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Country Risk Management: China and Intellectual Property Protection

Today, American images of the People's Republic of China (PRC or China) are often both distorted and confused. Many American businessmen have not paid enough significant attention to the PRC since June 4, 1989, and, therefore, have a murky picture of its current trade and investment environment. Unfortunately, Americans depend too much on information gleaned from the press reports and commentaries associated with highly political issues such as those relating to human rights and the extension of most-favored-nation status. Ergo, one of the difficulties is in properly evaluating risk.

Since the unfortunate incidents in and surrounding Tiananmen Square, Beijing, in June 1989, foreign investors have been concerned with the ongoing potentiality for instability within the Chinese ruling elite. With the increasing likelihood for chaos associated with political disintegration in Eastern Europe, the concerns vis-à-vis the PRC have intensified within many circles.

No one owns a crystal ball within which to glean the direction towards which China may be heading. The scope and intensity of the problems confronting China's leadership today are staggering; a foreign observer cannot give too much thought to the subject. Debates on the future viability of post-Tiananmen China have proliferated in recent months as cracks in the old veneer are becoming evident. While it can be said confidently that a reform movement does exist in China, the real question is, what is the direction of the reformation process?

China's vast history has witnessed countless and varied efforts to reform its deeply entrenched bureaucracy and to address endless problems incumbent with managing a society of the diversity and complexity of China. Modern (post-eighteenth century) problems associated with overpopulation, environmental disasters, civil strife, and assimilation of Western ideas and technologies have often

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been too much for China's tradition-oriented leadership to handle effectively. There is concern that today's leadership will succumb to a similar fate.

Furthermore, both the recent social-political events and remarkable economic development have induced the cyclical return of euphoria over opportunities and expectations for foreign trade and investment. Unless careful, Americans may stumble into the quagmire of past follies and miscalculations.

Nevertheless, as foreign investors in China, American businessmen will need to take a calculated gamble on the direction towards which reform is heading. Will the nature of such reform be moderate, radical, peaceful, or violent? Will the government that emerges from the process be Confucian-based, authoritarian, paternalistic, democratic, an extension of the current socialist state, or any of the above? Will the economy be of a capitalistic, socialistic, or communistic orientation? To some companies, socio-political-economic characteristics may not be of significant concern so long as their investment not only is secure and protected by the state, but also capitalizes on lower manufacturing costs that give them a competitive edge globally. But, for many high-tech companies, which often depend on maintaining a high degree of protection of their intellectual properties, such characteristics may be of crucial importance since they often dictate the state's position on intellectual property rights and protection. Current developments in China's legal environment pertaining to intellectual property may provide an indicia to the changes and elements of risk that lie ahead.

I. Risk Analysis from an Intellectual Property Perspective

A. HYPOTHETICAL

The Acme Company is a leading U.S. participant in the highly competitive widget-xs market. Renowned for its high quality and technological superiority, Acme manufactures its widgets in state-of-the-art manufacturing facilities. Acme has maintained its competitive edge in recent years largely because of its leading-edge technological innovations and the concomitant strict enforcement of its intellectual property rights (especially for patents and trade secrets). While patent or other laws no longer protect Acme's "sunset" products, its high-tech widgets have extensive patent coverage in the United States, Canada, Western Europe, and Japan.

Unfortunately, as with many other companies, Acme did not foresee the dramatic growth of the global widget-xs market. Therefore, it did not dedicate sufficient resources in Third World countries, including the PRC, to register its patents and other intellectual property rights to the fullest extent permitted under local law (however, since it had previously sold some of its widgets in the PRC, Acme had registered several of its key trademarks in China).

Acme's most technologically advanced widget-xs models incorporate components that contain software imbedded in an integrated circuit chipset. Therefore, Acme has also sought protection for its software and semiconductor maskworks

in Western nations and Japan. As the competition intensifies, the software and maskworks will increasingly differentiate Acme's products from the rest of the field.

B. THE PRESENT INTELLECTUAL PROPERTY REGIME

1. *Patent Protection*

In the early 1950s, the PRC Government enacted provisional regulations on the protection of inventions. While originally modeled after Soviet laws, the regulations developed a more antielitist posture after the antirightist campaigns of the late 1950s. With the promulgation of new regulations in 1963, all inventions made by an individual were considered property of the state.

