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REFORMING CHINA'S PARTNERSHIP LAW: ACHIEVEMENTS, PROBLEMS AND PROSPECTS

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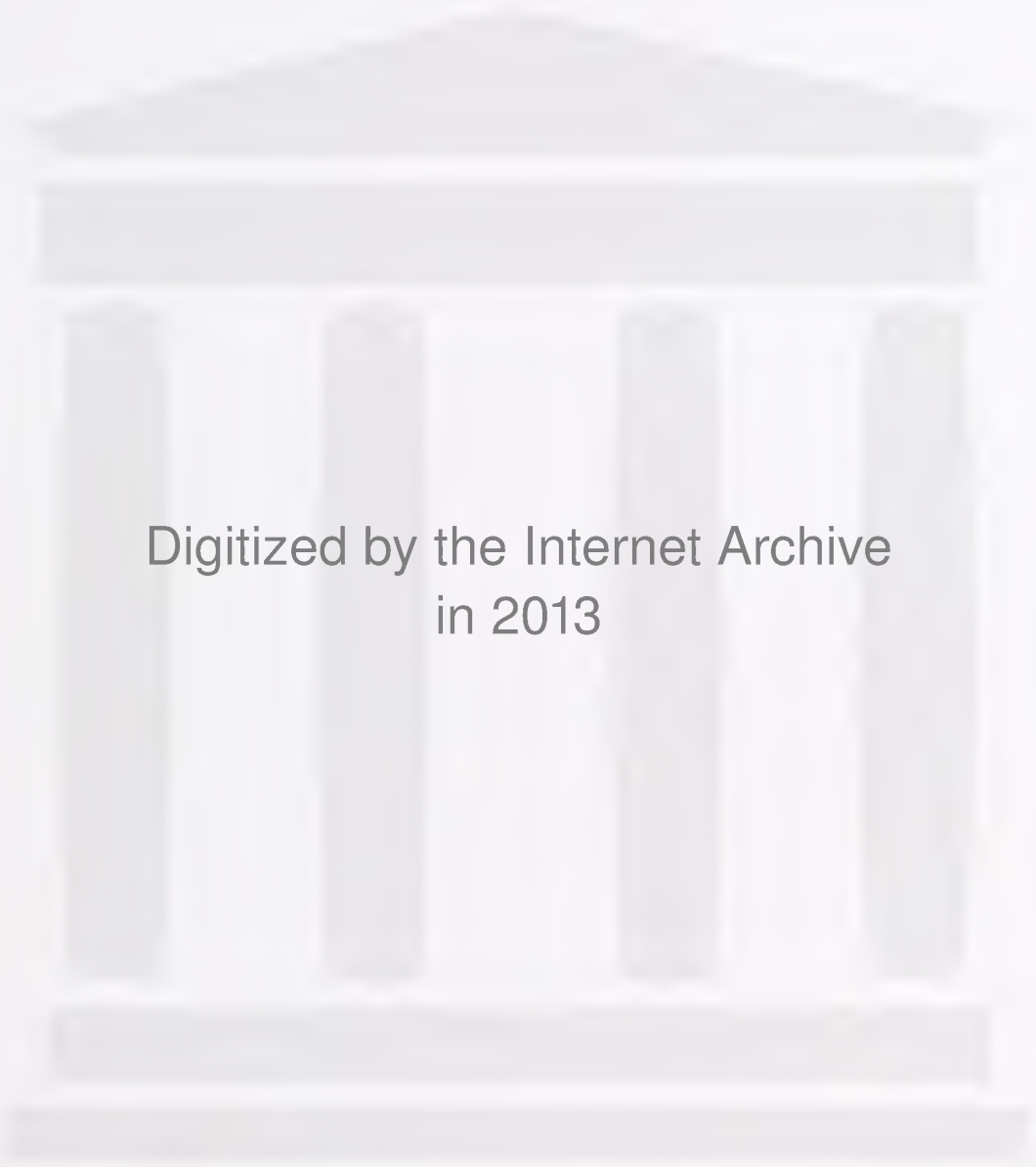

REFOMING CHINA'S PARTNERSHIP LAW:

