

NORONHA ADVOGADOS GLOBAL LAWYERS

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THE EVOLUTION OF THE CHINESE LEGAL SYSTEM;
CONTRACTS; COMPANIES AND PARTNERSHIPS

UIA SEMINAR— *LEGAL ASPECTS OF DOING BUSINESS WITH CHINA*
Pallazo Affari ai Giurisconsulti, Milan, Italy, April 12, 2008.

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Senior Partner - Noronha Advogados



POINTS OF PRESENTATION

1. GENERAL ASPECTS;
2. CHINESE LEGAL SYSTEM;
3. CONTRACTS;
4. COMPANIES AND PARTNERSHIPS.





GENERAL ASPECTS

National Flag





GENERAL ASPECTS

Map





CHINESE LEGAL SYSTEM

Historical

ESTABLISHMENT OF THE PEOPLE'S REPUBLIC OF CHINA (PRC):

- Chinese codes were replaced by those adopted by the socialist system under the influence of the Soviet Union;
- changes in the Chinese laws lasted until the beginning of the 1980's

THE FOUNDATION OF THE PRC TO THE END OF 70'S:

- period marked by the concept of the Rule of Man or *Renzhi Zhuyi*;
- during this period the party's policy prevailed over the existing law.

THE SECOND PERIOD (RETURN OF DENG XIAOPING):

- period marked by the adoption of the principle of Rule of Law or *Fazhi Zhuyi*;
- necessary for the development of the country according to a socialist market economy.



CHINESE LEGAL SYSTEM

Historical

1996 – Lawyers became recognized professionals due to the enforcement of the Lawyer's Law.

2002 – The Chinese government established that judges, prosecutors and lawyers should be undertake to exams in order ensure their legal knowledge.

2002 Scenario* :

- 01 judge for each 7.000 inhabitants, and
- 01 lawyer for each 11.000 inhabitants.

* (located in the most developed cities in the seashore region)



CHINESE LEGAL SYSTEM

Law's Professionals of China

- There are still very few judges and lawyers.
- Legal professionals seek to improve their knowledge abroad (United States and Europe).
- Nowadays, most of the judges and prosecutors are retired policemen or officials who received very limited legal training (3 to 6 months).





CONTRACTS

Historical

The new CHINESE CONTRACT LAW was adopted during the 9th National People's Congress on March 15, 1999, and it came into force on 1st October 1999.

The law is aimed at regulating all contractual issues in China and it has substituted three other laws that regulated contracts:

- Economic Contract Law from 1981;
- Foreign Economic Law from 1985; and
- Technology Contract Law from 1987.



CONTRACTS

Chinese Contract Law Features

The new Chinese Contract Law is the most extensive law ever passed by the National People's Congress:

- 23 Chapters featuring 428 articles.

The law establishes two different categories of contract clauses:

1. general provisions – related to the General Principles of State, validity, performance, amendment, termination and also, liability and penalties for the default; and
2. specific provisions – sets out the rules applicable to 15 (fifteen) specific types of contracts.



CONTRACTS

Chinese Contract Law Features

Principle of Freedom to Contract - pursuant to such principle both parties are free to enter into a contract, discussing each and every part of it, from its preparation to its enforcement.

Principle of Equality - was adopted as part of the transition of China to a market economy. It provides that the parties are both entitled to the same rights and cannot be forced to agree to any clauses or conditions.

Principle of Autonomy - was also adopted as part of the transition of China to a market economy. This sets out that no third parties are allowed to interfere with a contract entered into by two parties.



CONTRACTS

Chinese Contract Law Features

The law specifically regulates the following contracts among others:

- . sales
- . loans
- . intermediation
- . transportation
- . warehousing
- . brokerage
- . energy
- . lease and financial lease
- . construction projects
- . technology
- . commission

The application of the Chinese law is mandatory in case of:

- . joint ventures; and
- . exploration and use of China's natural resources.



