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## CHINA'S FOREIGN INVESTED PARTNERSHIP ENTERPRISE LAW: THE LIFELESS OR SLEEPING DRAGON?

Samuel H. Shaddox<sup>†</sup>

*Abstract:* Investors and the Chinese government tout the March 2010 authorization of the Foreign Invested Partnership as an exciting new method for foreign investment in China. However, this comment argues that the Foreign Invested Partnership is not likely to become a vibrant short or long-term platform for foreign direct investment. The historical trends of China's three other vehicles for foreign direct investment from 1979 to the present provide two key conclusions. First, foreign investors will not utilize Foreign Invested Partnerships until they receive detailed implementing regulations from China's central government. Second, support or restrictions from the Chinese government can drive or inhibit use of an investment vehicle. China's Foreign Invested Partnership lacks detailed regulations, and is also not likely to receive them in the future because of increased involvement with local authorities. Additionally, it is not likely to receive support from the Chinese government because of lingering suspicions of the partnership enterprise and an ongoing political transition. Because foreign investors will shy away from this unpredictability, the Foreign Invested Partnership is not likely to be widely utilized in the short or long term. The author recommends that Foreign Invested Partnership proponents overcome these hurdles by pushing for detailed, favorable regulations for equity investment-focused Foreign Invested Partnerships.

### I. INTRODUCTION

Partnerships were once commonplace in China.<sup>1</sup> In fact, many Chinese still refer to friends with full confidence in one another as a friendship between Guan and Bao, a reference to a business partnership from feudal times.<sup>2</sup> During the middle of the twentieth century, partnerships fell into complete disfavor with China's socialized economy and were essentially forgotten as a business entity.<sup>3</sup>

After slowly easing restrictions on domestic partnerships during the last fifteen years,<sup>4</sup> China authorized the Foreign Invested Partnership ("FIP")

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<sup>1</sup> Fang Liufang, *Chinese Partnership*, 52(3) LAW & CONTEMP. PROBS. 43, 43-47 (Xia Yuantao, Sang Binxue & Danian Zhang trans., 1989).

<sup>2</sup> *Id.*

<sup>3</sup> *Id.*

<sup>4</sup> JAMES ZIMMERMAN, CHINA LAW DESKBOOK: A LEGAL GUIDE TO FOREIGN INVESTED ENTERPRISES 92-105 (3d ed. 2010).

in March of 2010. Authoritative texts hail FIP as a promising development for foreign investors.<sup>5</sup> According to the Chinese government, the law was designed to “build . . . a friendly environment for foreign companies and individuals [for] establishing partnership enterprises in China.”<sup>6</sup>

Foreign direct investment has grown remarkably since China opened to it in 1979.<sup>7</sup> During the 1980s investment in China grew at an annual rate of about \$1.6 billion USD before accelerating rapidly during the 1990s and 2000s.<sup>8</sup> During the first six months of 2012, China received \$59 billion in investments, making it the world’s largest recipient of foreign direct investment, while the United States, the second largest recipient, received \$57.4 billion.<sup>9</sup>

However, foreign direct investment in China has fallen over the past year, a trend that analysts expect will continue at a much greater rate during the next year.<sup>10</sup> In response to this decline, the Chinese government has taken numerous measures to reverse the trend.<sup>11</sup> Left undefined is the role FIP will play within this recovery.

The FIP joins three pre-existing foreign direct investment vehicles: the equity joint venture (“EJV”), authorized in 1979;<sup>12</sup> the wholly foreign-owned enterprise (“WFOE”), authorized in 1986;<sup>13</sup> and the cooperative joint venture (“CJV”), authorized in 1988.<sup>14</sup> During the past thirty years, the percent-share of foreign direct investment between EJV, CJV, and WFOE has changed dramatically.<sup>15</sup> The recent approval of FIP makes it a natural vehicle for China to seek increased amounts of foreign direct investment.

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<sup>5</sup> *Id.* at 92–111.

<sup>6</sup> Laney Zhang, *China: Rules on Foreign Invested Partnerships*, LIBRARY OF CONGRESS (Dec. 7, 2009), [http://www.loc.gov/lawweb/servlet/lloc\\_news?disp3\\_l205401719\\_text](http://www.loc.gov/lawweb/servlet/lloc_news?disp3_l205401719_text).

<sup>7</sup> See K.C. FUNG, LAWRENCE J. LAU & JOSEPH S. LEE, *U.S. DIRECT INVESTMENT IN CHINA* 42–47 (2004) (chronicling the growth of foreign direct investment after 1979).

<sup>8</sup> VAI IO LO & XIAOWEN TIAN, *LAW AND INVESTMENT IN CHINA: THE LEGAL AND BUSINESS ENVIRONMENTS AFTER WTO ACCESSION* 100 (2005).

<sup>9</sup> Jack Perkowski, *China Leads in Foreign Direct Investment*, FORBES (Nov. 5, 2012), <http://www.forbes.com/sites/jackperkowski/2012/11/05/china-leads-in-foreign-direct-investment>.

<sup>10</sup> *China Foreign Investment Falls for 11th Time in 12 Months*, BLOOMBERG (Nov. 19, 2012), <http://www.bloomberg.com/news/2012-11-20/china-foreign-direct-investment-falls-for-11th-time-in-12-months.html>.

<sup>11</sup> *China to ‘simplify’ procedures for foreign investors*, BBC NEWS (Nov. 21, 2012), <http://www.bbc.co.uk/news/business-20440206>.

<sup>12</sup> JUN FU, *INSTITUTIONS AND INVESTMENTS: FOREIGN DIRECT INVESTMENT IN CHINA DURING AN ERA OF REFORMS* 27 (2000).

<sup>13</sup> *Id.* at 48.

<sup>14</sup> PHILLIP DONALD GRUB & JIAN HAI LIN, *FOREIGN DIRECT INVESTMENT IN CHINA* 67 (1991).

<sup>15</sup> FU, *supra* note 12, at 10.

However, this comment argues that it is unlikely that a significant number of foreign investors will be interested in playing out a modern day Guan and Bao through the formation of an FIP. Part II of this comment analyzes China's foreign direct investment patterns and concludes that FIP utilization by foreign investors will depend on authorization by the government of detailed implementing regulations. Additionally, the historical trends indicate that FIP will fail if the Chinese government does not provide support. Part III of this comment argues that FIP is unlikely to receive detailed implementing regulations, which will limit its adoption with foreign investors. Similarly, China's historical suspicion of partnerships and an ongoing political transition suggest FIP will not receive government support. Part IV concludes that FIP's best chance of becoming a vibrant investment vehicle is through development of detailed implementing regulations for a specific category of foreign direct investment: equity investments.

## II. THE FIP IS BORN

In 2007, the Chinese government stated that rules regarding FIPs would be issued at a future date by the State Council.<sup>16</sup> In considering authorization of FIP, the government faced an important challenge. Were they to make FIP too advantageous as an investment vehicle, large-scale abandonment of the other foreign direct investment vehicles could ensue.<sup>17</sup> But of course, FIP had to include some advantages over other investment vehicles or foreign investors would not utilize it.<sup>18</sup>

Between 2007, when the Chinese government indicated that rules regarding FIP were forthcoming and the 2009 authorization, the government considered two potential FIP laws. The first was created by the Ministry of Commerce and was highly restrictive.<sup>19</sup> It required central approval for both levels of capital investment and all amendments to partnership agreements.<sup>20</sup> The second model, authored by the State Council Legislative Affairs Office,

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<sup>16</sup> Partnership Enterprise Law of the People's Republic of China, ch. VI, art. 108 (promulgated by the Standing Comm. Of the Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020061018643910006967.pdf](http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020061018643910006967.pdf).

