Usually, a shareholders' meeting is, unless otherwise provided for in the Company Law, convened by the board of directors.⁵³ Thus, it is clear that the shareholders have the real power to elect a new board of directors and thereby to retain or remove the chairman of the board. Another power of shareholders under the Chinese Company Law is removal of errant directors. When a director has done anything causing great loss or damage to the company or has committed a serious violation of law or the articles of incorporation, a shareholder who has continuously held five percent or more of the total number of issued shares for a period of one year or longer may institute suit for removal of the director, provided that a shareholders' meeting has not adopted a resolution to remove the director from office.⁵⁴

It is also important to note here that, under Chinese Company Law, stock without voting rights is not permitted. How-

⁴⁹ The legal ramifications of these juristic acts are covered by specific sections in the code (e.g., maritime, insurance, negotiable instrument and company laws), or by the General Principles Section Book of Obligation.

⁵⁰ We have dealt with only the principal means of maintaining corporate control. There are other methods, such as that provided in Article 198 of the Company Law, which provides for cumulative voting.

⁵¹ Company Law, Article 193, Article 208, Article 29-39.

⁵² *Id.*, Article 208.

⁵³ *Id.*, Article 171.

⁵⁴ *Id.*, Article 173, Article 172. The Chinese Company Law also provides that shareholders who have continuously held more than three percent of the total number of issued shares for a period of one year or longer may request the board of directors to convene a special meeting of shareholders. If the board refuses to do so, the shareholders may apply to the local competent authority for permission to convene the meeting themselves (Article 175). Once such a meeting is convened, they can accordingly reelect directors and auditors and modify or alter the articles of incorporation (Article 172).

ever, the voting rights of special shares may be restricted as compared with the voting rights of common shares.⁵⁵ For instance, the voting rights of common shares may be one vote for each share held while the voting rights of special shares may be one voting right for every two shares or for every five shares held. However, having 50 percent local participation, while limiting the voting rights of this party so as to have actual management control by the 50 percent foreign investor, will certainly have an adverse effect on government approval of the foreign investment application.

As a principle, the voting power of shareholders under the Chinese Company Law is not based on the number of shareholders but rather on the number of shares a shareholder holds. In other words, each share has one vote.⁵⁶ There are few exceptions to this principle.⁵⁷ It is therefore clear that the most effective means of assuring corporate control is simply to hold a majority of the company's stock.

A secondary means for corporate control is found in the statutory power of the chairman of the board. According to the Chinese Company Law, the statutory power of a chairman cannot be limited or changed by the articles of incorporation.⁵⁸ The Law provides the chairman of the board with the following powers:

- (1) The chairman of the board shall preside at the meeting of shareholders, meetings of the board of directors, and meetings of the managing directors that represent the company.
- (2) In case the chairman of the board of directors is on leave of absence or cannot exercise his powers and authority, he may designate one of the managing directors or, where there are no managing directors, one of the directors, to act on his behalf.
- (3) Since a chairman of the board represents the company, he shall have power to conduct all affairs pertaining to the

⁵⁵ Company Law, Article 157, Article 158.

⁵⁶ *Id.*, Article 179.

⁵⁷ (1) The articles of incorporation may prescribe a restriction on the number of votes of any shareholder holding three percent or more of the total number of issued shares (Article 179).
(2) A company, shall have no voting power for shares held by itself (Article 178).
(3) A shareholder who has a personal interest in the matter under discussion at a meeting, which may impair the interest of the company, shall not vote nor exercise the voting power of another shareholder (Article 178).
(4) Except in case of trust business, when a person acts as the proxy of two or more shareholders, the voting power of such proxy shall not exceed three percent of the total number of issued shares and, in case of excess, such excessive votes shall not be counted (Article 177).

⁵⁸ Company Law, Article 208 (3).

business of the company pursuant to Article 208 and Article 57 of the Chinese Company Law which set forth the general power of the chairman.⁵⁹

The Chinese Company Law requires that a chairman of the board must have Chinese nationality, with domicile within the national boundary.⁶⁰ This requirement, however, is waived in the case of a company formed to carry out an investment approved under the Statute for Investment by Foreign Nationals.⁶¹ It is important to note here that Article 58 states that, "[a]ny restriction imposed by the company on the power of representation of a shareholder cannot be set up as a defense against a bona fide third person."⁶² This article is also applicable *mutatis mutandis* to directors representing the company including the chairman of the board.⁶³

It is thus clear that the chairman as well as the board of directors has a considerable degree of power in corporate control, and that to be able to appoint a majority number of directors on the board is always a positive measure in strengthening one's position of control in the joint venture company.⁶⁴

As to the power of the general manager, there is nothing under the Chinese Company Law which would limit or restrict giving to the general manager the power to run the daily operations of the corporation. Of course, his duties and powers may be limited by the articles of incorporation as well as by an employment contract. In addition, a general manager "shall not modify or alter the decision of shareholders or shareholders conducting the business, or resolutions adopted at the shareholders' meeting or the board of directors, nor exceed the scope

⁵⁹ *Id.*, Article 208 (6). "Provisions in Article 57 and 58 shall *mutatis mutandis* apply to directors representing the Company."

⁶⁰ *Id.*, Article 208 (5).