CONTRACTS

Positive and negative aspects of the new law:

Pros

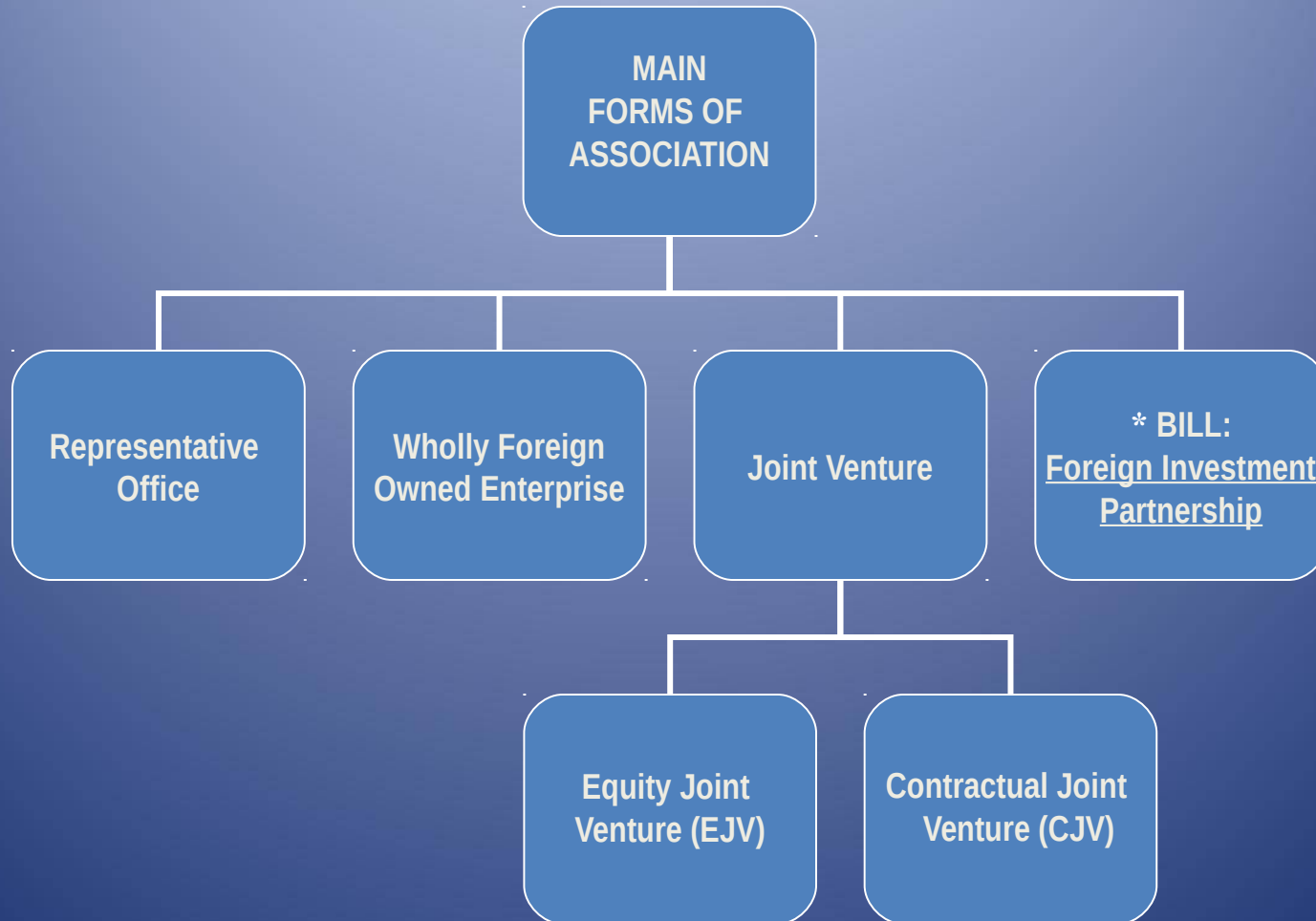
- makes contracts a more accessible subject;
- is more comprehensive;
- fills out the gaps left by previous laws;
- reduces the conflict of laws;
- makes Chinese transactions safer;
- codifies administrative rules;
- adapts China to international laws and treaties.

Cons

- not all terms it uses fit in with the Chinese business reality;
- terms and ideas are different from other Chinese laws;
- the establishment of oral contracts open up possibility for increase in disputes;
- the combination of Common and Civil Law elements confuses Chinese lawyers.