<sup>17</sup> Wei Cui, *Will Partnership Law Be Worth It?*, 27 INT'L FIN. L. REV. 30 (2008).

<sup>18</sup> *Id.* at 31.

<sup>19</sup> *Id.* at 30.

<sup>20</sup> *Id.*

was less restrictive; it did not have any limits on capital structure and did not require approval of changes in partnership structure.<sup>21</sup>

The law adopted by the government was more restrictive because it required an application for and approval of any changes in the partnership structure of the firm.<sup>22</sup> As one commentator notes, this requirement throws the essence of a partnership “out the window” by requiring that the government itself be an indispensable partner and giving it the final say in any major partnership decision.<sup>23</sup>

China tempered this considerable limitation by providing several incentives for foreign investors. First, it did not require an initial capital investment or subsequent modification within the FIP regulations beyond the general foreign investment enterprise requirement of thirty-thousand RMB.<sup>24</sup> Additionally, other foreign investment enterprises have required registered capital, normally \$100,000 USD, depending on the business plan, fifteen percent of which must be contributed within three months of the business license issuance, and the remainder within two years.<sup>25</sup> An FIP does not have to meet either of these requirements.<sup>26</sup> In addition, foreign investors have the ability to better control investments with Chinese partners in an FIP than in a joint venture.<sup>27</sup>

The FIP has several other advantages that foreign investors should consider. First, an FIP, unlike other foreign investment enterprises, is not required to publicly announce its formation, provide guarantees to investors, or acquire approval from the government when decreasing capital.<sup>28</sup> Second, unlike the other foreign investment enterprises, an FIP is not required to make up for accumulated losses or allocate reserve funds from its profit until the statutory reserve fund reaches fifty percent of the foreign

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<sup>21</sup> *Id.*

<sup>22</sup> See Administrative Provisions on the Registration of Foreign Invested Partnership Enterprises Decree of the State Administration for Industry and Commerce, No. 47, ch. 3, arts. 21–30 (promulgated by the State Admin. for Indus. & Commerce, Jan. 29, 2010, effective Mar. 1, 2010) (China), *translated in* 24(3) CHINA L. & PRAC. 41–42 (Apr. 2010).

<sup>23</sup> Cui, *supra* note 17, at 30.

<sup>24</sup> See Administrative Provisions on the Registration of Foreign Invested Partnership Enterprises Decree of the State Administration for Industry and Commerce, No. 47, ch. 2–3 (promulgated by the State Admin. for Indus. & Commerce, Jan. 29, 2010, effective Mar. 1, 2010) (China), *translated in* 24(3) CHINA L. & PRAC. 41–42 (Apr. 2010).

<sup>25</sup> *China's Latest Partnership Investment Vehicle for Foreign Investors*, SALANS, <http://www.salans.com/~media/Assets/Salans/Publications/1006%20Salans%20Foreign%20Invested%20Partnership%20Enterprise%20Alert%20En.ashx> (last visited Dec. 18, 2011).

<sup>26</sup> *Id.*

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

investment enterprise's capital.<sup>29</sup> Third, unlike CJVs or EJVs, which prevent complete foreign control because of their governance structures, FIPs may designate its Chinese partners as limited partners, which results in greater control for the foreign investor.<sup>30</sup>

In addition to its benefits, FIP is also subject to many of the limitations common amongst other foreign investment enterprises. These limitations are applied more strictly against FIP. Like all forms of foreign investment enterprise, FIP is governed by the 2012 Foreign Investment Industrial Guidance Catalogue (“Catalogue”).<sup>31</sup> The Catalogue has three different categories: encouraged, restricted, and prohibited.<sup>32</sup> These are defined according to industry fields and subcategories within each industry.<sup>33</sup> The Catalogue is especially limiting regarding FIP, prohibiting its use in 1) any industry prohibited to foreigners, 2) any industry which is open to only EJVs and CJVs, 3) any industry which is only open to a project with either absolute or relative controlling Chinese shareholders, and 4) any industry which requires a specific shareholding ratio of foreign investors in a project.<sup>34</sup> This indicates that the Chinese government intends to more severely limit FIP *vis-à-vis* other vehicles for foreign direct investment.

Compounding these restrictions is an absence of detailed implementing regulations for FIP. Investors have universally called for the development of regulations that will provide foreign investors with an understanding of the regulatory treatment of FIP.<sup>35</sup> Nevertheless, language from a 1990 analysis of the legal framework for foreign investments remains accurate concerning the new FIP law and regulations: the “[l]aws and regulations are couched in broad, ambiguous and sometimes conflicting terms, leaving local or central implementing agencies a wide scope for

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<sup>29</sup> *Id.*

<sup>30</sup> *Id.*

<sup>31</sup> See Administrative Provisions on the Registration of Foreign Invested Partnership Enterprises Decree of the State Administration for Industry and Commerce, No. 47 (promulgated by the State Admin. for Indus. & Commerce, Jan. 29, 2010, effective Mar. 1, 2010) (China), *translated in* 24(3) CHINA L. & PRAC. 41–42 (Apr. 2010); Catalogue for the Guidance of Foreign Investment Industries (Amended 2011), Decree of the State Development and Reform Commission, the Ministry of Commerce of the People's Republic of China, No. 57, ch. 1, art. 3 (promulgated by the State Council, Oct. 31, 2007, effective Dec. 1, 2007).

<sup>32</sup> Catalogue for the Guidance of Foreign Investment Industries (Amended 2011), Decree of the State Development and Reform Commission, the Ministry of Commerce of the People's Republic of China, No. 57 (promulgated by the State Council, Oct. 31, 2007, effective Dec. 1, 2007).

<sup>33</sup> *Id.*

<sup>34</sup> *China's Latest Partnership Investment Vehicle for Foreign Investors*, *supra* note 25, at 5.

<sup>35</sup> *Id.* at 12; Alan Wang & Chen Yong, *Foreign-invested Partnership Regulations: Radical Reform or Unmet Expectations?*, 24(1) CHINA L. & PRAC. 17 (Feb. 2010).

interpretation and leading to inconsistent treatment.”<sup>36</sup> Foreign investors seek a determinacy that Chinese regulation has consistently refused to give FIP.

The FIP law lacks detailed implementing regulations and appears to be restricted by the Chinese government. In order to determine the significance of these two factors, this comment analyzes the impact of vague regulations and government support on the other three modes of foreign direct investment in China.

### III. THE DIFFICULT PATH OF FOREIGN INVESTMENT ENTERPRISES IN CHINA INDICATES TROUBLE FOR FIP

In 1978, China adopted the open door policy that invited substantial foreign participation and investment in its economy for the first time since the Chinese civil war.<sup>37</sup> Over the following thirty years, China implemented three principal foreign investment enterprises in an effort to secure foreign direct investment, complete with a body of law distinct from existing domestic rules.<sup>38</sup> The history of these previously enacted foreign investment enterprises indicate that FIP will have difficulty becoming a viable direct investment platform for western investors.