⁶¹ Statute For Investment by Foreign Nationals, Article 17 reads: "Investors who form a company according to the Company Law and other relevant laws may be exempted from the restrictions of the following provisions:

1. Those concerning domicile in Chinese territory contained in Articles 98-(1), 128-(1), 208-(5) and 216-(1) of the Company Law.
2. Those concerning Chinese Nationality contained in Article 208-(5) of the Company Law."

⁶² Company Law, Article 58.

⁶³ *Id.*, Article 208 (6).

⁶⁴ Although Article 27 of the Civil Code provides that a director of a company can represent the company for the management of its affairs, the company law somewhat limits the representing power of a director. Under the Company Law, the collective body of the directors (i.e., board of directors), not a director acting individually, is vested with power as the supreme decision-making body of the company. Article 202 of the Company Law states, "The transaction of business of the company shall be decided by the board of directors. Unless otherwise provided for in this law or in the articles of incorporation that certain matters must be resolved at the meeting of shareholders, all may be decided by resolutions of the board of directors."

of their prescribed authority."⁶⁵ Although his duty is to carry out the policy of the board of directors, the general manager as the chief executive officer of the company has broad discretion.

The function of the supervisor under the Chinese Company Law is not to take active control of the company, but rather to act as a watchdog over the company's affairs.⁶⁶ Supervisors, unlike general managers, are elected at a meeting of shareholders from among the shareholders.⁶⁷ Their statutory function is to investigate from time to time the business and financial condition of the company, examine books and records, and request that the board of directors submit reports.⁶⁸ In carrying out these functions, a supervisor may appoint a lawyer or public accountant for the company to undertake an examination.⁶⁹ Also, a supervisor checks for accuracy statements and records prepared and submitted by the board of directors to the meeting of shareholders.⁷⁰ A supervisor may convene a shareholders' meeting when he deems it necessary.⁷¹ On the other hand, a supervisor may not be a director or managerial officer of the company at the same time. Outside of the functions set forth in the Company Law, supervisors have no actual control of the company's business operation or policy making. The function of supervisors under Chinese law is relatively foreign to lawyers trained under the Anglo-American legal system, especially the fact that supervisors may have the right to convene shareholders' meetings and that they sometimes seem to be in a position somewhat superior to the board of directors.⁷²

Therefore, in order to acquire effective control of a company, one must first acquire the majority interest of shares and thereby appoint the supervisor, and then appoint a majority to the board of directors. Since the decision to appoint, discharge, or renounce a corporate officer must be by a majority of all the directors (as distinguished from a majority of the

⁶⁵Company Law, Article 33.

⁶⁶ *Id.*, Article 218 (1). "A supervisor may at any time investigate the business and financial condition of the company examine books, records and documents and request the board of directors to submit reports."

⁶⁷ *Id.*, Article 216.

⁶⁸ *Id.*, Article 218 (1).

⁶⁹ *Id.*, Article 218 (2).

⁷⁰ *Id.*, Article 219.

⁷¹ *Id.*, Article 220.

⁷² *Id.*, Article 218 (1).

directors as a specific meeting),⁷³ majority control then means the power to appoint the general manager.

The articles of incorporation of most foreign-local joint venture enterprises stipulate the exact number of board members each party may appoint. In addition, the articles of incorporation may also regulate explicitly which party may appoint the chairman of the board, managing director and general manager. These provisions are usually first found in the joint-venture agreement itself before the new company is formed. Their purpose, of course, is to assure effective control of the corporation.

The protection of minority interest

The lawyer's task is somewhat more difficult when his client is the party having a minority interest in a joint venture than when he seeks to maintain control. In protecting the interest of minority shareholders, the Chinese Company Law provides the following:

- (1) A shareholder or shareholders, who collectively hold more than three percent of the total number of issued shares over a period of one year, may petition the board of directors to convene a special meeting of shareholders. They must do this in writing stating the reasons for the request. If the board fails to give notice of the convening of a meeting within fifteen days after such request, the shareholders may apply to the local competent authority for permission to convene the meeting themselves.⁷⁴ This provision is of special significance when the board of directors is controlled by members of one joint venture party which refuses to convene a shareholders' meeting to deal with matters which are deemed to be important by another party of the joint venture.
- (2) Another factor in minority shareholder protection is a "buy out" provision. If the company decides to alter the character of the business (Article 185), a shareholder may serve notice in writing upon the company stating his intention to object to such a resolution. If he also raises his objections in a shareholder's meeting, he may request the company to buy back all of his shares at the prevailing fair price.⁷⁵ If the shareholders decide to dissolve the enterprise and to transfer a major portion of the business or assets, the provision does not apply.⁷⁶ This "buy back"

⁷³ *Id.*, Article 29 (2).

⁷⁴ *Id.*, Article 173.

⁷⁵ *Id.*, Article 186.

⁷⁶ *Id.*, Article 186. "A shareholder who had, before a resolution was adopted at a shareholders' meeting to do any of the acts mentioned in paragraph 1 of the preceding article, served a notice in writing to the company declaring his intention to object to such an act and also raised such objection during the meeting, may request the company to buy back all the shares held by him at the prevailing fair price; provided, however, that this shall not apply where, at the time of adopting a resolution

provision serves to prevent a minority shareholder's interest from being overwhelmed by the decision of the majority.