Upon cessation of the Cultural Revolution, new regulations on inventions were issued in 1978 and revised in 1982. Those regulations granted new rights and interests to the individual inventor. In March 1979 a patent law drafting committee was formed. A Patent Bureau was subsequently established in 1980. Several years later, in March 1984, the PRC promulgated the Patent Law effective on April 1, 1985 (as were the Implementing Regulations).¹ The PRC officially acceded to the Paris Convention for the Protection of Industrial Property on March 19, 1985. Despite initial weaknesses of the Patent Law (from Western perspectives), China has continued to address foreign concerns, albeit as a result of significant pressure, especially from the United States.

2. *Copyright and Computer Software Protection*

Upon its establishment, the PRC Government repealed the Copyright Law of the Kuomintang Government. Although the PRC Government recognized certain limited rights of authors (for example, in 1958, through the Temporary Provisions for Payment for Published Works in Literature and Social Sciences²), a copyright law did not become a conceptual reality until July 1985 when the State Council authorized the establishment of a National Bureau of Copyright to draft a copyright law. After extensive debate on numerous drafts, the Copyright Law was adopted in 1990 and became effective on June 1, 1991 (at which time the Implementing Rules also took effect).³

Article 53 of the Copyright Law provided for separate legislation to be enacted to protect computer software. Subsequently, on May 24, 1991, the Computer Software Protection Rules (the Rules) were adopted at the 83rd Meeting of the State Council. The Rules took effect on October 1, 1991.⁴

1. Patent Law of the People's Republic of China, China L. Foreign Bus. (CCH) § 11-600.

2. SPECIAL SUBCOMMITTEE ON U.S. TRADE WITH CHINA, HOUSE COMMITTEE ON ENERGY AND COMMERCE, 98TH CONG., 2D SESS., CHINA IS DEVELOPING LEGAL STRUCTURE FOR TRADE AND COMMERCE 17 (1984).

3. Copyright Law of the People's Republic of China, China L. Foreign Bus. (CCH) § 11-700.

4. Computer Software Protection Rules, China L. Foreign Bus. (CCH) § 11-704 [hereinafter Software Rules].

3. *Trademark Protection*

Despite the capitalistic roots of a system that protects commercial marks for product differentiation, the PRC Government acknowledged the importance of trademark protection from almost the outset of its existence.

Not only would trademarks enable the masses to identify products with particular manufacturers, but they would also encourage distinctions between higher and lower quality goods. Less than one year after liberation, the government enacted its Provisional Regulations Governing the Registration of Trademarks. In 1963, the 1950 Regulations were replaced by the Regulations Governing the Control of Trademarks. At that time a foreign enterprise was first allowed to register a trademark in the PRC (but only if a bilateral agreement with its foreign country existed).

The 1963 Regulations proved ineffective in controlling the quality of goods because most products were in short supply and, therefore, the Regulations were not seriously enforced. Once the country began to pull out of the ashes of the Cultural Revolution, and as products and supplies became more plentiful, focus turned again to product quality and trademark differentiation. Subsequently, in 1982, the Trademark Law replaced the 1963 Regulations.⁵ Implementing Regulations were promulgated in 1983, but were nullified and replaced by the Detailed Rules for the Implementation of the Trademark Law on January 13, 1988.⁶

Despite those recent revisions, a number of holes exist. Accordingly, Chinese authorities are considering new trademark legislation that may: (i) expand protection to service marks, certification marks, and the like; (ii) revise the registration process; (iii) allow a single application to cover multiple classes; and (iv) establish harsher criminal liability, penalties, and equitable relief.⁷ Should these changes be made, foreigners and Chinese nationals alike should gain greater comfort that product quality and trademark differentiation will be better promoted and preserved throughout China.

C. SINO-U.S. INTELLECTUAL PROPERTY ISSUES

The 1979 Sino-American Trade Agreement provided that the United States and the PRC would seek "under its laws and with due regard to international practice, to ensure to legal or natural persons of the other Party protection of patents and trademarks equivalent to the patent and trademark protection correspondingly accorded by the other Party."⁸ Subparagraph 5 of the same article required the PRC to provide copyright protection to U.S. nationals.

Unfortunately, intellectual property protection (as deemed by the United States

5. Trademark Law of the People's Republic of China, China L. Foreign Bus. (CCH) § 11-500.

6. *Id.* § 11-520.