ACHIEVEMENTS, PROBLEMS AND PROSPECTS

by

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CHAPTER I

INTRODUTION

The development of the laws on partnership in China is closely related with continuing economic reform. From 1949 to 1978, the Chinese economic system was based on a planned model. That system was very rigid. Within such an economy, the means of production (productive resources) were owned mostly by the state, leaving a minor portion in the hands of enterprises (normally in one form of a collective ownership). The decision-making power for macroeconomic activities and for business activities of enterprises was concentrated in the hands of the state. While the market still existed, since currency-commodity relations [1] remained, various targets were realized through mandatory plans drawn up by the state hierarchy. The enterprises immediately responsible for production had to follow state orders in business activities, including finance, management, marketing, employment, wage policy and expansion, and enjoyed hardly any independence. As the economic benefits of enterprises were not linked with their performance, enterprises with significant profits had no right to dispose of their profits while enterprises with heavy losses were subsidized by the state. Economic information was transmitted vertically between the higher and lower levels in the administrative system in the form of instructions and reports. Within this system, there was no role for the law of business associations, including partnerships.

With the adoption of open door and reform policies in 1978, the rigid planned economy has been abandoned and replaced by a market-oriented economy. Private ownership has been allowed and protected; foreign investment and foreign trade has been encouraged and promoted. To accommodate such a drastic change, China has begun embarking a large scale legislative endeavor which has embraced over 200 laws and 80 decisions of the National People's Congress; more than 700 administrative regulations of the State Council and its ministries, commissions and other branches; about 3000 local regulations, and more than 10,000 local administrative rules of the local governments and their agencies. This even-expanding constellation of laws and regulations in a nascent but growing legal regime embraces almost every aspect of society and constitutes a complex hierarchy of law in China. Laws and regulations concerning partnership are an important part among them.

Partnership, as a form of business, has long existed in China. But it was squashed in 1956. More than twenty years later, with the economic reform, it reemerged, and then flourished. In order to regulate these "new things", the government rushed to insert nine articles concerning partnerships in the General Principles of Civil Law [2] (hereinafter "Civil Law"). The Opinions of the Supreme People's Court on Questions Concerning the Implementation of the Civil Law (hereinafter "the Opinions") has some relevant provisions. The most recent law on partnership was adopted on February 23, 1997 which is called Partnership Enterprise Law (hereinafter "PEL"). In addition, there

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[1] Although production of most goods or services was planned by the State, these goods or services were not directly allocated to individuals. Instead, these goods or services were exchanged through the medium of money on the market.

[2] The Civil Law was adopted on April 12, 1986.

are some other rules, regulations and opinions issued by different governmental agencies, which have provisions relevant to partnerships.

This thesis proposes some measures to reform China's partnership law after providing an overview of China's partnership development in a historical perspective. After a brief introduction in Part I, Part II reviews the historical development of partnerships since the founding of the People's Republic of China. Much emphasis is put on the significant changes since 1978. Part III examines the basic structure and content of the present laws and regulations on partnership in China. Part V highlights the problems and limits facing China's partnership law. Measures are proposed in Part IV with detailed reference to United States partnership law. As a conclusion, the thesis predicts in Part IIV that China will establish a uniform partnership law that conforms to the international standard.

CHATER II

HISTORICAL DEVELOPMENT OF PARTNERSHIPS IN CHINA

A. A Flash in the Pan: Status before 1956

By the time the People's Republic of China was founded in 1949, there were about 1.3 million industrial and commercial enterprises. Among them about 1.2 million were sole proprietorships and partnerships. [3] In view of the fact that the civil war was just over, and many things needed to be done to restore the economy and stabilize the market, the communist government did not hasten to replace the numerous private enterprises with state owned enterprises. On the contrary, a statute was passed to specifically recognize and protect the development of private businesses.[4] This, at least temporarily, dispelled the fears and doubts of the private capitalists and business owners. They enthusiastically joined in an effort to establish more enterprises and increase production.