- (3) A shareholder may ask for a court order to annul a resolution adopted at a shareholders' meeting if the procedure in convening the meeting or the means of adopting the resolution was in violation of law or ordinance or the articles of incorporation.⁷⁷
- (4) If a director, acting in his capacity as such, commits an act which is seriously prejudicial to the company, or is in violation of law or ordinance, or of the articles of incorporation, and the shareholders do not adopt a resolution to remove him from office,⁷⁸ then a shareholder who holds over five percent of the total number of issued shares for a period over one year, may institute an action in court for a judgment for removal.⁷⁹
- (5) Shareholders who hold more than ten percent of the total number of issued shares over a period of one year may request a supervisor to institute an action against a board director.⁸⁰
- (6) Shareholders who hold over ten percent of the total number of issued shares over a period of six months may ask for a court ruling for readjustment (reorganization of the company) in the case of temporary suspension of business or reasonable anxiety over ceasing of business of a company due to financial difficulty.⁸¹

Under Chinese law, a company's articles may require the quorum or the number of votes required for passage of a resolution to be greater than that provided by the law. There-

on any matter specified in subparagraph 1 of paragraph 1 of article, the meeting of shareholders also resolved to dissolve the company."

⁷⁷ *Id.*, Article 189.

⁷⁸ According to Article 199 of the Company Law, a director may be removed from office at any time by a resolution adopted at a shareholders' meeting.

⁷⁹ *Id.*, Article 200.

⁸⁰ *Id.*, Article 214.

⁸¹ *Id.*, Article 282. "Where a company suspends its business due to financial difficulty or there is an apprehension of suspension of business, the court may, on the application of any of the following interested persons, rule for reorganization:

1. Board of directors;
2. Shareholders who have been continuously holding shares representing ten percent or more of the total number of issued shares for a period of six months or longer;
3. Creditors of the company who have claims equivalent to ten percent or more of the capital from the total number of issued shares.

The board of directors shall, for the aforesaid application to court, adopt a resolution by a majority vote at a meeting of the board of directors attended by over two-thirds of the directors."

Article 185 of the Company Law requires that certain acts of the company, such as merger, consolidation or dissolution be resolved at a shareholders' meeting attended by shareholders representing at least two-thirds of the issued shares and that the resolution be passed by a majority vote of those present. However, the special provisions mentioned here require that certain resolutions of shareholders' meeting be adopted with the approval of a certain percentage of the total issued shares, not the percentage of shares which attend such meeting.

fore, one of the most effective means to afford protection to minority shareholders is to stipulate in the joint venture agreement or the articles of incorporation of the joint venture company a provision which requires a greater number of votes than that required by law in order to pass certain resolutions which might alter the company's character or affect its equity. A typical sample for such provision usually reads:

That the power vested in the shareholders to change the location of the company, to change the capitalization of the company or to modify the articles of incorporation, or to merge, consolidate, or dissolve the company shall be exercisable only upon the affirmative vote of *seventy* percent of the shares issued and outstanding.⁸²

This special arrangement may be also applied to protect minority interest on the board of directors.

Such a provision is designed specifically for the protection of minority interests; the percentage required in the provision is always larger than the percentage of shares held by the shareholder(s) acquiring the majority interest. Several well-known joint venture operations have inserted such provisions in both their joint venture agreement and articles of incorporation. The government opposed this arrangement when it first became aware of it, based on the ground that such provision was not in compliance with Article 246 (now Article 277)⁸³ of the Company Law which stipulated the requirements in voting. The parties involved then filed an appeal to the Ministry of Economic Affairs requesting the government to withdraw this ruling, arguing that the article only set forth the minimum but not maximum requirements of votes. This argument was also supported by an opinion of the Grand Judges Council.⁸⁴ The government finally withdrew its ruling, thus clarifying the matter.

As another measure protective of minority joint ventures, Article 179 of the Company Law stipulates that the articles of incorporation must restrict the number of votes of a shareholder who holds more than three percent of the total number of issued shares.⁸⁵ The following provision is usually inserted to offer token compliance with this article:

⁸² *Id.*, Article 185.

⁸³ *Id.*, Article 277. "A company shall not modify or alter its articles of incorporation without a resolution adopted at a meeting of shareholders. The aforesaid resolution at the meeting of shareholders shall be adopted by a majority of shareholders at a meeting attended by shareholders representing over two-thirds of the total number of issued shares."

⁸⁴ Grand Judges' Council Explanation number 100.

⁸⁵ Company Law, Article 179.

A stockholder shall be entitled to one vote for each share of stock held by him provided, however, that any stockholder holding more than 3 percent of the total outstanding capital stock shall have his voting rights on the shares exceeding 3 percent of the total outstanding capital stock discounted at one percent, i.e. 99 voting rights for every 100 shares.

Article 229 sets forth the minority shareholder's right to obtain information relating to company management, including statements and records of accounts prepared by the board of directors and the report made by the supervisor. The articles of incorporation may also provide the minority shareholder with additional access to information, thus offering some degree of protection.⁸⁶

Article 267 provides that shareholders are entitled to maintain their original ratio in newly issued shares. The minority shareholder will then have his interest protected from dilution if the majority resolves to issue new shares. However, if the shareholder is unable to exercise or to transfer his preemptive rights, they will expire within a given period.⁸⁷

There are instances in which the minority shareholder is unable to raise the funds to exercise his preemptive rights and must then see his interest diluted. To prevent this and to maintain the fixed ratio of shares between the joint venture parties, the following clause may be inserted into the articles of incorporation:

The ratio of the original contributions to the capital of the corporation and the ratio of loans or additional contributions to capital shall be on the basis of (sixty-five) percent for A and (thirty-five) percent for B.