7. 18 BUS. CHINA 9, 66 (May 11, 1992).

8. Agreement on Trade Relations, July 7, 1979, U.S.-P.R.C., art. VI(3), 31 U.S.T. 4651, 4658.

to be a comprehensive, basic coverage) did not materialize as quickly as the United States Government had envisioned in 1979. The absence of such comprehensive protection undoubtedly has led some foreign investors to decide not to make any significant investments in the PRC and to limit the nature of technologies transferred. By December 1991 bilateral relations had soured significantly because of U.S. perception of Chinese intransigence on this issue. Relations between the two countries appeared to have deteriorated to a point of no return over the issue of intellectual property protection.

Fortunately, a potential trade war between the United States and the PRC was averted with an eleventh-hour agreement by the PRC to recognize the U.S. position on most intellectual property issues. On January 17, 1992, the governments of the PRC and the United States entered into a Memorandum of Understanding on the Protection of Intellectual Property (MOU).⁹

Recognizing the requirements of the 1979 Treaty, the MOU addressed the following intellectual property rights issues:

1. *Patents*

The PRC agreed to extend the scope of patentable subject matter to cover chemical inventions, including pharmaceutical and agricultural chemicals. The term of patent protection in the PRC will be twenty years from the date of filing the patent application. The provisions on compulsory license were diluted significantly. The PRC Government also agreed to enact appropriate legislation by January 1, 1993.

2. *Copyrights*

The PRC Government agreed to accede to the Berne Convention and to use its best efforts to enact a bill to that effect by June 30, 1992.¹⁰ The PRC also agreed to accede to the Geneva Convention for Protection of Producers of Phonograms by June 1, 1993. The government finally agreed to issue new regulations to bring its current laws in conformity with the Berne and Geneva Conventions.

3. *Software*

The PRC announced it would recognize and protect computer programs as "literary works" under the Berne Convention and to provide protection thereto for fifty years. It also agreed to extend full protection to U.S.-protected works. The PRC Government recognized the MOU as a formal agreement under its Copyright Law, thereby affording greater protection to U.S.-protected works. Furthermore, China has agreed generally to conform its copyright law to international standards.

9. Memorandum of Understanding on the Protection of Intellectual Property, Jan. 17, 1992, U.S.-P.R.C. (available in Office of the United States Trade Representative, Washington, D.C.).

10. On July 3, 1992, China officially acceded to the Berne Convention.

4. *Trade Secrets*

Finally, the PRC Government confirmed that it would pass trade secret legislation, thus filling one of the two remaining major voids in the protection of intellectual property (the other being semiconductor maskwork protection). The trade secret bill is to be enacted before January 1, 1994. The PRC will likely adopt legislation comparable to similar legislation passed in Japan and Korea during the last several years.

D. POTENTIAL RISKS

The MOU, and subsequent PRC actions, confirm the government's commitment to protect intellectual property rights in China in conformity with international standards. Over time, the risks of infringement and abuse of intellectual property should also be brought in line with comparable risks in the Western world and Japan.

Nevertheless, as this author wrote back in 1987, eight environmental factors in the PRC continue to pose varying degrees of risk to a high-tech investor:

- (1) Inefficient allocation and use of natural and manpower resources, as well as of certain existing technologies, for technological development (partially the result of decentralization);
- (2) inadequate infrastructure for absorbing and disseminating technology rapidly;
- (3) inability to translate experimental, laboratory or small-scale production successes into broader production gains;
- (4) inadequate management skills, training, discipline, and problem-solving expertise;
- (5) lack of qualified scientific, engineering, and technical personnel;
- (6) absence of standardization in instrumentation and scientific measuring equipment;
- (7) shortage of hard foreign currency and inability to generate requisite levels of foreign exchange through exports of high technology products due to substandard products or global overcapacity in certain product categories; and
- (8) lack of uniform dissemination and/or enforcement of laws, rules, and regulations.¹¹

During Acme's preinvestment preparation of a feasibility study, it should analyze carefully the aforementioned factors. Since the factors will differ significantly from region to region, Acme should focus on different localities before establishing its base of operations. While progress in a number of areas has been and continues to be made, most PRC capabilities lag behind the rest of the modernized world.