The first approved method of foreign direct investment was equity joint venture (“EJV”) which was officially authorized on July 8, 1979.<sup>39</sup> Typically, an EJV is a limited liability company established by two or more partners in which parties are liable for losses and share profits according to their respective equity interest.<sup>40</sup> This fixed, inflexible ratio of profit and loss sharing between the partners is the defining characteristic of EJV.<sup>41</sup>

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<sup>36</sup> Zafar Khan, *Patterns of Direct Foreign Investment in China*, 120 WORLD BANK DISCUSSION PAPERS 27 (1991).

<sup>37</sup> FENG LI & JING LI, *FOREIGN INVESTMENT IN CHINA* 5 (1999).

<sup>38</sup> WILLIAM B. GAMBLE, *INVESTING IN CHINA: LEGAL, FINANCIAL AND REGULATORY RISK* 155 (2002).

<sup>39</sup> Xiaoguang Zhang, *Foreign Investment Policy, Contribution and Performance*, in *FOREIGN DIRECT INVESTMENT AND ECONOMIC GROWTH IN CHINA* 11, 13 (Yanrui Wu ed., 1999); LI & LI, *supra* note 37, at 54.

<sup>40</sup> See Law of the People’s Republic of China on Chinese-Foreign Contractual Joint Ventures, Order of the President of the People’s Republic of China (promulgated by the Standing Comm. Nat’l People’s Cong., Oct. 31, 2000, effective Oct. 31, 2000), available at [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/law\\_en\\_info.jsp?docid=51032](http://www.fdi.gov.cn/pub/FDI_EN/Laws/law_en_info.jsp?docid=51032). For a detailed description of the Cooperative Joint Venture in China, please refer to ZIMMERMAN, *supra* note 4.

<sup>41</sup> Zhou Ziya, *A Comparative Study of Three Kinds of Enterprise Involving Foreign Investment in China*, in *LEGAL ASPECTS OF FOREIGN INVESTMENT IN THE PEOPLE’S REPUBLIC OF CHINA* 110-11 (William Tai ed., China Trade trans., 1988).

China next authorized wholly foreign-owned enterprise (“WFOE”) in 1986. An WFOE is a limited liability company that is one-hundred percent foreign-owned in which a foreign party’s liability is limited to its contributed investment.<sup>42</sup> Accordingly, the largest advantage of a WFOE is the ability of the foreign party to manage and operate the enterprise as desired, without the involvement of a Chinese partner.<sup>43</sup> The lack of a Chinese partner, however, can be a disadvantage because it increases the importance of the foreign entity’s familiarity with Chinese culture and business practices.<sup>44</sup>

China approved the cooperative joint venture (“CJV”) through formal legislation in April of 1988.<sup>45</sup> It is also known as the “contractual joint venture”<sup>46</sup> because the main terms and conditions of cooperation are established in the joint venture contract itself.<sup>47</sup> Therefore, a CJV, unlike an EJV, does not require investment partners to assume risk or share profits according to their respective capital contribution.<sup>48</sup> Instead, risk and profit ratios are established in the initial contract between the parties.<sup>49</sup>

*A. Existing Foreign Investment Enterprises Struggled Initially Because of Regulatory Uncertainty*

Historic foreign direct investment trends in China indicate that FIP needs detailed implementing regulations before foreign investors will widely adopt it. Each of the precursor investment vehicles floundered in the years between their adoption and government regulation. Without the Chinese government clearly indicating the limitations of an investment method, foreign investors were essentially asked to take on substantial risk and hope legal challenges were not forthcoming. The 1979 approval of EJV established a pattern of authorizing laws that speak only in very broad terms

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<sup>42</sup> ZIMMERMAN, *supra* note 4, at 85.

<sup>43</sup> GRUB & LIN, *supra* note 14, at 72.

<sup>44</sup> HAISHUN SUN, FOREIGN INVESTMENT AND ECONOMIC DEVELOPMENT IN CHINA: 1979–1996 51 (1998).

<sup>45</sup> See PRC, *Sino-Foreign Cooperative Joint Venture Law* (Promulgated by the Nat. People’s Cong., Apr. 13, 1988), translated in 2(4) CHINA L. & PRAC. 41–42 (May 1988).

<sup>46</sup> Lutz-Christian Wolff *China’s Private International Investment Law: One-Way Street into PRC Law?*, 56 AM. J. COMP. L. 1039, 1042 (2008) (citing Clark T. Randt Jr., *Joint Ventures*, in DOING BUSINESS IN CHINA 1–3, § 2.02 [4]; OWEN D. NEE JR., SHAREHOLDER AGREEMENTS AND JOINT VENTURES IN CHINA 65 (2005)).

<sup>47</sup> Wolff, *supra* note 46, at 1042.

<sup>48</sup> YUWA WEI, INVESTING IN CHINA 74–76 (2000).

<sup>49</sup> GRUB & LIN, *supra* note 14, at 67.



regarding the enterprises they legalize.<sup>50</sup> The 1979 act is best viewed as an “enabling act, leaving specific details and programs to be worked out either in regulations or the joint venture documents.”<sup>51</sup> The act was simply a three page authorizing statute without any specific provisions, regulations, or guidelines for implementation.<sup>52</sup> The simple, limited nature of the enabling act for EJV contributed to low utilization rates, but implementing regulations were not issued until four years later.<sup>53</sup>

Similarly, China approved WFOE in April of 1986, but it was again merely an authorizing law.<sup>54</sup> The lack of implementing regulations placed one-hundred percent of WFOE risk creation on the foreign investor, who was forced to guess whether an investment would run into legal challenges.<sup>55</sup> Yet, China took two years to issue detailed implementing regulations for WFOE.<sup>56</sup>

The CJV faced similar regulatory uncertainty. When it was authorized in 1988, its viability was limited, especially for multinational companies that, as a matter of practice, required certainty and predictability to make large investments.<sup>57</sup> Despite the need to ameliorate CJV’s lack of certainty and predictability, China’s government did not issue detailed regulations until seven years after CJV’s initial approval.<sup>58</sup>

The FIP is following a similar pattern to EJV, WFOE, and CJV. It lacks detailed implementing regulations. This deficiency, similar to those investment vehicles, will likely contribute to low utilization rates by foreign investors.

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<sup>50</sup> Eileen Golden, *People’s Republic of China—1983 Joint Venture Implementing Regulations—The Supplement of Detail, In An Attempt to Attract Foreign Investment*, 15 GA. J. INT’L & COMP. L. 389, 393 (1985) (noting that the initial approval of the EJV lacked accompanying specific regulations).

<sup>51</sup> William Alford & David Birenbaum, *Ventures in the China Trade: An Analysis of China’s Emerging Legal Framework for the Regulation of Foreign Investment*, 3 NW. J. INT’L L. & BUS. 56, 71–72 (1981).

<sup>52</sup> *Id.*

<sup>53</sup> Crawford Brickley, *Equity Joint Ventures in the People’s Republic of China: The Promised Land Not Yet in Sight for Foreign Investors*, 10 U. PA. J. INT’L BUS. L. 257, 260 (1988).