Other provisions, such as the appointment of managers and key personnel and the restriction of assignment of the interest of one party in the joint venture operation to a third party, are relevant in protecting the interest of minority shareholders.

The disadvantage of a 50-50 arrangement

Lawyers would not normally recommend a 50-50 participation in a joint venture company since questions on which the parties differ become practically impossible to settle by vote in a shareholders' meeting. Consequently, there is a possibility of an impasse on important decisions. Such events have actually occurred in several joint venture operations in the Re-

⁸⁶ *Id.*, Article 229.

⁸⁷ *Id.*, Article 267.

public of China.⁸⁸ The result was, needless to say, frustrating to both parties.

The proposal of a 50-50 joint venture is usually based on good faith and friendly relations between the two parties involved. There is an implicit agreement between the two parties that both shall share control and decision making powers equally. However, good faith can hardly be maintained when disputes arise and no compromise solution is found. Reliance on the shareholders' meeting to resolve these conflicts are then fruitless.

If equal participation is a necessary feature in the joint venture company, there are several provisions which would at least diminish the possibility of deadlock. To maintain the balance and good faith of the original parties to the joint venture company, a provision in the joint venture agreement to restrict stock transfers is appropriate.

Sometimes, even when there is equal participation, one party is given the right of management control. The most effective method is to permit the party to appoint one more director. This majority of the board of directors will then set corporate policy and appoint the officers of the company. A less effective measure is to obtain the right to appoint managerial personnel or to set up certain corporate control mechanisms such as special voting rights in conflict situations.

Another measure to reduce the possibility of deadlock is to insert an arbitration clause in the articles of incorporation. Binding arbitration is most effective. "Buy out" agreements are also useful if the joint venture parties are irreconcilable.

A further measure which could be taken to eliminate conflicts in an equal participation joint venture company is to assign specific functions to each party. Thereby management responsibilities may be divided between the two parties.

A more realistic possibility, which could be effective, is to tie the joint venture operation to another future joint corporation. The same could be done with supplemental agreements such as trademark, patent, and know-how licenses; sales agencies; supply contracts; capital equipment imports; employment contracts for key engineers and managers; and any other items which may be of critical importance in the over-all bargain to

⁸⁸ In one instance a foreign electronics firm decided to go into a joint venture with a local manufacturer. They formed a joint venture corporation with equal participation. An impasse was reached when they could not decide on a proper division of the market, and the firm had to be finally dissolved.

the other party, thereby creating the need to maintain a "good faith" atmosphere.

Articles 14 and 15 of the Statute for Investment by Foreign Nationals also have an effect upon the share a foreign investor would want in the new joint venture company. These are the expropriation articles. If the foreign investor holds less than 51 percent of the total capital of the enterprise he is subject to expropriation at any time by the government if national defense needs dictate. Of course, he will be reasonably compensated and may convert the compensation into foreign exchange from time to time upon application to the proper government authority. If, however, the foreign investor holds more than 51 percent of the total capital of the enterprise, he will not be subject to expropriation within twenty years after he commences business so long as he continues to maintain his majority interest.

When the licensing of industrial properties is involved

It is common business practice to invest in a proposed company by licensing patent rights or technical know-how to the new enterprise instead of making a cash contribution. This practice has frequently been employed by new companies as a convenient substitute for the often cumbersome process of allocating capital.⁸⁹

Some governments, however, impose stringent requirements on the valuation of intangible assets contributed in exchange for shares. In addition, some intangible assets do not qualify as capital assets for special investment incentives. Many governments also do not permit certain intangible assets such as unpatented know-how to be capitalized.⁹⁰

Like the law in most countries, the law of the Republic of China permits capitalization of intangible assets.⁹¹ However, few local investors are willing to invest in this manner because in assessing the value, the government usually takes a very conservative view and estimates the value of the intangible assets at a rate much lower than its real potential. Therefore, the owners of patent rights or technical know-how are most reluctant to capitalize these assets as part of an investment in

⁸⁹ Paragraph 3 of Article 11 of the Chinese Company Law reads: "The payment of subscription in the first paragraph may be made in assets required in the business of the company." There is no question under the Chinese law that the so-called assets include intangible assets such as patent rights and technical know-how.

⁹⁰ Friedman, *Legal Problems in Foreign Investments*, 14 Bus. L. 746, 756 (1959).

⁹¹ *Id.*, see also Article 41(5), 131, 359(3) of the Chinese Company Law.

a joint venture company since they might be able to sell them at a higher price later.

The government adopts a different attitude towards capitalization of intangible assets by foreign investors. Although Article 3 of the Statute for Investment by Foreign Nationals stipulates that capital for investments referred to in this statute includes technical know-how and patent rights, the regulations for approval of these investments are stringent.⁹² The regulations which supplement Article 3 are entitled "Regulations Governing the Licensing of Patent Rights or Technical Know-how as Equity Investment."⁹³ Article 6 of this regulation defines the restrictions upon foreign investors as follows:

The licensing of patent rights or technical know-how as equity investment by an investor, unless in the occasion of being an unlimited liability stockholder, shall have the following restrictions:

- 1) The value of the patent rights shall not exceed 20 percent of the actual paid-in capital of the company.
- 2) The value of the technical know-how shall not exceed 15 percent of the actual paid-in capital of the company. This technical know-how investment must be coupled with another equal percentage of equity investment in the form of cash and/or equipment.⁹⁴