According to a survey conducted in 1956 by the State Bureau of Statistics, the number of private owners who had investment in industrial sectors was 53,37,00. 53.8 percent of their businesses were partnerships, 38 percent sole proprietorships, and only 8.2 percent companies. [5] This indicates that partnership once played an important role in remedying the war-torn economy in 1950s.

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[3] Collection of Civil Law Materials, Beijing Institute of Politics and Law (1956) at 208-209.

[4] Provisional Regulations Concerning Private Enterprises, adopted on December 29, 1950 by the State Council.

[5] National Economic Construction and People's Life of Our Country, Statistical Publishing House (1956) at 92.

However, the direction of the wind suddenly changed in 1955. In order to establish the socialist regime, socialist reform was launched in urban and rural areas. In the cities, after the confiscation of bureaucratic capitalist property, national capitalist ownership and small private business became the major forms of ownership, which were alien to socialist ownership. The socialist reform in urban areas, following the policy of redemption, intended to transform capitalist ownership and private ownership into socialist ownership by persuading or forcing private proprietors to establish public and private joint ventures with the State. Gradually, private ownership was melded into state-ownership. Rural reforms went through several stages and finally led to the establishment of People's Communes [6] In the face of such a drastic socialist reform, partnership, as "an spontaneous force of capitalism", was gradually eradicated. Two reasons account for the disappearance of partnerships from the economic scene. First, by 1956, state-ownership had occupied an absolutely dominant position in the national economy. Partnership – an association of private owners – was sure to be doomed. Second, in the late fifties, following the example of the former Soviet Union, the government established a highly centralized planned economy. The market economy was completely abandoned. Partnership, a product of a commodity economy, naturally had no soil for existence.

B. Back on the Right Track: Developments after 1978

In late 1978, China's economic reform and open-door policies were initiated at the Third Plenary Session of the Eleventh Chinese Communist Party Congress.[7] The reform

[6] People's Commune was a rural organization existing before the reform in which the peasants received equal pay in spite of the disproportionate amount of work they did.

[7] For an overview of China's economic reform and open door policy, see generally Harry Harding, China's Second Revolution: Reform after Mao (1987). See also Richard Baum, Burying Mao (1995).

began in rural areas. A new system of contractual responsibility was adopted which increased the role of markets as more agricultural products were circulated on the market. Until the end of 1985, there were more than 48,00,00 " rural commodity economic associations " which employed 4.2 million people with a total operating income of 13 billion RMB Yuan.[8] That income was 200 million Yuan more than the total industrial output of private enterprises of the whole country in 1953.

The State Bureau of Statistics defined the association as " an economic organization jointly established by some peasants before or after production. It is based on the principles of voluntariness and mutual benefit, joint operation and management. It has some organizational scale, a place of business and permanent staffs. It should have comparatively stable operating projects and establish an accounting system and distribution system. Seasonal economic associations should have a fixed term of more than three months."

Similar changes have taken place in the cities. The number of "urban cooperative operating organizations " had reached 27,00,00 with 3.1 million employees by 1986.[9] Urban cooperative organizations were defined as "those jointly established by urban individual proprietors, the unemployed or social idlers to engage in industrial or commercial business for profit."[10] All the urban cooperative organizations were established according to the Provisional Regulations Concerning Urban Workers' Cooperative Operating Organizations adopted in 1983 by the State Council.

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[7] People's Daily, June 14, 1986.
[8] 7 Statistics (1986)

The rights and obligations of the members of the urban cooperative organization are provided in the articles of association or agreement. The ownership of the capital and other property contributed to the organization belonged to the contributing members, but they were to be jointly managed and used by the organization. Profits of the organization were to be distributed according to the principle of equal pay for equal work: wages were to be agreed to by the members through negotiation; the yearly after-tax surplus should be divided into four parts: accumulation fund, public welfare fund, dividends for labor and dividends for shareholding. The amount of dividends for shareholding should not be more than 15 percent of the shareholding. The cooperative organization should file for registration at the relevant registration and tax authorities. Upon dissolving the organization, the members should liquidate the property in the following order: paying taxes, discharging debts, repaying the contributions, and distributing the remaining property through negotiation. A liquidation report should be submitted to the relevant administration of industry and commerce for deregistration of the organization. Two or more cooperative organizations can establish joint ventures, or they can engage in joint ventures with state-owned enterprises or individual proprietors. Those joint ventures will not be limited by regions and economic sectors. [11]

Partnerships jointly operated by family members were also prevalent among some of the more than 110,00 individual industrial and commercial proprietorships in 1986.

