

What You Need to Know About Chinese Companies:

Key Issues for Canadian Companies

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Goodmans

Chinese Local Enterprises

- Individually Owned (sole proprietorships)
- Partnerships
- Collectively Owned (Cooperative) Companies
- State Owned Enterprises
- Limited Liability Companies
- Joint Stock Companies

Also a large class of unregistered enterprises doing business in China

Issues with Various Types of PRC Enterprises

- Individually Owned Enterprises
 - Unlimited personal liability for the owner
 - Cannot enter into agreements with foreign parties
 - Cannot enter into joint venture agreements with foreign parties
 - Co-mingling of funds
- Partnerships
 - Unlimited joint and several liability of partners
 - Partners cannot operate a business that competes with the business of the partnership
 - Distribution of profits to embody the concept of “voluntariness, equality, and fairness and good faith”

Issues with Various Types of PRC Enterprises (cont'd)

- Collectively Owned (Cooperative) Companies
 - Rarely used now
 - Often used in the past as a way for private individuals to operate a company
 - Cannot enter into joint venture agreements
- State Owned Enterprises
 - Often carrying historical burdens
 - Retired/non-existing employees that are (still) on the payroll
 - Often do not have the required approvals
 - Land ownership issues

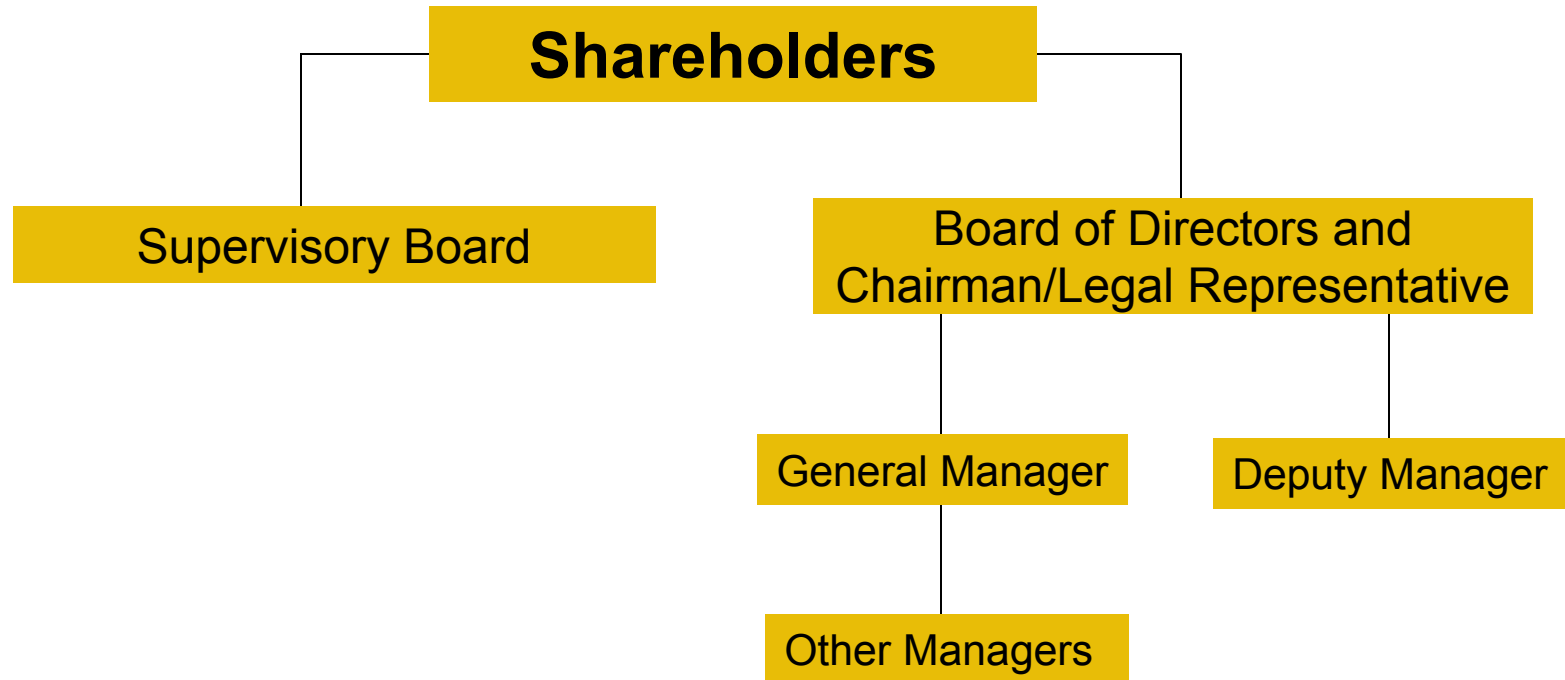
Issues with Various Types of PRC Enterprises (cont'd)

- Limited Liability Companies
 - Most common type of company
 - At least two shareholders required (often held in trust for one true owner)
 - Similar to the concept of limited liability corporations in Canada
 - Supervisory Board
 - Legal Representative = Chairman

Issues with Various Types of PRC Enterprises (cont'd)

- Joint Stock Companies
 - Company limited by shares
 - Required structure for PRC companies listing on Shanghai or Shenzhen stock exchanges
 - At least five shareholders
 - More stringent corporate governance requirements

A Closer Look at PRC Limited Liability and Joint Stock Companies



Corporate Governance

- There are three main reasons corporate governance matters are not a major concern for PRC companies:
 - Difficult business culture
 - Closely held
 - Short term approach

Corporate Governance

- There are four primary problems that result from the lack of good corporate governance in PRC companies:
 - **Transparency**
 - Corporate structure often problematic
 - Complex structures (so it can be difficult to know what type of enterprise you are dealing with)
 - Not properly established
 - Difficult to determine true ownership
 - Not familiar with due diligence process (reluctant to disclose information to outside parties)
 - **Accounting**
 - Most enterprises file the required financial information, but this is an issue of form over function
 - Not GAAP to say the least

Corporate Governance

- **Minority Shareholder Rights**
 - Not well understood
 - Most companies closely held (often by families)
- **Related Party Transactions**
 - Significance of non-arm's length transactions not understood
 - Very common in PRC companies
 - Foreign companies must pay particular attention to non-arm's length transactions when partnering with PRC companies

DD Issues

- Laws are often unclear / not implemented
- Laws / policies are not always made public
- Local treatment of laws / procedures is common
- Non-compliance with laws is common (often for practical reasons)
- Difficult to do credit / litigation searches
- Legal opinions not always reliable

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