In addition, Article 4 of the same regulation restricts patent rights and technical know-how to (1) that which can be used to produce new products not yet producible in the Republic of China, or (2) that which can improve the quality or reduce the cost of local products.⁹⁵ Article 7 further requires that shares paid by patent rights are not transferable during the valid period of the patent right and shares paid by technical know-how are not transferable within two years from the completion of the investment plan.⁹⁶

However, the foreign investor who possesses these intangible assets may avoid coming under Article 3 of the Statute for Investment by Foreign Nationals. This may be done in two steps:

- (1) Instead of using the intangible assets as contribution to capital, he may either sell it outright or license it for royalties;
- (2) He may then use the proceeds to buy shares in the company and thereby avoid the restriction as to percentage of contribution to capital as well as the resale restrictions.

⁹² Statute for Investment by Foreign Nationals, Article 3.

⁹³ Regulations Governing the Licensing of Patent Rights or Technical know-how as Equity Investment, as promulgated May 9, 1968.

⁹⁴ *Id.*, Article 6.

⁹⁵ *Id.*, Article 4.

⁹⁶ *Id.*, Article 7.

The problem the investor may face is government approval of his investment plan in purchasing the company's shares.

The licensing of trademarks presents a different problem under relevant Chinese laws and government policy. Although Article 131 of the Company Law indicates that trademark rights may be capitalized,⁹⁷ it is of little use to the foreign joint venturer since trademark rights do not fall into the category of invested capital entitled to the privileges and benefits provided by the Statute for Investment by Foreign Nationals.⁹⁸ However, the foreign joint venturer may capitalize his trademark rights under Article 131 of the Company Law if he is not interested in those privileges.

The problems of capitalization of intangible assets (i.e., patent rights and technical know-how) in a joint venture has been briefly discussed above. Sometimes, however, the foreign party possessing an advanced technical skill or patent right does not want to capitalize it as an equity investment. Yet, since the technology is important to the success of the joint venture, both parties are eager to utilize it. To achieve this purpose, the foreign venturer may in accordance with the Statute for Technical Cooperation enter into a technical cooperation agreement with the new enterprise.⁹⁹ He must submit this agreement to the competent government authority for approval.¹⁰⁰ Under the Statute, the foreign venturer agrees to furnish the new enterprise with the technical skill or patent rights for a fixed royalty,¹⁰¹ which may be repatriated in foreign currency.¹⁰² Also, if the foreign joint venturer does not apply for settlement in foreign exchange, but chooses to invest the royalty earnings in domestic enterprises, the provisions of the Statute for Investment by Foreign Nationals apply.¹⁰³ However, the technical skill and patent rights furnished under this Statute must be those capable of producing new products or increasing the volume of production.

Other considerations

It is beyond our scope to deal comprehensively with all the

⁹⁷ Company Law, Article 131.

⁹⁸ Regulations Governing the Licensing of Patent Rights or Technical Know-how as Equity Investment, Article 2, Article 3.

⁹⁹ Statute for Technical Cooperation as promulgated August 9, 1962 and as amended, May 29, 1964.

¹⁰⁰ *Id.*, Article 11.

¹⁰¹ *Id.*, Article 3.

¹⁰² *Id.*, Article 13.

¹⁰³ Statute for Technical Cooperation, Article 13, as amended, on May 29, 1964.

considerations involved in preparing a joint venture agreement. However, there are several major considerations worth noting.

First, the question of the choice of law always draws the attention of lawyers. In most joint venture agreements, the law governing the agreement is the law of the country in which the joint venture company is incorporated. This arrangement is reasonable since there are many substantive as well as procedural difficulties in enforcing the law of one country within the territory of another country. Assuming that the law governing the joint venture agreement is Chinese law, the question becomes whether the foreign venturer is prejudiced in his right to bring action against the Chinese party in the Chinese court. Article 40 of the Code of Civil Procedure reads: "Whoever has capacity to enjoy rights has the capacity to be a party to an action."¹⁰⁴ This rule offers the basic principle for becoming a plaintiff or defendant in a Chinese court. Article 2 of the Law Governing the Application of the Book of General Principle of the Civil Code further regulates that "within the limits prescribed by law or ordinances, a foreigner has the capacity to enjoy rights."¹⁰⁵ When a foreign corporation is involved, a "recognized"¹⁰⁶ foreign corporation has the same capacity to enjoy rights as a Chinese juristic person.¹⁰⁷ However, the law does not say much about a "non-recognized" foreign corporation's right to become plaintiff or defendant in a Chinese court. A Supreme Court ruling in 1961 clarified this point and affirmed that even a "non-recognized" foreign corporation may be a plaintiff or defendant in a Chinese court.¹⁰⁸

¹⁰⁴ Code of Civil Procedure, Article 40, promulgated on February 1, 1935; as amended, December 26, 1945.

¹⁰⁵ Law Governing the Application of the Book of General Principle of the Civil Code, Article 2, promulgated September 24, 1929, effective on October 10, 1929.

¹⁰⁶ Article 292 of the Company Law stipulates:

"A foreign company shall not transact business or establish a branch office within the territory of China without a certificate of authenticity given after admission, and cannot apply for admission without incorporation in its own country."

¹⁰⁷ Article 12 of the Law Governing the Application of the Book of General Principles of the Civil Code reads: "Within the limits prescribed by law and ordinances, a recognized juristic person has the same capacity of enjoying rights as a Chinese juristic person."