All the above-mentioned rural commodity economic associations, urban cooperative organizations and proprietorships jointly managed by family members are different forms of partnerships in reality, though in name, none of

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[10] Regulations on Urban Worker's Cooperative Operations. 1983. State Council.
[11] Wang Liming, New Theories on Civil Law at 312, 313.

them was so called. The reason is that in the past quarter of a century, "partnership" was a derogatory term associated with capitalism; even after the resurrection of partnerships in the 1980s, people were still fearful of directly using the term, and they tried to coin some other terms with socialistic characteristics to replace it. However, mere words should not blind us to realities.

The promulgation of Civil Law in April 1986 put partnerships on the fast track. For the first time, it recognized partnership as a form of business in China. By the end of 1995, the number of partnerships stood at 12,00,00. At present, there are five different forms of partnership in China:

1. Individual partnerships. Partnerships between individual persons, including both registered and unregistered partnerships.

2. Joint ventures between Chinese legal entities.

3. Contractual joint ventures between Chinese enterprises and foreigners.

4. Collective enterprises. These enterprises exist under the cloak of collective-owned enterprises, but in reality they are individual partnerships.[12]

5. Partnership enterprises. These partnerships have been established in accordance with PEL.

[12] Collective-owned enterprises in rural areas and in towns or cities are respectively regulated by the Regulations on Rural Collective Enterprises (Rural Enterprise Regulations) and the Regulations on Urban Collective Enterprises (Urban Enterprise Regulation). Rural Enterprise Regulations do not define the term "rural collective enterprise". In contrast, Urban Enterprise Regulations provide a definition and some criteria. An urban collective enterprise is collectively owned by the people of the enterprise. The owners make joint contributions, and remuneration is mainly based on the contribution of labor of each individual person. Such an enterprise may be a single entity or a combination of several entities. Generally, the proportion of assets collectively owned should be more than 51 percent. Both urban and rural collective enterprises may obtain the
status of legal persons as specified in the Civil Law. As legal persons, the owners will not be liable for the debts of the enterprises.

CHAPTER III

LEGAL STRUCTURE OF PARTNERSHIP LAW IN CHINA

In 1986, there existed only a few provisions in the Civil Law on individual partnerships and joint ventures. The brief provisions, however, have given rise to many application problems in the courts. To deal with that problem, the Supreme People's Court issued in 1988 the Opinions to the lower courts, instructing them how to apply the law of partnerships. The newly enacted PEL provides relatively detailed provisions, facilitating the organization of partnerships in China.

A. The Civil Law and the Opinions

The Civil Law divides partnerships into two categories; individual partnerships and joint ventures. Individual partnerships refer to two or more natural persons associated in a business and working together, with each providing funds, materials, skills, intangible properties according to a partnership agreement. [13] Rights and duties between partners, methods of profit distribution, conditions of joining in and withdrawing from a partnership, liabilities for debts of the partnership shall be spelled out in the partnership agreement. [14] The operational activities of an individual partnership shall be decided jointly by the partners, each of whom shall have the right to carry out these activities. [15] Partners may delegate their powers to a responsible person or other persons, provided that all partners shall bear civil liability derived from the operational activities of the

[13] Civil Law Art 30.
[14] Id., Art 31.

responsible person or other persons. [16] With respect to the debts of the partnership, each partner is jointly and severally liable to creditors.[17] However, after satisfying the claim of the creditors, the satisfying partner may seek indemnity from other partners for the amount exceeding his or her proportion as specified in the partnership agreement. [18]

Under the Civil Law, joint ventures are specified in the legal person chapter. [19] Basically, if the enterprises, or an enterprise and an institution that engage in an economic association, conduct joint operations but do not have the qualifications of a legal person, [20]each party to the venture shall, in proportion to its respective contribution of investment or according to the agreement made, bear civil liability with the property each party owns or manages. If joint liability is specified by law or by agreement, the parties shall assume joint liability. [21]