In analyzing legal risks and exposure, Acme should study the PRC's various laws on contracts, most specially the Foreign Economic Contract Law¹² and the

11. Tek Ling Chwang & Richard L. Thurston, *Technology Takes Command: The Policy of The People's Republic of China with Respect to Technology Transfer and Protection of Intellectual Property*, 21 INT'L LAW. 129, 139 (1987).

12. China L. Foreign Bus. (CCH) § 5-550.

Detailed Rules for the Implementation of the Administrative Regulations of the People's Republic of China on Technology Import Contracts (1988) (particularly as they relate to Sino-foreign equity joint ventures). Attention should be given to articles 7 and 18 on requisite contractual provisions.¹³ In light of the absence of uniform enforcement of intellectual property laws, the foreign investor must continue to push for stringent contractual provisions pertaining to intellectual property and not ignore the possibility of enforcement overseas.

Should any technical assistance be required, Acme can minimize its risks by preparing a technical assistance agreement that should, *inter alia*:

- (1) identify ownership rights, title, and other interests in and to the transferred intellectual property and improvements thereto, or new inventions arising therefrom;
- (2) define key, dispositive contractual terminology such as: "technical information," "trade and industrial secrets," "product," "affiliates," and the like;
- (3) specify any grant of rights or license to make, use, or sell and state any and all limitations thereon (be certain to segregate trade secrets from the rest of the intellectual property rights granted);
- (4) clearly identify and explain the nature and methods of transfer of technical assistance (for both initial and continuing transfers) as well as the specific locations where such assistance is to be provided;
- (5) construct fairly tight and comprehensive nondisclosure and confidentiality obligations;
- (6) not overlook provisions for technical assistance fees, other charges, and cost reimbursement;
- (7) establish appropriate royalty schedule(s) (to the extent that a license is required);
- (8) pay close attention to quality control, testing and inspection, corrective action, customer services, and the like;
- (9) establish a right to place resident inspectors on site;
- (10) focus on warranties, representations, indemnification, disclaimers, and limitations of liability;
- (11) provide for security measures comparable to those undertaken in the foreign investor's global operations;
- (12) cover export control provisions;
- (13) address specifically term, breach, and termination of the agreement (including whether or not it is coterminus with the joint venture or shareholder's agreement);
- (14) carefully provide for dispute resolution process but avoid arbitration for any and all disputes pertaining to intellectual property rights;

13. *Id.* § 5-573.

- (15) provide for any applicable conditions precedent or subsequent, or both, for parties' obligations; and
- (16) provide not only for waiver of jurisdiction, but also for injunctive relief in the United States, Japan, and other countries where protection is available in the event of breach by the PRC party.

These provisions need to be drafted carefully so as not only to comply with Chinese contract law requirements, but also in such a manner so as to obtain appropriate governmental approval. Despite this challenge, experience shows that the task can be accomplished successfully.

Normally, the technical assistance provider will be compensated by receipt of a technical assistance fee. This fee can be in the form of either a lump-sum payment or equal payments spread out over a specified period of time. Another method, in the case of a joint venture, is to make an equity contribution and then to receive part of the contribution back in the form of the technical assistance fee. In all cases be certain that a proper tax analysis is prepared ahead of time.

To the extent that technology is not contributed to the capitalization of the joint venture company, or is not limited to a grant of "have made" rights only (which is highly recommended during the early phase of most projects), then the technology transferor will, most likely, license certain intellectual property rights to the joint venture for limited purposes either of making, using, marketing, or selling the output of the venture. Several general licensing considerations should be injected into the planning process, such as:

- (1) Is the license to be exclusive or nonexclusive?
- (2) May the licensee sublicense the technologies (including subcontract)?
- (3) May the licensee assign its license rights?
- (4) Is the licensee obligated to license back to the licensor any improvements or inventions based on the licensed technology?
- (5) What is the scope of the license rights with respect to make, use, market, and sale of products?
- (6) Are any royalties to be charged?
- (7) Is the licensor obligated to license to the licensee or licensor's partner subsequent improvements or related inventions made by the licensor?

Also, to the extent that a legal person is involved, one should be very certain to address the status of the license rights in the event that the entity is dissolved or the underlying relationship terminated. The contractor should always provide specifically for consequences of termination.