¹⁰⁸ The Chinese Supreme Court ruled as follows:

"Although a foreign juristic person not 'recognized' by Chinese authority is not deemed a juristic person under Chinese law, it is nevertheless a *non-juristic person organization* under subdivision 3 of Article 40 of the Code of Civil Procedure. In other words, as long as it has a representative or administrator, a *non-juristic person organization* may be a plaintiff or defendant in a Chinese Court. Whether the foreign juristic person has an office or business in China is not relevant for this purpose." (Case number: Tai-sang No. 1898, 1961).

It is thus clear that a foreign venturer enjoys rights in litigation in a Chinese court equal to those of Chinese nationals and may not be prejudiced. Needless to say, the generally recognized principles of international law and treaty obligation on the part of the Republic of China also play a major role if foreign venturers are discriminated against in a Chinese court.

Parties in disagreement do not always look upon litigation as the best solution. Therefore, an arbitration clause is a most effective preventive measure. The main questions in drafting the arbitration clause are where the arbitration is held and what laws and rules are applicable. In arbitration the primary concern is how and where to enforce the arbitral award. In the Republic of China, foreign awards cannot be enforced directly, but may be enforced by an action as a foreign court judgment. In other words, if the foreign arbitral award is reduced to a foreign court judgment, then that judgment may be enforced in the Republic of China.¹⁰⁹ If a foreign award has not been reduced to judgment, an action for breach of contract may be instituted in the case of binding arbitration. Since the arbitration clause or agreement is basically a contract between the parties involved, the award itself is a contractual obligation; and its breach can result in an action for breach of contract against the party which refuses to act pursuant to the arbitral award.¹¹⁰

Other aspects such as financing arrangements, warranty provisions covering each party, covenants not to compete, expenses, and assignments are also of keen interest to lawyers involved in drafting a joint venture agreement.

IV. SPECIFIC PROBLEMS FACED BY JOINT VENTURE OPERATIONS

Foreign exchange restrictions

Foreign exchange restrictions affecting foreign investors also apply to foreign joint venturers. Although, there are international conventions such as the Bretton Woods Agreement and sections of the treaties of friendship, commerce, and navigation which deal with the foreign exchange issue,¹¹¹ it is a basic principle of international law that foreign exchange restrictions are purely a question of domestic law. Therefore, the

¹⁰⁹ Hsu, *The Enforcement of American Arbitral Awards in the Republic of China*, 1 CHENCHI L. REV. 53, 57 (1969).

¹¹⁰ *Id.*

¹¹¹ Articles of Agreement of the International Monetary Fund, July 1, 1944, Art. 8, § (2b), 60 Stat. 1401, T.I.A.S. No. 1501, 3 Bevans 1351, 2 U.N.T.S. 39, as amended, May 31, 1968, 20 U.S.T. 2775, T.I.A.S. No. 6748.

courts of one country will not enforce the foreign exchange laws of another.

Article 19, section 1 of the FCN treaty between the Republic of China and the United States, states that if one party establishes or maintains any form of control of international payment or of international financial transactions, it shall accord fair and equitable treatment to the nationals, corporations and associations, and commerce of the other party.¹¹² Since there is no general recognized principle of international law governing foreign exchange restrictions, the foreign exchange regulations of the Republic of China are applicable to all foreign investors as well as foreign parties to joint venture operations.¹¹³

Under the Statute for Investment by Foreign Nationals, the foreign joint venturer may apply for exchange settlement against the yearly net profit or interest accruing from his investment.¹¹⁴ Also, a foreign joint venturer may annually apply for exchange settlement against 15 percent of the total amount

¹¹² Treaty with the Republic of China on Friendship, Commerce and Navigation, Nov. 4, 1946 [1948], Art. 19, 63 Stat. 1299, T.I.A.S. No. 1871.

¹¹³ In addition to the Rules Administrating Foreign Exchange and Trade, which are the basic rules of law governing foreign exchange control, the Republic of China has promulgated many supplemental rules and regulations covering foreign exchange restrictions. In general, it is permitted to hold but not to buy or sell foreign currencies and foreign exchange. Chinese and foreign exchange may only be sold to appointed foreign exchange banks or their designated agencies. The following kinds of foreign exchange should be sold to appointed foreign exchange banks for New Taiwan Dollars at the prevalent buying rate: (1) foreign exchange derived from export of commodities or other types of transactions; (2) foreign exchange derived from service income by the navigation industry and the insurance industry, etc. (including commission in foreign exchange acquired by importers); (3) inward remittances; (4) income from investments abroad by Chinese nationals; (5) foreign currencies or foreign exchange held by nationals or foreigners for conversion into New Taiwan Dollars.

The Statute for Foreign Exchange Control was promulgated by the Legislative Yuan on December 24, 1970 to supersede the former Regulation Governing Foreign Exchange issued by the Executive Yuan.

The following kinds of foreign exchange may be purchased with New Taiwan Dollars at appointed foreign exchange banks at the banks' prevailing selling rate: (1) foreign exchange required for import of commodities; (2) foreign exchange required for payment for transactions by navigation and insurance industries, etc. (including commission in foreign currencies paid abroad by exporters); (3) foreign exchange required for payment by people going abroad for study, inspection tours, traveling, medical treatment, employment, visiting close relatives and business consultation; (4) foreign exchange required for remittance of family maintenance expenses by nationals or foreigners serving in government organizations and private enterprises in the territory of the Republic of China for their dependants abroad; (5) foreign exchange required for remittances of principal and interest and profits accrued from investments in the Republic of China by foreigners and overseas Chinese. The above mentioned categories are by no means exhaustive but only provide a general picture of the kind of foreign exchange restrictions the Republic of China has.