Partners may specify ways of withdrawal from a partnership. Where losses are incurred by other partners in case of such a withdrawal, damages may be awarded, taking into account the causes of withdrawal and the degree of fault of the parties. [22] As for the debts of the partnership, the withdrawing partner is liable if he has not paid his portion as agreed in the partnership agreement. But even though the withdrawing

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[15] I.d., Art 34.
[16] I.d.
[17] I.d., Art 35.
[18] I.d.
[19] The Chinese legal system is closer to the continental European legal system in that the laws are codified. The civil code is a very important code in these countries. Compared with these countries, China only codified some general principles instead of detailed provisions of civil law. However, the basic structure in the Civil Law is very similar to the Civil Codes in some continental countries such as Germany and France. In the Civil Codes of these countries or in the Civil Law in China, there are two essential chapters. One is on natural persons, and the other is on legal persons. One difference between natural persons and legal persons is whether there is a separate entity. Legal persons are legal entities separate and different from the equity investors.
[20] Under the Civil Law, a legal person must satisfy the following requirements: (1) establishment in accordance with law; (2) having necessary property or money; (3) having a name, an organization and place of business; and (4) being able to bear liability independently.
[21] Civil Law, Art 52.
[22] Opinions, Art 52.

partner has paid his or her agreed share, that person may be still liable for the debts of the partnership so long as the partnership does not have sufficient assets to satisfy all the creditors at the time of withdrawal. [23] With respect to distribution of assets of the partnership when the partnership ceases its business, the partnership agreement shall be respected. In a case where there is no ex ante or ex post agreement on that issue, the view of the majority partners shall prevail if all partners made an equal investment in the partnership or the view of the partner with most assets involved shall be respected if the partners' contributions differ. In the latter case, the interest of other partners shall be taken into account. [24] Obviously, the court has the discretion in balancing the interests of the dominant partner and the interests of other partners concerning the distribution of assets.

B. Partnership Enterprise Law

As previously mentioned, the PEL was promulgated against the background of the sketchy provisions on partnership-related issues in the Civil Law. It purports to establish a comprehensive legal framework for partnerships. It should be mentioned that the phrase "partnership enterprise" is used in the Law for the reason that it only regulates registered partnership entities.

1. Formation of a Partnership

Under the PEL, a partnership enterprise shall be established if it satisfies the following requirements:

[23] I.d., Art 53.
[24] Id.

(a). The partnership must have at least two partners, both or all of whom bear unlimited liabilities. [25]

One person alone cannot be a partnership. Partners must be natural persons who have full capacity for civil acts. The Civil Law will govern the issue of legal capacity.[26] Typically, however, a minor can contract to join a partnership, but that contract is subsequently voidable by the minor because he or she did not have the capacity to enter into it. Similarly, a person who is mentally incompetent, but not so adjudicated, can repudiate the contract. A person already adjudicated incompetent, on the other hand, simply lacks the capacity to enter into a contract or consent to becoming a partner, and the incompetent's agreement to join would therefore be wholly void. Also, persons prohibited by laws and administrative regulations from engaging profit-making activities may not become partners, such as judges, [27] public procurators, [28] police officers [29]and public officials. [30] Business associations, such as companies, partnerships and other organizations are also prohibited from becoming partners.

(b). There must be a written partnership agreement. [31]

A partnership agreement should include provisions as to the following matters: (1) name and place of the partnership; (2) the purpose and business scope of the

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[25] PEL, Art 8(1).

[26] Under the Civil Law, Persons over the age of 18 have full capacity for civil acts, and their acts are valid; persons between 10 to 18, and persons who are mentally retarded and cannot fully understand their acts, have limited capacity for civil acts, and their acts are voidable; Persons below 10 ,and persons who are mentally retarded and cannot understand their acts, have no capacity for civil acts, and their acts are void .

[27] Law on Judges Article 32(11) provides that judges cannot engage in business for profit.

[28] Law on Public Procurators Article 33(11) provides that public procurators cannot engage in business for profit.