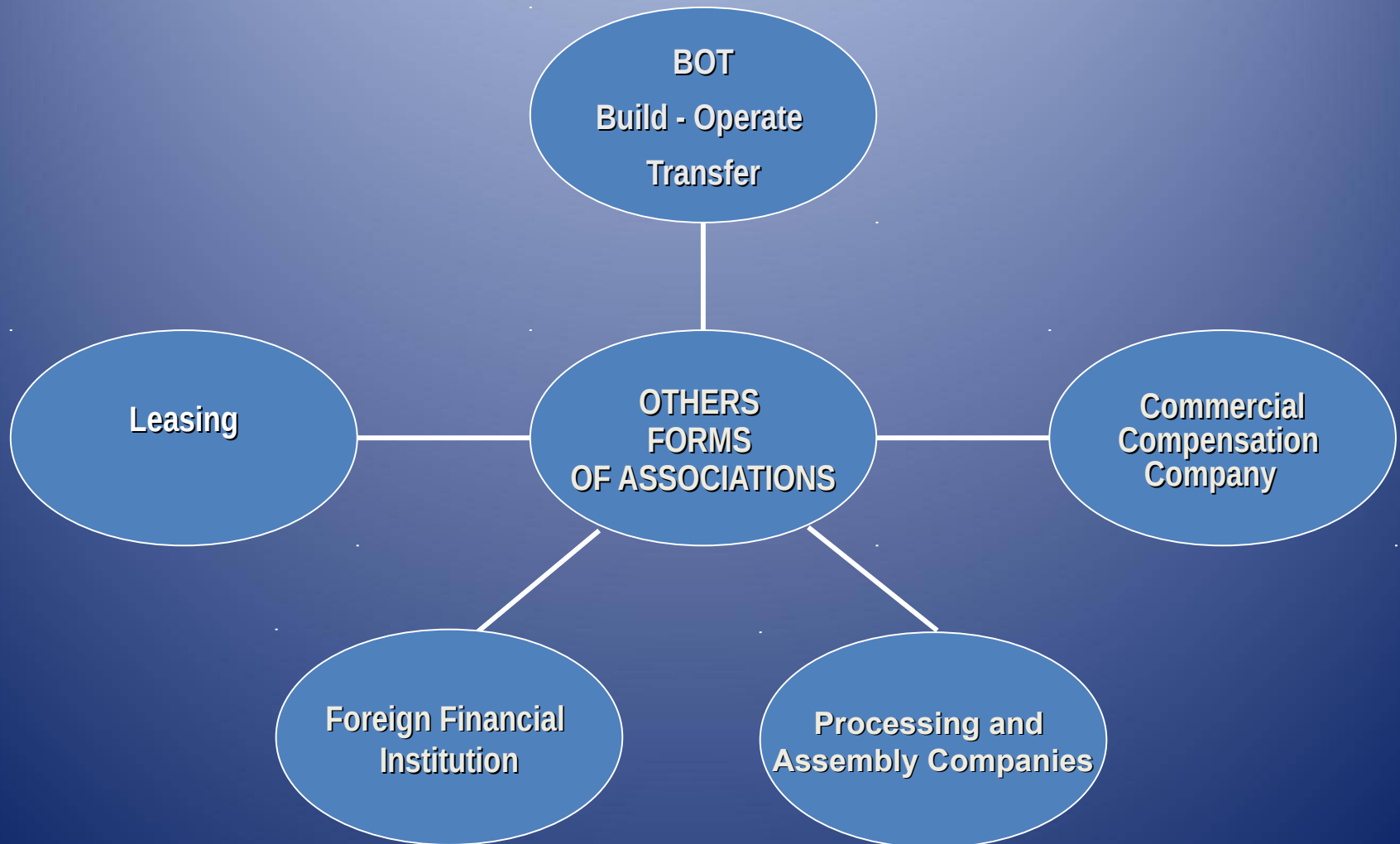
COMPANIES AND PARTNERSHIPS



* The model, if approved, will allow partnerships between Chinese or foreign individuals and legal entities.