¹¹⁴ Statute for Investment by Foreign Nationals, Article 12, *as amended*, on December 14, 1959.

of his invested principal two years after the completion of the approved investment plan.¹¹⁵ The determination of the total amount of the so-called "invested principal" is based on the total amount of equity investment, consisting of cash and properties such as equipment and machinery.¹¹⁶ The foreign joint venturer is permitted to repatriate only his original capital and remit only his share of the profits.¹¹⁷ The right to repatriate capital and earnings is granted only to the foreign investor; the joint venture company does not enjoy these privileges. It is important to note that because of the prohibition against transferring the shares paid by capitalized patent rights and the limitation imposed on the transfer of shares paid by capitalized technical know-how, the 15 percent annual remittance of total capital is not applicable to that portion of capital based on these capitalizations.

Foreign exchange restrictions often present difficult problems to the foreign party in a joint venture operation since the determination of what constitutes foreign exchange and how it is restricted is highly involved. Moreover, government policies play an important role in foreign exchange restriction issues. In addition to penalties provided by the Statute for Foreign Exchange Control, violation of foreign exchange restriction may constitute violation of the National Mobilization Law. The penalty is very severe.¹¹⁸

Taxation

Tax benefits provided under the Statute for Encouragement of Investments are enticing to the joint venturer. It may be noted that a five year tax holiday on the Business Income Tax (sometimes known as the Profit-Seeking-Enterprise Income Tax) is provided by the Statute for Encouragement of Investment, while the Statute for Investment by Foreign Nationals

¹¹⁵ *Id.*

¹¹⁶ *Id.*, Article 3.

¹¹⁷ The remittance of capital will only occur after the assets of the invested company have been transferred.

¹¹⁸ Statute for Exchange Control, as promulgated on December 24, 1970, Articles 19, 20, 21, 22, 23, 24, 25 and 26. The Former Regulation Governing Foreign Exchange, as issued by the Executive Yuan was thereafter superseded by the Statute for Exchange Control.

By order of the Executive Yuan on April 11, 1958, foreign currencies or foreign exchange are designated as "general mobilization commodities" as prescribed under Clause 9, Article 3 of the National General Mobilization Law. According to the stipulation of Clause 1, Article 7 of the National General Mobilization Law, buying and selling freely or transfer of foreign exchange is prohibited. Violators shall be punished in accordance with Item 2 of Clause 1, and Clause 2 of Article 5 and Article 7 of Temporary Rules Governing Penalties for Violation of the National General Mobilization Law.

only provides the privilege of remittance of foreign exchange on earnings and capital.¹¹⁹ Therefore, in preparing an investment application, it is vital to request the granting of privileges and benefits provided by both the Statute for Encouragement of Investment and the Statute for Investment by Foreign Nationals. On the other hand, if the foreign venturer does not intend to make his investment as a foreign investment under the Statute for Investment by Foreign Nationals, it is unnecessary for the foreign venturer to himself obtain government approval in order to enjoy the tax benefit provided by the Statute for Encouragement of Investment; it is for the company to do so.¹²⁰ In this case, the foreign venturer may enjoy the tax exemptions and accumulate his profits in New Taiwan Dollars, but he will not be able to remit them from the Republic of China.

An important aspect of Chinese taxation relevant to a foreign-local joint venture operation is taxation of a foreign party to a joint venture operation. First, if the company wishes to enjoy all the benefits under the Statute for Encouragement of Investment, the enterprise must be in the form of a "Company Limited by Shares."¹²¹ Secondly, a foreign joint venture party within the joint venture company is not treated separately from the company. The joint venture company is taxed as an entity. The only possible difference between a foreign party and a local party is that the foreign party may remit his earnings and capital (if he sold his shares) out of the Republic of China provided that approval of investment under the Statute for Investment by Foreign Nationals is granted. The amount he may remit is, of course limited to his share of the profits.

Note that all tax exemptions and benefits only apply to the company, while individual shareholders of the joint venture company still must pay an individual income tax. American companies may credit any Chinese income tax paid or accrued against its U.S. income tax under IRC §904 and Reg. 1.904-1.¹²²

¹¹⁹ The privileges provided under the Statute for Encouragement of Investments are granted to the newly formed joint-venture company. These privileges accrue to the invested company not to the investing company. The privileges of repatriation as provided under the Statute for Investment by Foreign Nationals belong to the investor or investing company. See Statute for Encouragement of Investment, Article 5, as amended, on January 4, 1965, and Statute for Investment by Foreign Nationals, Article 12, as amended, on December 14, 1959.

¹²⁰ *Id.*

¹²¹ Statute for Encouragement of Investment, Article 3, as amended, January 4, 1965. The Statute for Investment by Foreign Nationals does not stipulate in what form the invested enterprise must be.

¹²² INT. REV. CODE of 1954, § 904; Treas. Reg. § 1.904-1 (1964).