[29] Law on Police Officers Article 22(10) provides that police officers cannot engage in profit-making business or be employed by any person or organization.

[30] Provisional Regulations on Public Officials Article 31(13) provides that the State public officials must obey discipline and should not engage in commercial activities, establish enterprises or take part in other profit-making activities; Article 49(2) provides that the State public officials must not hold part-time positions in any enterprise or profit-making institutions.

[31] PEL, Art 8(2).

partnership; (3) names and residences of the partners; (4) mode and amount of contribution and the deadline when it should be paid in; (5) sharing of profits and losses; (6) carrying out of partnership business affairs; (7) entering into and withdrawing from the partnership; (8) dissolution and liquidation of the partnership; and (9) liability for breach of the agreement.

It is left to the partners' discretion whether they will specify in the agreement such matters as a fixed term and how to settle disputes among themselves. [32]

(c). The partnership must have paid-up contributions from each of the partners. [33]

Property contributed by partners may be in the form of cash, kind, land use rights, intellectual property rights or other property rights.[34] Labor services may also be counted as contribution if unanimously approved by all of the partners.[35] Kind can be anything which is legally owned by the contributing partner, for example, house, machines, raw materials, spare parts, etc. Land use rights refer to the rights to use and benefit from the land. [36] Intellectual property rights include patent, trademark, copyright, right of invention and discovery, trade secrets. Bonds, securities and rights to accounts receivable can also be contributed by the partners.

(d). The partnership must have a name. [37]

A partnership, as a separate legal entity, should have a name to distinguish it from other entities. The name should not be the same as, or similar to, the names of other

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[32] I.d., Art 13.
[33] I.d., Art 8(3).
[34] I.d., Art 11.
[35] I.d.
[36] In China, no individual person is entitled to own land. Land can only be owned by the State and the people of villages as a whole. But the right to use land and gain profit from it can be granted to individuals by the landowners.
[37] I.d., Art 8(4).

enterprises in the same line of business. [38]The name must not: (1) contain the words "limited" or "limited liability"; (2) be contrary to the interest of the State or the public; (3) embrace illusory or misleading words; (4) use the names of foreign countries, international organizations, political parties, governmental bodies, armies or social organizations; or (5) use numbers. [39]In addition, the name should indicate both its line of business and its business form of partnership. [40]

(e). The partnership must have a place of business and the conditions necessary to engage in the partnership business. [41]

Two reasons are given by the authority for the place of business requirement: first, the partnership should have a place where its business affairs are conducted, and outsiders can conveniently locate the partnership; second, it is easy for the government to exercise supervision and control over it.

Upon satisfying the above-mentioned requirements, the proposed partners must file with the enterprise registration authority a written application, the written partnership agreement and other documents such as proof of identity of the partners. [42] The authority shall issue a decision as to whether to approve the partnership within 30 days of receiving the application documents.[43]

2. Partnership Property

Capital contributions of the partners and all profits obtained in the name of the partnership shall be the property of the partnership, which shall be jointly managed and

[38] Regulations on Registration of Names of Enterprises. Art 6.
[39] I.d., Art 9.
[40] I.d., Art 7.
[41] I.d., Art 8 (5).

[42] I.d., Art 15.
[43] I.d., Art 16.

used by all the partners. [44] Partnership property is owned by the partnership. No partner may claim his or her ownership to any specific partnership property. Individual partners only have a share of interest in the partnership assets taken as a whole.

Before liquidation of the partnership, no partner may request the division of the partnership property, except as otherwise specified in this law. [45] Because ownership of partnership property vests in the partnership, no partner can transfer or otherwise dispose of the partnership property for other than partnership purposes. [46]Such illegally transferred or disposed of property can be recovered unless the transferee had no knowledge of the fact that the transferring partner had no authority. [47]

In contrast with general non-disposability of partnership property, the assignment by a partner of all or part of his share in the partnership property is not so restricted. Under the PEL, a partner can assign all or part of his share of interest in the partnership property to a third party subject to the unanimous consent of the other partners. [48] However, if the transfer is made to another partner, the transferring partner need only notify other partners. [49] Pledge of a partner's share is also subject to the unanimous approval of the other partners, otherwise his act shall be invalid, or alternatively be deemed as dissociating from the partnership. [50]