COMPANIES AND PARTNERSHIPS



COMPANIES AND PARTNERSHIPS

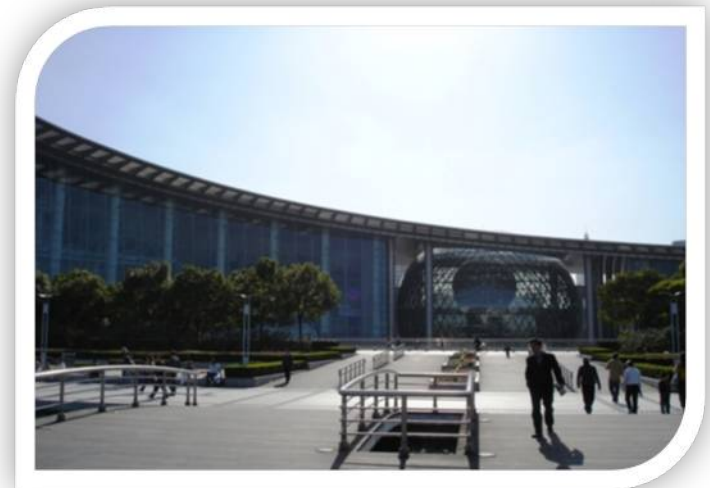
Representative Office

The Representative Office is the Chinese liaison of a foreign company that is established under local rules in order to promote its business in China.

Activities:

- promoting the company's business
- arranging contracts;
- consultancy
- market research; and
- gathering information.

Representative Offices cannot settle any contracts or issue invoices on the behalf of the company it represents.





COMPANIES AND PARTNERSHIPS

WFOEs

Wholly Foreign Owned Enterprises or WFOEs must be established as limited liability companies.

The liability of the foreigner partner is limited to the paid-in capital, which must be wholly foreign.

The company is legally obliged to support the Chinese economy, being allowed to produce and use high end technology as well as to export its entire production.

Involvement in the media (newspapers, magazines, radio and television), domestic commerce, insurance, mail, telecommunication, among others, is not permitted.



COMPANIES AND PARTNERSHIPS

Equity Joint Venture (EJV)

EJVs are created through the partnership between Chinese and foreigners in a limited liability company that, having its own legal status, is subject to Chinese law.

The registered capital, in local or foreign currency, represents the amount the parties invested in the joint venture.

The Board of Directors is the top authority in such companies. The Board is composed of a Director and a Deputy Director both appointed by common agreement of the parties.



COMPANIES AND PARTNERSHIPS

Equity Joint Venture (EJV)

Board of Directors

- the most important organ of a EJV.

Purchases

- they are free to choose between Chinese and foreign suppliers;
- the Chinese government encourages selling their products in the international market;
- they have the right to export their production directly or through trading companies.



COMPANIES AND PARTNERSHIPS

Equity Joint Venture (EJV)

Control of the Foreign Capital

- foreign capital will be used according to Chinese policies and rules;
- EJVs are allowed to open accounts in foreign or local currency – *renminbi* – in banks established in China.
- *if necessary, they will be able to request loans in foreign currency or renminbi from the Chinese banks.*