In 1972, the Chinese Government decided to eliminate the pre-withholding of income tax on undistributed earnings. Since the undistributed earnings of a joint venture company are no longer subject to the withholding of a 10 percent income tax, the disadvantage formerly encountered by the joint venture operation in the expansion of enterprise is no longer in existence. With this development, foreign investors may be more willing to reinvest their investment earnings in the expansion of the joint venture operation.

Some potential disputes in a joint venture

Besides the major problems such as management and control in an operation as sophisticated and complex as a foreign-local joint venture, there exists the possibility of future conflicts. The following is by no means an exhaustive list.

Fertile ground for conflict is typified by one member of the joint venture party deciding to compete with the joint venture company. To prevent this, a covenant not to compete may be inserted in the joint venture agreement. This may read as follows: "X Party shall not at any time after the conclusion of the agreement be engaged in or have an interest, directly or indirectly, either by itself or in conjunction with any other person or persons, in any business in the Republic of China detrimental to the business then being carried on by Y."¹²³

Another possible item for dispute is the allocation of expenses incurred in preparing the joint venture agreement when the agreement fails to be concluded. Some advance arrangement as to the allocation will be helpful.

The assignment of the joint venture agreement by one joint venture party to a third party could also cause disputes between the original parties. A non-assignment clause would eliminate the problem.

The joint venturer's responsibility for obtaining government approvals, permits, authorizations, and other requirements should be explicitly agreed upon by the parties concerned. Also, it would be wise to insert a provision stating that the agreement is valid only if the necessary documents are obtained.

¹²³ First paragraph of Article 209 of the Company Law provides "A director who engages anything for himself or on behalf of another person that in within the scope of the company's business, shall explain to the meeting of shareholders the essential contents of such act and secure its approval." Article 32 of the Company Law provides:

"Managerial officer shall not concurrently be managerial officer of other profit-making enterprises and shall not engage in the same kind of business either for himself or on behalf of others, unless otherwise agreed upon by a majority of executive shareholders or directors."

The control of certain trade secrets is also of great concern to the joint venture parties and disputes in this regard are always likely to arise when the mutual trust and good faith between these parties diminish. Again, preventive draftsmanship must be employed.

How would a loan from abroad affect a joint venture operation?

From time to time, a joint venture operation needs financing from either domestic or foreign sources. If a lender from abroad does not expect repayment in foreign currency, the loan would not require any Government approval. The amount loaned would stay in Taiwan since the repayment could only be made in local currency.

On the other hand, if the loan from abroad is expected to be repayed in foreign currency, then Chinese government approval of the loan is necessary under Chinese law.¹²⁴ Such loans are usually treated in two different ways. First, a straight loan must be approved by the Central Bank of China. Once such approval is obtained, the borrower has the right to remit the loan amount and interest earned from the Republic of China in foreign currency.

The Central Bank of China recently adopted measures against inflation limiting loans from abroad.¹²⁵ Such measures are based on the following guidelines:

- (1) The maximum amount of the loan is \$5,000,000 and the minimum is \$10,000;
- (2) The purpose of such loan is limited to the purchase of equipment, machinery and raw materials from abroad for the local productive enterprises;
- (3) The period for the loan is from two years to seven years.¹²⁶

However, it is anticipated that once the trend of inflation is over, such restrictions will be lifted by the government. Secondly, if the loan is to be treated as investment, then a foreign investment application must be filed pursuant to the Statute for Investment by Foreign Nationals.¹²⁷ In this instance, it is the lender (or the foreign joint venture party) who files the

¹²⁴ Measures Governing the Obtaining of Loans from Abroad by Productive Enterprises, Article 1, promulgated by the Central Bank of China on November 13, 1970.

¹²⁵ The inflow of foreign currency by way of loans requires the issuance of more local currency, since all inward remittances in foreign currency have to be sold to the government appointed bank.

¹²⁶ Measures Governing Productive Enterprises to Obtain Loans From Abroad, Articles 3, 4, 5; issued by the Central Bank of China, November 13, 1970; see also China Times, November 14, 1970, at 7.

¹²⁷ Statute for Investment by Foreign Nationals, Article 12, as amended, December 14, 1959.

investment application. When approval is granted, it is the lender who obtains the privilege to repatriate the repayment of his loan investment when it is due.¹²⁸

V. CONCLUSION

A joint venture between a Chinese and a foreign venturer is a valiant undertaking considering the differences in law, in environment, and most importantly, in concepts. It is thus safe to assume that some tribulations have been experienced by both local and foreign parties during the early phases of joint venture operations in the Republic of China. But in general, joint ventures in the Republic of China have worked out satisfactorily, often with the blessing of the government. Nevertheless, there have been some unpleasant experiences. The most severe cases have involved foreign parties with dominant economic power who have controlling interest in the joint venture. Because of their majority interest, they have managed to have resolutions adopted at shareholders' meetings increasing the capital. The local party lacked the economic power to catch up and was eventually squeezed out.

But on the whole, there are encouraging signs for the future of joint ventures in the Republic of China, especially since the government is now very concerned about local participation in the newly established industries. Therefore, a joint venture proposal is likely to obtain government approval.

As a final word, we suggest that in the case of a foreign investor who only intends to invest a relatively small amount of capital and is not involved in a sophisticated technical field, it would be advisable for him to create a joint venture with a local party. Otherwise, it would be difficult to obtain the required government approval. If a foreign investor intends to invest a substantial amount of capital and assures a foreign market for his product, the government still looks upon his establishing a wholly-owned subsidiary in a favorable light.

¹²⁸ *Id.*