A primary example of China's recent efforts to continue the reform efforts and, thus, to minimize the concerns of foreign investors, is reflected in the recent issuance of software registration guidelines.¹⁴ Prior to the execution of the MOU, officials of the Ministry of Machine Building and Electronics Industry (MMEI)

14. Measures for Computer Software Copyright Registration, China L. Foreign Bus. (CCH) § 11-706.

had announced the proposed promulgation of fairly rigid registration guidelines, unsatisfactory to the United States, which deficiencies were a focal point of U.S. criticism in late 1991. Based on that criticism, MMEI went back to the drawing board. Effective April 6, 1992, the Procedures supplement the Computer Software Protection Regulations (effective October 1, 1991)¹⁵ by adopting guidelines and procedures governing the administrative review and registration process for computer software and whereby MMEI is responsible for the administration of software copyright registration.

As in the United States, judicial protection of software will depend on registration, unless protection arises from an international convention or treaty (article 5). But, unlike the United States, registration is not automatic; it requires a formal, substantive review process.

Under the Procedures, each application to the Software Registration Centre is limited to one independently released or used software (article 7). In addition to an application form and proof of ownership (article 10), software authentication must be submitted (comprising twenty consecutive pages from each of the beginning, middle, and end of the source code and corresponding software) (article 12). Most importantly, the Procedures provide for maintaining confidentiality of trade secrets or proprietary business information upon special request, including the possible deletion of up to 30 percent of the source code or by providing specified redacted or extracted material (article 12). This latter provision is a fundamental development because it addresses a significant past concern of foreign investors.

The Procedures require that any software published prior to June 4, 1991, but that was not in the public domain, must have been registered by April 5, 1992, to be effective. Unfortunately, the Procedures establish an extremely formal process that, on its face, is inconsistent with the Berne Convention. However, in light of China's accession to the Berne Convention, the PRC authorities should automatically register foreign developed software. Nevertheless, until clarification is obtained, a risk remains to foreign software.

Most importantly, until trade secret legislation is promulgated (and even thereafter), Acme will need to maintain strict control over its trade and industrial secrets to the fullest extent possible. At a minimum, Acme must negotiate nondisclosure and confidentiality agreements with any PRC partner and rely initially on protection under the Foreign Economic Contract Law and the Detailed Rules on Technology Imports Contracts (article 13). Since PRC legislation is expected to resemble provisions of the Paris Convention, Japanese and Korean counterparts, such nondisclosure and confidentiality agreements should be drafted with such laws in mind so as to fill anticipated voids in legislation and to provide independent judicial relief (as discussed previously).

15. Software Rules, *supra* note 4; see also Richard L. Thurston & Jia Zhao, *Committee Insights: People's Republic of China*, 26 INT'L LAW. 589, 592-93 (1992).

Item 8 of the above-mentioned environmental risk factors poses the greatest unquantifiable legal risk to Acme. The vast majority of recent rights and protections legally granted to intellectual property in China are relatively new and untested. From past experience in countries such as Japan, Taiwan, and Korea, the enforcement of intellectual property rights in the courts often lags considerably behind legislation. Cognizant of this pattern, and concerned with already serious domestic issues over the uniform enforcement of its reform legislation, the State Council has recently announced that it is establishing a group of representatives from the various ministries to supervise the creation and enforcement of intellectual property laws and regulations. It is hoped that this group will give serious consideration to the creation of a national court that would have exclusive jurisdiction (on appeal from the People's Courts) over intellectual property rights.

In an attempt to deal with foreign concerns over lack of uniform enforcement of laws, the Chinese Government has made a special effort to develop a fairly equitable, expeditious arbitral process. Under the auspices of the China Council for the Promotion of International Trade (CCPIT), most arbitration in China has been handled by the China International Arbitration Commission (CIETAC). The CIETAC has developed a solid reputation among foreign parties appearing before the body. However, according to growing reports, many arbitration decisions are either not being enforced by the People's Courts or are delayed significantly by bureaucracy. As one author has noted, "the increasing parochialism of the country's court system is a predictable result of the growing economic and political independence enjoyed by China's provinces. As a result, the Chinese judicial system suffers from rampant court-to-court hostility. . . ."16

At the same time, however, a recent issue of *Business China* contends that enforcement of the trademark law is improving and, according to Tan Loke of Baker and McKenzie, "They are getting stricter. China is getting there [closer to international practices]."17 Mixed enforcement will likely continue for some time, especially in the interior of China.