<sup>54</sup> Z.Y. James Fang & David K.Y. Tang, *The Wholly Foreign-Owned Enterprise Law: Defining the Legislative History and Interpreting the Statute*, 2 J. CHINESE L. 153, 153 (1988).

<sup>55</sup> GRUB & LIN, *supra* note 14, at 80.

<sup>56</sup> See *Foreign Direct Investment in China*, U.S.–CHINA BUS. COUNCIL, [http://www.uschina.org/statistics/fdi\\_cumulative.html](http://www.uschina.org/statistics/fdi_cumulative.html) (last visited Jan. 2, 2012) (showing that WFOE utilization by foreign investors accelerated after promulgation of implementation regulations).

<sup>57</sup> *Editors’ Notes*, 9(9) CHINA L. & PRAC. 32, 32 (1995).

<sup>58</sup> KUI HUA WANG, CHINESE COMMERCIAL LAW 115 (2000).

B. *Government Support Was a Significant Contributor to the Relative Success of EJV, WFOE, and CJV*

Government support and regulation of EJV, WFOE, and CJV determined the degree to which investors utilize them. EJV flourished under substantial government backing, while both WFOE and CJV were hampered by excessive restrictions. The fate of FIP will similarly be determined by the balance between government support and regulation.

The presence of government support is even more critical when one considers that written laws and regulations often diverge substantially from how they are applied.<sup>59</sup> A governmental agency can trump any right guaranteed to a corporation by the law and the Constitution.<sup>60</sup> The Communist Party in China drives part of the divergence between written and applied laws, creating changes that are frequent and substantial enough to effectively repeal existing laws.<sup>61</sup> For example, a local government can require a corporation to submit a monetary contribution that is expressly prohibited by law.<sup>62</sup> In this example, the foreign investor would have to cope with unexpected costs and might be deterred from continuing the investment. Yet variance from written laws cuts both ways, as government agencies often choose not to enforce laws unfriendly to certain forms of foreign investment, especially in the case of local governments seeking capital.<sup>63</sup>

China's inconsistent treatment of foreign investors is also guided by market concerns. For example, China implemented an austerity program in 1989 and 1990 that resulted in massive losses for foreign investment firms and strong government pressure against certain business practices that the government had previously guaranteed as protected.<sup>64</sup> The result was that many joint venture firms scaled back production considerably.<sup>65</sup>

It is clear that the Chinese government can essentially control, through its own preferences, the success or failure of a given investment vehicle through both official and unofficial means. Government support was a

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<sup>59</sup> Anyuan Yuan, *Foreign Direct Investment in China—Practical Problems of Complying with China's Company Law and Laws for Foreign-Invested Enterprises*, 20 NW. J. INT'L L. & BUS. 475, 482 (2000).

<sup>60</sup> *Id.*

<sup>61</sup> *Id.*

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> GRUB & LIN, *supra* note 14, at 91.

<sup>65</sup> *Id.* at 209.

critical factor in the relative historical utilization of EJV, WFOE, and CJV by foreign investors.

During the first four years following approval of EJV, only eighty-nine joint ventures were approved.<sup>66</sup> This led the Chinese government to make significant revisions to EJV in 1983 with the goals of “enabl[ing] the existing Chinese-foreign joint ventures to be run more successfully and . . . attract[ing] more foreign investors . . . to establish new joint ventures.”<sup>67</sup> Notably, the purpose of these modifications was not to make the economy more liberal, but simply to clarify the existing regulations in order to encourage greater confidence amongst foreign investors.<sup>68</sup> The revised regulations provided detailed rules regarding organizational governance, registration, capitalization, management, taxation, and labor relations.<sup>69</sup>

As a result, foreign firms grew more interested in EJV in China.<sup>70</sup> Approved EJVs spiked to 279 between January 1983 and June 1984, and totaled 741 for 1984.<sup>71</sup> Yet, by 1986 foreign investment in China had dropped precipitously due to widespread recognition of legal difficulties, again disappointing both foreign investors and China’s government.<sup>72</sup> In 1990, reacting to foreign investors’ skepticism, China amended the joint venture law.<sup>73</sup> Most importantly, China eased onerous regulations that severely restricted the ability of a foreign investor to control a joint venture.<sup>74</sup> China also relaxed restrictions on the life span of joint ventures and the ability of foreign ventures to swap foreign exchange currencies among themselves.<sup>75</sup> After these modifications, EJV became the most utilized and prominent form of direct investment in China.<sup>76</sup> EJV remains popular because it has the longest track record (in terms of development and interpretation) of any foreign investment enterprise, offering an important measure of predictability.<sup>77</sup>

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<sup>66</sup> Brickley, *supra* note 53.

<sup>67</sup> MARGARET PEARSON, JOINT VENTURES IN THE PEOPLE’S REPUBLIC OF CHINA: THE CONTROL OF FOREIGN DIRECT INVESTMENT UNDER SOCIALISM 73 (1991) (quoting Yuan Mu, State Council spokesman (1983)).

<sup>68</sup> *Id.*

<sup>69</sup> See Golden, *supra* note 50, at 391-401.

<sup>70</sup> Li & Li, *supra* note 37, at 60.

<sup>71</sup> *Id.*

<sup>72</sup> Brickley, *supra* note 53, at 260-62.

<sup>73</sup> Zhang, *supra* note 39, at 15; Barbara Potter, *China’s Equity Joint Venture Law: A Standing Invitation to the West for Foreign Investment?*, 14 U. PA. J. INT’L BUS. L. 1, 27 (1993-94).

<sup>74</sup> Zhang, *supra* note 39, at 15.

<sup>75</sup> *Id.* at 15-16.

<sup>76</sup> Khan, *supra* note 36, at 36 (noting general investment patterns generally).

<sup>77</sup> Clark T. Randt, Jr., *Joint Ventures*, in 2 DOING BUSINESS IN CHINA II-2.1, § 2.02[2] (Michael J. Moser & Fu Yu eds., 2011).

Despite its evolution, investors have increasingly turned away from EJV and relied more heavily on WFOE for five reasons. First, many high profile joint ventures failed due to partnerships with inefficient and large PRC state enterprises.<sup>78</sup> Second, cultural differences sometimes resulted in the Chinese partner failing to act as expected.<sup>79</sup> Third, some foreign investors failed to select appropriate Chinese entities and partners for their investments.<sup>80</sup> Fourth, EJV regulations required technology transfers between the foreign entity and Chinese partner, which threatened to compromise foreign investors' trade secrets.<sup>81</sup> And finally, over time investors grew more comfortable investing without a Chinese partner.<sup>82</sup> Many of the reasons that led investors away from EJV will also deter foreign investors from an FIP with a Chinese partner.

The WFOE, in contrast to EJV, was not initially favored by China after it was approved in 1986.<sup>83</sup> The Chinese government barred WFOEs from certain industries and severely limited domestic sales of WFOE products.<sup>84</sup> China did not prefer WFOE because of a direct conflict with the socialist principle of public ownership.<sup>85</sup> Additionally, unlike joint ventures, in a WFOE there is no Chinese partner that benefits from foreign expertise and capital.<sup>86</sup>

Yet, over time China eased key WFOE restrictions. Important to the deregulation trend were the positive policy changes by the Chinese government, including removing unfavorable WFOE-specific tax provisions.<sup>87</sup> In 2001, additional barriers were removed as part of China's ascension to WTO membership.<sup>88</sup> This external pressure helped build even further momentum for WFOE.<sup>89</sup> WFOE's share of foreign investment enterprises increased from approximately ten percent in the late 1980s, to fifty percent by 2000, to almost eighty percent today.<sup>90</sup>

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<sup>78</sup> GAMBLE, *supra* note 38, at 158.

