MEMO ON WFOE & JV

Introduction

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III. Advantages and potential risks for shareholders in WFOE.

I. Brief introduction of JV and WFOE in China

Joint venture (**JV**) is a business arrangement in which the participants create a new business entity or official contractual relationship and share investment and operation expenses, management responsibility, loss and profit. It could either be form of limited liability company or unlimited liability partnership, and most of foreign investors adopt the latter form for the sake of personal assets protection. Only limited liability JV will be discussed hereto in this memo. (We suppose that the Chinese company is a Limited Liability Company –LTD- as it is the normal and more common legal status of Chinese company. After the transformation the status of Limited Liability will be kept by the new entity)

The Chinese authorities encourages foreign investors to use this form of company in order to obtain exposure to advanced technology and new management skills. In return, foreign investors can enjoy low labor cost, low production cost and potentially large Chinese market.

Wholly Foreign Owned Enterprise(WFOE) is a limited liability company wholly owned by foreign investors. The registered capital of a WFOE should be subscribed and contributed solely by foreign investors. Generally speaking, branches or representative offices set up by foreign companies are not WFOE.

Compared with JV, WFOE enjoys independence and freedom to implement its worldwide strategies of its parent company without having to consider the involvement of its Chinese partner.

II. Advantages and potential risks respectively for majority, minority and equal shareholders in JV

In all of China’s big ticket investment area, and certainly its restricted industry sectors, having a JV partner is mandatory. There are a number of reasons for this, related mainly to political and strategic sensitivities over certain industrial sectors over which China either wants to maintain control or to keep a close eye on. These include mining, aerospace, oil and gas, other energy production and distribution fields, education, much of the medical industry, amongst others. Since the business of your company does not fall into the

category of this list, only basic issues of advantages and potential risks of being majority, minority and equal shareholders will be discussed in this part.

-Majority shareholders

If your company owns over 50% equity interests in the JV(as reflected in its registered capital)，then your company are considered as majority shareholder and have vital management control in the JV. The benefits of being a majority shareholder lie in many facts which include but not limited to: i) majority shareholders will have the power to appoint the majority of its Board of Directors; ii) if it is stipulated in the JV's Articles of Association that the Board shall make resolutions on ordinary matters by a simple majority, your company, as the majority shareholder, will be able to have control in the Board's decisions on normal business matters; iii) also if it stipulated in the JV's Articles of Association that profits are allocated according to capital distribution in the JV, majority shareholder will be allocated to more profits than minority and in the same time, bear more loss if there is any.

-Minority shareholders

If a company owns less than 50% of equity interest in a JV, the company is considered as a minority shareholder in the JV. As a general rule, the number of directors that each investor can appoint should be determined in reference to the capital contribution made by

such investor, so minority shareholder obtains less voting power than majority shareholders in corporate governance. Of course the shareholders agreement can protect parties and minorities, giving more powers to the minority but the related obligation arising from the shareholder agreement is just a contractual obligation. As far as the profit allocation are concerned, minority shareholders are likely to get less profit than majority shareholders according to their respective capital contribution and at the same time, they bear less risk if any loss occurs.

-Equal Shareholders

In a JV, if each party owns 50% of equity interest as reflected in its registered capital, they are equal shareholders. As a general rule, equal shareholders share the same share of profit and take the same share of loss, and they participate in management and business operation with equal rights. Since each party shares the same fair share of risks or profit and enjoys the same rights in operation, so it could be understood that each equal shareholders undertake the same risks.

However, if placed in a deal breaker situation, it's preferable that the business to be able to have a decision making process and not to get into stalemate. Any side to take the majority and push things forward rather than have a 50-50 dilemma and get everything indefinite.

III. Advantages and potential risks for shareholders in WFOE

The advantages of establishing a WFOE compared to other forms such as JV include independence and freedom to implement its strategy

without having to consider the involvement of Chinese partner and secure its relationship with local Chinese partner through regular contract. Furthermore, a WFOE could avoid itself jumping into to a mysterious system with a Chinese partner whose motivations may be hard to discern.

However, a flip side of WFOE is that it has to start from scratch for everything from distribution channel or sales network which could be an advantage in a JV and which could be a time consuming and costly proceeding.