3. Partner Liability to Third Parties

A partner is unlimitedly liable to third parties for the obligations of the partnership. However, this liability does not cover all obligations of the partnership. Obviously,

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[44] I.d., Art 19.
[45] I.d., Art 20.
[46] I.d.
[47] I.d.
[48] I.d., Art 21.
[49] Id.
[50] I.d., Art 24.

partnership obligations are incurred as a result of dealings of its partners or other agents, such as its employees, with third parties. As every partner is deemed to be an agent of the partnership, some agency law rules will be employed to determine what acts of a partner can legally be the acts of the partnership, and thus bind it.

a. Partnership Acts Defined.

The authority of an agent to his principal is most generally in the form of either actual authority or apparent authority. Actual authority is divided into express and implied authority. Simply put, actual authority is the authority the agent can reasonably believe the principal has granted to the agent, based on the principal's manifestations to that agent. Express authority is self-explanatory, but implied actual authority refers to the acts that the agent can reasonably believe he or she is authorized to take because they are implicitly necessary, given the express actual authority, received from the principal.

Apparent authority, on the other hand, is the power of the agent to bind the principal based on the principal's manifestations to the third party. Here it is the third party who is to be analyzed. Given what the principal said, did or omitted, if the third party believed that the agent had the actual authority to act, that act then binds the principal. Apparent authority is generally defined for partnership purposes as an act that is within the scope of the partnership business. The scope of a partner's authority is therefore measured by the character of business conducted, and is limited only by the scope of the partnership business, and within the scope of such authority, he may bind his copartners as any other general agent may bind his principals. For example, a partner may bind the partnership by a contract to purchase materials such as are ordinarily purchased by men

engaged in the same business. Matters of general management, such as incurring firm debts, borrowing money, mortgaging or pledging personal property, purchasing goods and merchandize, hiring employees, paying and collecting debts, making releases, compromising and settling claims, and litigation are generally deemed within the normal business of the partnership. Moreover, acts of a partner which are subject to the unanimous consent of all the partners as stipulated in PEL Article 31 can also bind the partnership if the third party has reasonable grounds for believing that the acts are within the scope of the partnership business.

In summary, if an agent of the partnership acts in a way that he or she reasonably believes is within the actual authority granted by the partnership (i.e., by the partners), or in a way the third party reasonably believes is within the agent's actual authority, then the agent's act will bind the partnership.

b. Extent of Partner's Liability for Partnership Acts

PEL article 39 provides that the partners are jointly and severally liable for partnership obligations. The impact of joint and several liability is, essentially, that the plaintiff can select the defendant: the partnership is liable, of course, but suit can also be brought against any or all of the partners. Each of the partners can be forced to pay the entire judgement. There is only one limitation: a creditor should first proceed against partnership assets before going against partners individually. Only if partnership assets are insufficient to pay its obligations, shall the partners be personally responsible for payment of such debts.[51] In this case, each partner is liable for the whole debt, and the degree of his blameableness as between himself and his copartners is immaterial, and he

[51] Id., Art 40.

cannot excuse himself by showing the insignificance of his participation as compared with that of other partners.

4. Partner Liability to One Another

A partner's liability to other partners can arise out of the partner's direct obligation to the other partners. For example, the partner may have agreed with his or her partners to contribute a specified amount to capitalize the partnership business. Alternatively, the partner's liability can arise indirectly, i.e., from the obligation of the partnership as an aggregation.

a. Liability Due to Obligation Owed Directly to Partnership

A partner's liability to the other partners can arise from his or her promises made directly to those other partners upon formation of the partnership. Certainly, the simplest example of such a liability is one that the partner accepts under a partnership agreement. And the most typical example of such a liability is a partner's undertaking to contribute a specified amount of capital to the enterprise. Once the partner agrees to make the contributions, however, that partner becomes contractually bound to the other partners to the same extent, as he would be under any other contract. Certainly, if the partnership suffers losses, the promisor will be obligated to share those losses to the fullest extent of his or her promised contribution. [52]

Another way in which a partner can become directly liable to the other partners is under agency principles in the event that a partner oversteps his or her authority. Under basic rules of agency, the agent owes the principal a duty of loyalty, and if the agent exceeds the actual authority and is not protected by some other form of authorization, [53]

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[52] Id., Art 69, 76.