If Chinese history serves any indication of the likelihood of ongoing progress in uniform enforcement, then the foreign investor should take solace in the belief that enforcement by the courts of intellectual property rights should improve. As noted by this author in his study of China's civil law reform movement from 1912-1930 and the Reform Courts of that era, the initial promulgation of new laws and the establishment of new courts in China

at the outset will encounter varying degrees of visible resistance from the populace. . . . Problems might also arise because the laws run counter to established customs, or, judicial and police personnel are too few to enforce them effectively. These problems,

16. Matthew D. Bersani, *Enforcement of Arbitration Awards in China*, 19 CHINA BUS. REV. 3, 7 (May-June 1992).

17. 17 BUS. CHINA 9, 65 (May 11, 1992).

however, are usually correctable provided that the ruling government is blessed with time, social stability/continuity and financial solvency.¹⁸

Where given the opportunity, Chinese courts in the 1910s to 1930s proved capable of the challenge in enforcing what few intellectual property laws and regulations existed as well as in enforcing contractual engagements related thereto.

The foreign investor should remember that, unlike the early to mid-1900s, special, extraterritorial courts with jurisdiction over actions involving foreign nationals no longer exist in China.¹⁹ Today, to the extent a contract does not provide for a different jurisdiction or other international principles do not apply, foreign nationals are subject to the jurisdiction of the People's Courts in accordance with the Code of Civil Procedure, which was adopted by the 4th Session of the Standing Committee of the 7th National People's Congress on April 9, 1991.²⁰ Foreign nationals enjoy the same legal privileges and obligations as Chinese citizens or legal persons in civil proceedings. Although the Code of Civil Procedure is newly enacted, both the trial implementation of the civil procedure law beginning in 1982 as well as historical precedence (during implementation of a Code of Civil Procedure in the 1920s to 1940s) provide strong support for the eventual success of a civil procedure process.

To minimize risks, Acme must develop a comprehensive intellectual property strategy incorporating decisions on whether and what patents should be filed in the PRC, whether additional trademarks should be registered, and when software should be registered. Establishing an approach that will most likely discourage the unlawful dissemination of Acme's intellectual property should be the primary objective. Initially, a decision may be desirable to hold back the introduction into the PRC of Acme's most advanced technologies and instead introduce an older generation. Finally, Acme must dedicate sufficient resources for monitoring enforcement.

Additional elements of the strategy will involve a careful selection of partners, full control over operations by an experienced expatriate staff, and close attention to the fine details of all contractual undertakings. To the extent that Acme can establish a good working relationship with government agencies or other institutions and businesses and establish a base of interests that will also be damaged in the event that Acme's intellectual property is diluted, then battles against infringers in the PRC will be easier to fight.

The vastly improved intellectual property environment (as compared with even five years ago) is a significant development. Nevertheless, some problems still exist. In particular, the uniform and judicious enforcement of the PRC laws has

18. Richard L. Thurston, *China's Civil Law Reform Movement, 1912-1930*, 68 (1979) (unpublished Ph.D. dissertation, University of Virginia).

19. For example, the United States established in 1906, by act of Congress, a full-scale U.S. district court, which sat in Shanghai until 1943. The author is currently writing a history of that court.

20. Code of Civil Procedure of the People's Republic of China, China L. Foreign Bus. (CCH) § 19-201.

yet to become a reality. But, progress is being made and, assuming a continued march in this direction, Acme's risks can be minimized over time.

II. Risk Analysis from an Investment Perspective

One of the driving concerns of many foreign investors has been the absence of a general company or corporation law establishing national guidelines for corporate matters and within which to shelter one's assets, including intellectual property. Most notably, there has not existed until recently, any post-1949 laws, regulations, or court precedent on corporate governance issues or matters concerning shareholder rights, mergers and acquisitions, dissolution, and the like, aside from those relating to joint venture operations.

The basic body of previously enacted national laws governing business entities has consisted of the following principal legislation (a nonexclusive list): (1) the Joint Venture Law²¹ and related legislation; (2) the Co-operative Enterprise Law;²² (3) the Provisional Regulations Governing Foreign Resident Representative Offices;²³ (4) the Provisional Regulations on State-Owned Industrial Enterprises;²⁴ (5) the Law on Wholly Owned Foreign Enterprises;²⁵ and (6) the Regulations Governing Registration of Enterprise Names.²⁶ Yet, it is at the local level that guidance on company law issues is developing.