<sup>79</sup> *Id.*

<sup>80</sup> *Id.*

<sup>81</sup> WANG, *supra* note 58, at 130.

<sup>82</sup> Randall Peerenboom, *Wholly Foreign Owned Enterprises*, in 2 DOING BUSINESS IN CHINA II-3.2, § 3.01 (Michael J. Moser & Fu Yu eds., 2011).

<sup>83</sup> See Potter, *supra* note 73, at 13.

<sup>84</sup> Zhang Lixing, *The Statutory Framework for Direct Foreign Investment in China*, 4 FLA. INT'L L.J. 289, 293 (1988-1989).

<sup>85</sup> Fang & Tang, *supra* note 54, at 156-57.

<sup>86</sup> See Potter, *supra* note 73, at 13.

<sup>87</sup> SUN, *supra* note 44, at 23.

<sup>88</sup> Wolff, *supra* note 46, at 1043.

<sup>89</sup> David Boitout & Bastien Trelcat, *The Pros and Cons of Joint Ventures*, 25 INT'L FIN. L. REV. 87, 87 (2006).

<sup>90</sup> FUNG, LAU & LEE, *supra* note 7, at 48; *Foreign Direct Investment in China*, *supra* note 56.

In contrast to WFOE's mounting support, the Chinese government has not backed CJV. CJV was developed by investors as a response to restrictions placed by China on EJV.<sup>91</sup> Its three comparative advantages were 1) no requirement of substantial investment by the Chinese partner, 2) flexible profit disbursement that allowed for reinvestment of capital, and 3) investment certainty for both the Chinese and foreign investor.<sup>92</sup> Prior to the 1988 approval of CJVs, it was already more popular than EJV: over five-thousand similar arrangements had been approved without the official legal framework.<sup>93</sup>

Following the Chinese government's initial approval in 1988, commentators were optimistic that CJV would become the dominant Chinese foreign investment enterprise:

It has been proved in practice that Chinese-foreign cooperative ventures, as compared with Chinese-foreign joint ventures, are more flexible, more suitable for the conditions of China, where both capital and technology are inadequate, and they embody more favourable terms and conditions for foreign investors. Therefore, they are readily accepted by Chinese and foreign parties and have become the best way to introduce and make use of foreign capital in China.<sup>94</sup>

Having noted these advantages, Zhang Jielin, author of the above quoted passage and then-deputy director of the Institute of Legal Research for the Academy of Social Sciences of Guangdong Province, concluded that the central government needed to pass laws and regulations necessary to provide predictability in order for CJV to become a vibrant foreign investment enterprise.<sup>95</sup> As noted above, it took Beijing seven years to provide this framework.<sup>96</sup> Ambiguities in the 1995 Rules were subsequently addressed with another regulatory update in October of 1996.<sup>97</sup>

Even after the development of detailed regulations, CJV continues to decrease in popularity as an investment vehicle, primarily because it lacks a

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<sup>91</sup> Wolff, *supra* note 46, at 1047-48.

<sup>92</sup> Zhang Jielin, *The Rise of Chinese-Foreign Cooperative Ventures and Their Legal Characteristics*, in LEGAL ASPECTS OF FOREIGN INVESTMENT IN THE PEOPLE'S REPUBLIC OF CHINA 126, 127-29 (William Tai ed., China Trade trans., 1988).

<sup>93</sup> Zhang, *supra* note 39, at 15; Jielin, *supra* note 92, at 126.

<sup>94</sup> Jielin, *supra* note 92, at 126.

<sup>95</sup> *Id.* at 133.

<sup>96</sup> WANG, *supra* note 58.

<sup>97</sup> Hui Huang, *The Regulation of Foreign Investment in Post-WTO China: A Political Economy Analysis*, 23 COLUM. J. ASIAN L. 185, 192 (2009).

“clear and independent legal form” and receives less favorable policy treatment from China—including outright refusal by Beijing to implement certain key CJV features.<sup>98</sup> For example, the initial regulatory provisions for CJVs had more stringent requirements than EJVs.<sup>99</sup> The lack of regulatory promulgation following CJV authorization was also problematic, causing confusion regarding foreign investors’ rights, benefits, and obligations.<sup>100</sup> As a result, CJVs have fallen almost completely out of favor with foreign investors; in 2010, only three-hundred of the 27,406 foreign investment enterprise projects were CJVs, or just over one percent.<sup>101</sup> At their peak during the 1980s, CJVs accounted for nearly fifty percent of the foreign investment enterprise projects in China.<sup>102</sup>

The CJV remains a viable option primarily for those from cultures closely related to China, because, lacking a clear and independent legal form, it requires comfort and a working familiarity with Chinese culture and laws.<sup>103</sup> Accordingly, foreign investors from Hong Kong (pre-integration) utilized the CJV at a greater rate than investors with greater sociocultural differences with China.<sup>104</sup>

In reviewing the path of EJV, WFOE, and CJV, it is apparent that government support played a critical role in their development. Government support will similarly have a substantial impact on whether FIP is widely utilized by foreign investors.

#### IV. THE FIP ENTERPRISE IS NOT LIKELY TO BE WIDELY UTILIZED BY INVESTORS

Two pre-eminent scholars, Lieberthal and Oksenberg, found that policy-making in China is a highly fragmented process that requires system-wide active cooperation among bureaucrats.<sup>105</sup> This has three important implications for the development of sufficiently detailed FIP implementation regulations. First, the need for detailed implementing regulations must be pushed to the central government by interested stakeholders (e.g., foreign investors and provincial authorities), where high-level political actors can

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<sup>98</sup> SUN, *supra* note 44, at 48; Wolff, *supra* note 46, at 1042.

<sup>99</sup> *Editors' Notes*, 9(9) CHINA L. & PRAC. 32, 32 (1995).

<sup>100</sup> GRUB & LIN, *supra* note 14, at 68.

<sup>101</sup> *Foreign Direct Investment in China*, *supra* note 56 (statistics issued by the Ministry of Commerce of the PRC).

<sup>102</sup> FUNG, LAU & LEE, *supra* note 7, at 48.

<sup>103</sup> SUN, *supra* note 44, at 49.

<sup>104</sup> *Id.* at 49-50.

<sup>105</sup> KENNETH LIEBERTHAL & MICHEL OKSENBURG, POLICY MAKING IN CHINA: LEADERS, STRUCTURES, AND PROCESSES 22 (1988).

both coordinate a response and bring together interested parties.<sup>106</sup> Second, any fragmentation of authority requires strenuous efforts to maintain the consensus necessary to move forward.<sup>107</sup> And finally, any proposed policy requires the attention and support of at least one top political leader.<sup>108</sup>

The FIP is unlikely to meet the second and third conditions of these policymaking requirements. Additionally, FIP is not likely to receive detailed implementing regulations because of its uniquely devolved approval process. Similarly, FIP is not likely to receive government support because of lingering resentment of the partnership entity and the ongoing political transition in China.