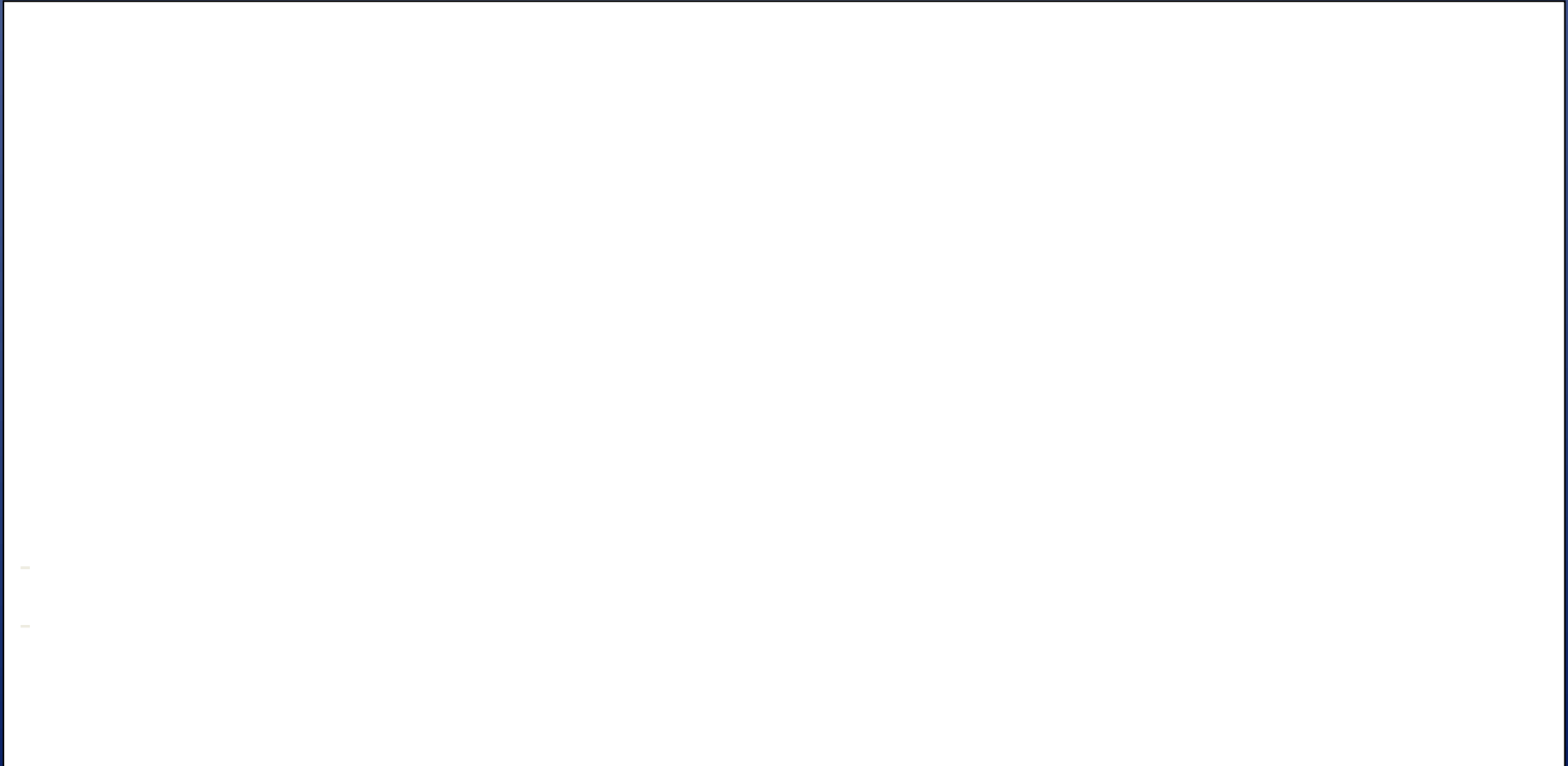
Accountancy and Financial Issues

- the fiscal year begins on January 1st and ends on December 31, and the currency adopted must be the *renminbi*;
- must adopt the accrual basis in its accountancy; and,
- annual and quarterly financial reports must be presented to the partners and Chinese tax authorities.



COMPANIES AND PARTNERSHIPS

Equity Joint Venture (EJV)





COMPANIES AND PARTNERSHIPS

Equity Joint Venture (EJV)

Any disputes should be resolved, when possible, through mediation. In case mediation is not applicable, the dispute must be submitted to Arbitration or to the Judiciary.

The partners of a EJV may initiate Arbitration before a Chinese or foreign Centre, pursuant to the arbitral clause.

In the event there is no arbitration clause, the parties may file a lawsuit.

COMPANIES AND PARTNERSHIPS

Contractual Joint Venture (CJV)

The CJV is a type of contractual association that may or not have legal status.

Having the legal status, the CJV will be a legal entity.

They are more flexible than the EJV. The parties are allowed to decide on the profits and losses, not necessarily according to the contribution of each party.





COMPANIES AND PARTNERSHIPS

Contractual Joint Venture (CJV)

The contributions, liabilities, rights and obligations of the partners of a CJV are established in the contract.

Usually, the foreign partner will have to provide the capital and the Chinese partner will have to provide land, facilities and, in a few cases, part of the capital.

As a rule, the Chinese partner will be entitled to all fixed assets of the CJV at the end of the contract.



COMPANIES AND PARTNERSHIPS

Main Differences between EJVs and CJVs

EJVs

Both partners share profits and losses pursuant to their contributions to the capital stock

The foreign partner cannot recover the investment made

CJVs

Liabilities are established in the contract

The foreign partner may recover the investment made

More flexible management.



NORONHA ADVOGADOS

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The Noronha Advogados office in Shanghai was opened in April 2001 and has a team of lawyers with fluency in English, Mandarin and Portuguese.



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