Both Shanghai and Shenzhen have recently passed legislation governing new companies and the issuance of securities in their respective jurisdictions. Such legislation sends a strong signal to foreign investors of the continued opening of the door to foreign investment. This new openness is indicative of the realization of the old and new bastions of commercial activity that trade and investment must be facilitated by providing further structure and comfort to investors.

In the case of Shenzhen, in 1992 the Shenzhen Municipal People's Government and the Shenzhen Securities Exchange were quite active. In January 1992, the Securities Exchange promulgated the Operating Rules of the Shenzhen Securities Exchange for Trading and Clearing of "B" Shares²⁷ and the Provisional Rules of Shenzhen Municipality for Registration of Special Renminbi-denominated

21. Law of the People's Republic of China on Sino-Foreign Joint Equity Enterprises, China L. Foreign Bus. (CCH) § 6-500.

22. Law of the People's Republic of China on Sino-Foreign Cooperative Enterprises, China L. Foreign Bus. (CCH) § 6-100.

23. Provisional Regulations of the State Council of the People's Republic of China for the Control of Resident Representative Offices of Foreign Enterprises, China L. Foreign Bus. (CCH) § 7-500.

24. Provisional Regulations on State-Owned Industrial Enterprises, China L. Foreign Bus. (CCH) § 13-500.

25. The Law of the People's Republic of China on Sole Foreign Investment Enterprises, China L. Foreign Bus. (CCH) § 13-506.

26. Administrative Regulations Governing the Registration of Enterprise Names, China L. Foreign Bus. (CCH) § 13-504.

27. China L. Foreign Bus. (CCH) § 73-565.

Shares.²⁸ For the first time since the Communist Party came to power in 1949, foreign investors are allowed to invest in publicly traded shares. This controlled opening of the stock market should be watched closely.

Of greater potential impact on investors throughout China, are the Provisional Regulations of the Shenzhen Municipality on Limited Liability Companies, issued on March 18, 1992, by the Shenzhen Municipal People's Government.²⁹ This new company law is applicable to joint stock limited companies established in Shenzhen as well as companies listed on the Shenzhen Stock Exchange. Article 3 defines a limited liability company as:

An enterprise with legal person status established pursuant to the provisions of these regulations which raises capital through the issue of shares, whose total registered capital is assigned as stocks, whose shareholders assume an amount of liability equal to the amount of shares purchased and which offsets its total assets against responsibility assumed for company debts.³⁰

Under the Regulations a company may be established by "promotion" or by share issuance.³¹ Distinction is made between private (internal) and public companies. The Regulations provide for the establishment of a preparatory (preincorporation) committee, application requirements, contents of the articles of association, public prospectus, public listing requirements, and the like. Furthermore, extensive provisions governing shareholders and boards of directors are provided (chapters VIII and IX). These provisions are generally compatible with Western practices.

Finally, the Regulations provide a general framework for mergers and divestitures (chapter XII) as well as termination and liquidation (chapter XIV). These latter provisions need to be closely studied and their subject matter addressed more fully in the shareholder's agreement as well as the articles of association. Overall, the Regulations bring a greater degree of certainty to the foreign investor by establishing basic guidelines for corporate procedures and governance. Comfort that the state is truly intent on privatizing industry may also be gleaned from these developments, thereby reducing a certain degree of risk for the investor.

III. Conclusion

The risks presented by the PRC to Acme today are similar in many respects to those encountered by U.S. companies earlier in other developing Asia-Pacific countries such as Korea and Taiwan. As experience shows, certain intellectual property issues, especially enforcement, take time to implement thoroughly and, in fact, to differing degrees, remain an issue even in those countries today. At the same time, the overall environment has improved to such an extent that greater

28. *Id.* § 73-567.

29. *Id.* § 73-571.

30. *Id.* art. 3.

31. *Id.* art. 11.

protection exists, with assurances that more is on the way. As in Taiwan or Korea, with a carefully-thought-out strategy and well-planned program in China, Acme should be able to minimize the potential risks to its intellectual properties as well as to avoid many future problems vis-à-vis yet-to-be-adopted national corporate legislation. Nevertheless, until the political environment in China becomes more clear, enforcement and application of current laws become more uniform and consistent, and government-to-government disputes on trade access are resolved, U.S. companies should move cautiously in the transfer of their advanced technologies to the PRC.