*A. Decentralized Authority for FIP Approval Will Likely Hamper the Promulgation of a Detailed Regulatory Platform*

Foreign investment is driven by two basic factors: the safety of the investment and the opportunity for profit.<sup>109</sup> China's lack of regulatory clarity has been a constant deterrent to investors, who have called attention to it repeatedly, going so far as to call it the "foremost issue" for foreign direct investment in China.<sup>110</sup> One unique aspect of FIP is its reliance on provincial, rather than national authorities for approval.<sup>111</sup> Some commentators have even suggested that this devolution might be an important step towards systemic deregulation of foreign investments.<sup>112</sup> Devolution of FIP approval has some potential benefits for foreign investors, but as a whole, will hinder the development of FIP as a viable foreign investment enterprise by making the development of detailed implementing regulations unlikely.

It is important to first note the potential benefits of devolved approval for FIP. Central approval from China's Ministry of Commerce ("MOFCOM")<sup>113</sup> for other foreign investment enterprises typically takes around three months and can be much longer depending on the proposed investment.<sup>114</sup> Accordingly, establishment of a foreign investment enterprise

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<sup>106</sup> *Id.* at 22–23.

<sup>107</sup> *Id.* at 23.

<sup>108</sup> *Id.*

<sup>109</sup> Khan, *supra* note 36, at 6 (noting general investment patterns generally).

<sup>110</sup> LIEBERTHAL & OKSENBERG, *supra* note 105, at 22.

<sup>111</sup> Wang & Yong, *supra* note 35, at 15.

<sup>112</sup> *Id.*

<sup>113</sup> MOFCOM was formerly known, and is often referenced in older material as the Ministry of Foreign Trade and Economic Commerce, or MOFTEC. For a thorough review of this transition, see Ghazala Nayyar, *China's Export Control System and the Role of MOFCOM*, 27 S. ASIAN STRATEGIC STABILITY INST. 1, 5 (Jan. 2009).

<sup>114</sup> *China's Latest Partnership Investment Vehicle for Foreign Investors*, *supra* note 25, at 3.

other than an FIP is a “time consuming, multi-step, and often expensive process involving various government agencies.”<sup>115</sup> A devolved approval process for FIPs should be much shorter, as the state authority is able to register FIPs upon application, and is strongly encouraged to make the decision within twenty days for most FIPs.<sup>116</sup> However, if necessary, an FIP must obtain relevant licenses or permits for specific businesses prior to enjoying this accelerated timeline.<sup>117</sup>

A streamlined and local approval process also presents a significant disadvantage. Foreign investors will likely struggle to navigate the inconsistent practices of many local authorities.<sup>118</sup> The devolved process will result in decreased predictability and necessitate greater reliance on informal discussions at the local level between investors and authorities to ensure approval and compliance.<sup>119</sup>

Some commentators are highly skeptical that devolved authority will lead to new investment opportunities and argue instead that it will increase uncertainty by presenting local investment opportunities that conflict with existing regimes.<sup>120</sup> For example, because minimum capital requirements for FIPs are not specified by law, these requirements will likely be developed through practice,<sup>121</sup> which, developed at the local level, introduces more unpredictability for foreign firms that will have to balance substantial regional differences. Elevating provincial authorities in the regulatory process is therefore likely to further obfuscate an already opaque process while introducing a much more difficult environment for effective informal contact by requiring the foreign investors to develop new relationships with provincial authorities.

The devolved FIP approval process is also likely to negatively impact the national development of detailed implementing regulations.<sup>122</sup> Decentralization of foreign investment policies can impede development of

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<sup>115</sup> ZIMMERMAN, *supra* note 4, at 137.

<sup>116</sup> See Administrative Provisions on the Registration of Foreign Invested Partnership Enterprises Decree of the State Administration for Industry and Commerce, ch. 3, art. 21–30 (promulgated by the State Admin. for Indus. & Commerce, Jan. 29, 2010, effective Mar. 1, 2010) (China), *translated in* 24(3) CHINA L. & PRAC. 41–42 (Apr. 2010).

<sup>117</sup> Edward Epstein & Olivia S. Lee, *Administrative Rules on Registration of Foreign Invested Partnership Enterprises*, MARTINDALE (Mar. 17, 2010), [http://www.martindale.com/investments-law/article\\_Troutman-Sanders-LLP\\_941560.htm](http://www.martindale.com/investments-law/article_Troutman-Sanders-LLP_941560.htm).

<sup>118</sup> Lutz-Christian Wolff, *Pathological Foreign Investment Projects in China: Patchwork or Trendsetting by the Supreme People's Court?*, 44 INT'L LAW 1001 (2010).

<sup>119</sup> *Id.*

<sup>120</sup> *New Foreign Partnership Regulations Fail to Impress*, 24(1) CHINA L. & PRAC. 7 (Feb. 2010).

<sup>121</sup> Epstein & Lee, *supra* note 117.

<sup>122</sup> LIEBERTHAL & OKSENBERG, *supra* note 105, at 138–140 (1988).



regulations. In the late 1970s, decentralization increased the capacity of localities to resist the central government's priorities, leading to conflict.<sup>123</sup>

Similarly, in the 1980s, investors had to watch as localities repeatedly frustrated the policies of upper level authorities.<sup>124</sup> For example, differing local preferences were partially to blame for China's failed national priority to procure investment in the energy and transportation fields.<sup>125</sup> During this time, localities and Special Economic Zones were given authority to approve certain joint ventures valued at less than either \$10 or \$30 million.<sup>126</sup> Yet, local preferences for profitability led to the approval of projects that clashed with national priorities, eventually leading to recentralization.<sup>127</sup>

This tension between localities and the central government demonstrates the importance of cooperation between officials when attempting decentralization, as both have the capacity to hinder the new policy.<sup>128</sup> FIP, with its local authorization, will face a similar struggle because it is a new form of foreign direct investment and an unprecedented shift toward decentralization.

The FIP also faces a much more fractured policymaking environment in comparison to the one in which the government refined EJV and WFOE laws to make them more attractive to foreign investors. Numerous interest groups with significant sway have created a contentious atmosphere and are forcing the government to balance conflicting goals.<sup>129</sup> Policymaking is much more difficult without central authority over the drafting of legislation.<sup>130</sup> Still, China's economic control of the planning system has largely been abandoned.<sup>131</sup> Implementation of detailed implementing regulations for FIP is thus more difficult now than it has been for past foreign investment vehicles such as EJV and WFOE.

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<sup>123</sup> David M. Lampton, *The Implementation Problem in Post-Mao China*, in *POLICY IMPLEMENTATION IN POST-MAO CHINA* 3, 10 (David M. Lampton ed., 1987).

<sup>124</sup> Kenneth G. Lieberthal, *Introduction: The "Fragmented Authoritarianism" Model and Its Limitations*, in *BUREAUCRACY, POLITICS AND DECISION MAKING IN POST-MAO CHINA* 1, 11 (Kenneth G. Lieberthal & David M. Lampton eds., 1992).

<sup>125</sup> Barry Naughton, *The Decline of Central Control Over Investment in Post-Mao China*, in *POLICY IMPLEMENTATION IN POST-MAO CHINA* 51, 64–68 (David Lampton ed., 1987).

<sup>126</sup> PEARSON, *supra* note 67, at 205.

<sup>127</sup> *Id.*

<sup>128</sup> *Id.* at 17.

<sup>129</sup> Randall Peerenboom, *Resistance, Revision, and Retrenchment in the Transition to a Competitive Market Economy in China*, in *REGULATION IN ASIA: PUSHING BACK ON GLOBALIZATION* 114, 134 (John Gillespie & Randall Peerenboom ed., 2009).

<sup>130</sup> *Id.*

<sup>131</sup> LI & LI, *supra* note 37, at 243.

B. *The Chinese Government Is Unlikely to Support FIP Because of Lingering Suspicions of Private Enterprise and Partnerships*

The 2010 authorization of FIP enterprises is an additional step that was built on previous decisions concerning partnerships generally. This history will likely have a substantial negative impact on the continued development of the legal and regulatory framework of FIPs.

As indicated by the feudal partnership of Guan and Bao, partnerships were common in China prior to the 1949 revolution.<sup>132</sup> However, China's emphasis on socialist centralization of the economy and complete government control following the Communist Party's takeover meant that partnerships mostly disappeared at the end of the 1950s until the 1980s.<sup>133</sup>

The communist government's shunning of partnerships continued to prevail after China emerged from political and economic isolation and began liberalizing its economy in 1979. Many business organizations with elements of partnerships were legalized, yet they were based in existing economic regulations and the label of "partnership" was intentionally avoided so as to not give an appearance of capitalism or privatization.<sup>134</sup> Accordingly, an entire generation of Chinese technocrats views capitalism and privatization with suspicion.<sup>135</sup>

This suspicion manifested in the refusal of China's leaders to approve partnerships within until 1997.<sup>136</sup> Even then, the 1997 authorization was only for general partnerships, in which partners have unlimited joint and several liability.<sup>137</sup> This led to the initial partnership authorization receiving limited attention.<sup>138</sup> Yet, it was not until 2007 that limited liability partnerships were authorized.<sup>139</sup> This finally allowed limited partners to be liable exclusively for debts to the extent of their capital contribution, similar to an EJV.<sup>140</sup>

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<sup>132</sup> See Liufang, *supra* note 1.

<sup>133</sup> *Id.* at 47.

<sup>134</sup> *Id.*

<sup>135</sup> Yuan, *supra* note 59, at 508.

<sup>136</sup> ZIMMERMAN, *supra* note 4, at 92–105.

<sup>137</sup> *Id.*

<sup>138</sup> Paul McKenzie & Fraser Mendel, *China's Partnership Enterprise Law Revised*, 21(2) CHINA L. & PRAC. 32, 32 (Mar. 2007).

<sup>139</sup> See Partnership Enterprise Law of the People's Republic of China, ch. III (promulgated by the Standing Comm. Of the Nat'l People's Cong., Aug. 27, 2006, effective June 1, 2007), [http://www.fdi.gov.cn/pub/FDI\\_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020061018643910006967.pdf](http://www.fdi.gov.cn/pub/FDI_EN/Laws/GeneralLawsandRegulations/BasicLaws/P020061018643910006967.pdf).

<sup>140</sup> *Id.*

China's strained history with the partnership enterprise is likely to detrimentally influence further development of FIPs. It is probable that of the three existing foreign investment enterprises, FIPs will most closely resemble CJVs, which has fallen into relative disuse because of the restrictions placed on it by the Chinese government.<sup>141</sup>

C. *The 2012 Political Transition Decreases the Probability That FIP Will Be Further Developed in the Short Term*

The current transfer of political leadership from President Hu Jintao, to Vice President Xi Jinping<sup>142</sup> may also significantly impede the development of detailed FIP regulations or government support for FIPs. Changes in China's leadership, no matter how subtle, make a substantial difference because of the divergent developmental strategies and policies preferred by each politician.<sup>143</sup> The impending change of leadership has already exposed disagreement between Chinese leaders over economic priorities, including the role of investment in the domestic economy.<sup>144</sup>

A similar transfer of political power at the top of the Communist Party in the 1980s, was a leading factor in the Chinese government's inability to secure investment in energy-related fields.<sup>145</sup> The next generation of politicians in China is likely to "bring fresh ideas, insights, and a rich range of experience to the pinnacle of China's governance."<sup>146</sup> It is unclear whether FIP, promulgated by outgoing leaders, will be given the attention necessary to succeed as an investment vehicle.

A natural response to this critique is to acknowledge that China has progressed beyond such uncertainty in its past. After all, since China's opening to the outside world, several thousand pieces of legislation on foreign-related trade and investment in China were promulgated and implemented,<sup>147</sup> suggesting a more stable environment.

But predictable economic development is anything but certain. Even with this existing body of regulations, it would be a mistake to assume that

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<sup>141</sup> See *infra*, Part IV.B.

<sup>142</sup> ROBERT KUHN, HOW CHINA'S LEADERS THINK: THE INSIDE STORY OF CHINA'S REFORM AND WHAT THIS MEANS FOR THE FUTURE 423 (2010).

<sup>143</sup> David Zweig, *China's Political Economy*, in POLITICS IN CHINA: AN INTRODUCTION 192, 192 (William A. Joseph ed., 2010).

<sup>144</sup> *The Next Emperor*, ECONOMIST (Oct. 21, 2010), <http://www.economist.com/node/17308123>.

<sup>145</sup> Naughton, *supra* note 125; Thomas Fingar, *Implementing Energy Policy: The Rise and Demise of the State Energy Commission*, in POLICY IMPLEMENTATION IN POST-MAO CHINA 190, 221 (David M. Lampton ed., 1987).

<sup>146</sup> KUHN, *supra* note 142, at 422.

<sup>147</sup> WANG, *supra* note 58, at 83.

foreign investments, especially in an entirely new platform like FIP, will be developed with the degree of consistency that is expected of other global economy-influencing countries. As *The Economist* notes in describing China:

Too many Westerners . . . assume they are dealing with a self-confident, rational power that has come of age. Think instead of a paranoid, introspective imperial court, already struggling with subjects and now embarking on a slightly awkward succession.<sup>148</sup>

This characterization, while meant for a decidedly western audience, finds support in atypical decisions made by the Chinese government. For example, the ongoing political transition influenced China's decision to issue regulations that punish television programs that are too entertaining because of a perceived subversive effect.<sup>149</sup> If China is nervous about television being too entertaining, it is hard to reliably predict how FIPs will be treated.

The capacity for economic upheaval and reprioritization is likely burnished by the different political outlook of China's incoming politicians, who are more open to political reform than outgoing leaders.<sup>150</sup> Considering that FIP is likely to continue to struggle without sufficient regulatory specificity,<sup>151</sup> it is unlikely that, during a period of remarkable political transition, FIP will be given the support and resources necessary to become a widely utilized foreign investment enterprise.

#### V. THE FIP CAN STILL SUCCEED THROUGH PROMULGATION OF DETAILED REGULATIONS FOR EQUITY INVESTMENTS

In order to become an effective foreign direct investment enterprise, several legal changes to FIP law are necessary. Because implementing these changes will be difficult in China's fractured policy making environment,

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<sup>148</sup> *The Next Emperor*, *supra* note 144.

<sup>149</sup> Edward Wong, *China TV Grows Racy, and Gets a Chaperon*, N.Y. TIMES (Dec. 31, 2011), <http://www.nytimes.com/2012/01/01/world/asia/censors-pull-reins-as-china-tv-chasing-profit-gets-racy.html>; *Let Me (Not) Entertain You*, ECONOMIST (Jan. 7, 2012), <http://www.economist.com/node/21542469>.

<sup>150</sup> KUHN, *supra* note 142, at 423 (detailing several younger, more reform minded Chinese politicians that have assumed leadership positions within the Communist party). For a more detailed account of Mr. Xi's rise to likely becoming the next leader of the PRC, see You Ji, *The 17th Party Congress and the CCP's Changing Elite Politics*, in CHINA'S REFORMS AT 30: CHALLENGES AND PROSPECTS, 55, 85-90 (World Scientific, Series on Contemporary China, Ser. No. 15, 2009).

<sup>151</sup> See *supra* Part IV.A.

China should instead focus on developing FIP for private equity funds and investments, a smaller category of foreign direct investment.

A. *China Should Build a Comprehensive FIP Regulatory Regime For Private Equity Funds*

Implementing regulations for FIPs that will have equity investment as a main business are notably lacking. FIP regulations themselves simply note that “[w]here a foreign-invested partnership, the main business of which is investment, makes an investment in China, matters shall be handled in accordance with relevant state laws, administrative regulations, and rule on foreign investment.”<sup>152</sup> This reliance on existing laws is unfortunate, as foreign investors hoped that FIP laws would finally open this nascent area to foreign direct investment.<sup>153</sup> FIPs in this sector would attract both local and foreign investors, enjoy tax-transparency, and be able to make investments at will, without having to go through foreign authorities.<sup>154</sup>

The only possible pre-existing state law on this subject is the Administration of Foreign-Invested Venture Capital Enterprise Provisions.<sup>155</sup> These administrative provisions, promulgated in 2003, predate not only FIP law (by nearly a decade), but also law authorizing domestic limited Chinese partnerships.<sup>156</sup> It is difficult to apply these rules to the newer FIP as they often conflict with more recent laws. For example, under the 2003 rules, any investment or Venture Capital FIP requires approval from multiple central authorities—directly at odds with FIP regulations.<sup>157</sup> The Enterprise Provisions also prohibit numerous practices favored by foreign investors, such as borrowing to make investments, high capital contribution requirements (again, contravening the subsequent FIP regulations), and structuring limitations that increase tax burdens for foreign investors.<sup>158</sup> These contradictions will continue to deter investors from utilizing FIPs for equity investments.

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<sup>152</sup> See Provisions for the Administration of the Registration of Foreign-invested Partnerships, ch. 3, art. 64 (promulgated by the State Admin. for Indus. & Commerce, Jan. 29, 2010, effective Mar. 1, 2010) (China), translated in 24(3) CHINA L. & PRAC. 59 (Apr. 2010).

<sup>153</sup> Wang & Yong, *supra* note 35, at 15.

<sup>154</sup> *Id.*

<sup>155</sup> See generally Administration of Foreign-invested Venture Capital Investment Enterprise Provisions (jointly issued by the Ministry of Foreign Trade and Economic Cooperation, the Ministry of Science and Technology, the State Administration for Industry and Commerce, the State Administration of Taxation, & the State Administration of Foreign Exchange, Jan. 30, 2003, effective Mar. 1, 2003) (China).

<sup>156</sup> *Id.*, art. 35.

<sup>157</sup> *Id.*, art. 8.

<sup>158</sup> Jeff Wood & Richard Xu, *China's Revised Venture Capital Rules: Limited Partnerships with Chinese Characteristics?*, 17(2) CHINA L. & PRAC. 18, 19–20 (Mar. 2003).

Yet even with these obstacles, foreign investors have increasingly utilized FIPs for private equity investments.<sup>159</sup> This would seem to indicate strong demand from foreign investors for the ability to use FIPs for equity investment. By channeling that demand into detailed regulations for this specific category of foreign direct investment, China could provide a limited, yet robust, sector for FIPs.

China should amend FIP regulations in order to provide the clarity necessary for equity-investment FIPs to flourish. A transitioning Chinese government could limit the promulgation of regulatory detail to this specific category of foreign direct investment, preventing the type of change that would impact other foreign investment enterprises and potentially disrupt existing foreign direct investment regulations and investments.

China should accomplish this by first indicating that it will make the necessary adjustments to ensure that FIPs are a viable platform for equity investment. Practitioners are hopeful that the Chinese government will take an important step by issuing detailed regulations on how an FIP can convert its capital into Chinese currency for equity investment.<sup>160</sup> The absence of a clear mechanism for conversion of FIP capital into Chinese currency limits the ability of FIPs to serve as an equity investment vehicle.<sup>161</sup> This initial step could either be accompanied or followed by detailed regulations that allow foreign investors to utilize FIPs for equity investments. Other necessary regulations include detail regarding the tax treatment of individual partners, the tax treatment of various enterprise incomes, the availability of tax benefits for certain favored industries, and taxes on company FIP partners.<sup>162</sup>

This limited development of regulatory specificity for implementation would provide a viable investment platform for foreign investors while limiting the institutional support necessary from central and local governments—equity investment could function as an incubator for FIPs. Limiting detailed implementing regulations to these investment-minded FIPs, would prevent an upset of the delicate balance between other foreign investment enterprises for foreign investors, who would not have the option of taking more traditional investments and categorizing them as investment funds. Finally, China could also maintain centralized control for this

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<sup>159</sup> David Yu, Sam Feng & Jerry Wei, *Foreign-invested partnerships: A new vehicle for investments?*, 26(8/9) CHINA L. & PRAC. 12 (2012).

<sup>160</sup> *China's Latest Partnership Investment Vehicle for Foreign Investors*, *supra* note 25.

<sup>161</sup> *Id.*

<sup>162</sup> *Id.*

particular FIP, as it does in the 2003 Venture Capital Rules, which is critical to achieving the aforementioned prerequisites to effective policy formation.

#### VI. CONCLUSION

While China has made a remarkable amount of progress in opening the country to foreign direct investment and creating a legal system amenable to foreign entities, there is still progress to be made. FIPs represent an important, if ultimately uncertain step towards allowing and encouraging foreign direct investment in China. However, broader use of FIP by foreign investors will hinge on two factors, as evidenced by the experience of other foreign direct investment vehicles. These two factors are detailed implementing regulations and government support.

Detailed implementing regulations and government support for FIP are both questionable. Implementing regulations are unlikely because of provisions in FIPs that conflict with the policymaking process in China. Government support is unlikely because of continued suspicion of the partnership entity and an ongoing political transition. Until exacting regulations are promulgated and established, foreign investment through FIPs will likely be tepid.

Issuance of detailed implementing regulations for FIP equity investments would help achieve China's stated interest in reversing downward foreign direct investment trends. Doing so would preserve the status quo of other investment enterprises while allowing the creation of a viable platform for foreign investors that can be later expanded into other categories more broadly, encouraging the formation of many Guan and Bao partnerships between foreign and Chinese investors.