[53] Such as, ratification, or emergency authority.

the agent must reimburse the principal for what the principal lost due to the disloyalty (as well as any benefit that the agent may have derived from the act of disloyalty). [54]

b. Liability Due to Partnership Obligation

As previously discussed, if the partnership owes an obligation to a third party, the third party may have rights against any partner unless the assets of the partnership are sufficient to satisfy the obligation. If a partner is forced to make a payment to the third party on the obligation, and that payment is in excess of the partner's obligation as set out in the partnership agreement or under the Law, the other partners will be liable to him for that portion of the payment.[55] The partners might also have liability to a partner for amounts owed directly by the partnership to the partner as a partner as opposed to liability owned by the partnership to a true third party. A simple example might arise out of an agreement between the partnership and the partner that the partner is to receive remuneration for his labor services. If the partnership fails to pay the partner's salary, the partner is a creditor of the partnership, and the other partners are personally liable to the partner as though he were a third party.

As to the potential risk for the liability of the partnership, and the other partners, for obligations owed by a partner to creditors unrelated to the partnership, the partners need not be concerned that the partnership's assets will be depleted by creditors of the partners, as opposed to creditors of the partnership. Under PEL, a partner does not have a direct ownership interest in the assets of the partnership. Rather, he holds a share of

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[54] PEL Article provides that a partner who has carried out the business without authority, and causes losses to the partnership or other partners, shall be liable for such losses. PEL Article 68 states that a partner who appropriated the partnership's benefits to himself shall be liable for the losses caused to the partnership or the other partners. PEL Article 70 provides that a partner who compete with the partnership or transact with the partnership shall be liable for any losses caused to the partnership or the other partners.

[55] PEL, Art 40.

interest in the partnership itself, which gives him the right to share in the partnership's profits. The assets that the partnership holds are therefore not owned directly by the partners in the normal sense; they can be used to pay off partnership debts, but they cannot also be used to pay off a partner's individual debts. [56] A partner could not voluntarily take partnership assets and apply them to paying the partner's separate debts. Also, creditors of a partner may not offset his claim to the partner against his debts to the partnership. [57] Indeed the only rights that a partner's individual creditor can obtain are those that the partner holds directly, i.e., the rights to receive the partner's share of partnership profits.[58] Under PEL Article 43, the creditor also has a right to petition the court for compulsory application of the partner's share of interest to repayment of the debts.

5. Management of Partnership Business Affairs

a. Statutory Norms Absent an Agreement

PEL Article 25 stipulates that "Each partner has equal rights in the conduct of the partnership business". [59] In the event that the partner's act is in the conduct of the partnership business, the partner will have acted with both actual and apparent authority. So long as he respects other duties to other partners, the

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[56] I.d., Art 43
[57] I.d., Art 41
[58] I.d., Art 43
[59] Under PEL, the management rights of a partner include the following rights:
(1) The right to information. "Every partner shall have the right to inspect the account books in order to understand the state of the business and financial affairs of the partnership." PEL, Article28.
(2)The right to conduct business. "Each partner shall have equal rights in respect of the conduct of the routine affairs of the partnership." I.d., Article 25.
(3) The right to make decisions. "The PEL provides that disagreement as ordinary matters shall be resolved by vote, and that each partner shall have one vote. I.d., Article 28.

partner has the authority to perform any act within the scope of the partnership business.

In the event that the partners disagree as to how to conduct a certain business affair, voting is the solution. PEL Article 28 provides that "disagreement arising from ordinary matters connected with the partnership business shall be decided by vote, and each partner will have one vote subject to an agreement to the contrary". Each partner's vote is wholly unrelated to the amount of capital the partner contributed to the business. For example, even if a partner had contributed only 10 percent of the partnership's capital and the other partner had contributed the balance; the former partner would have 50 percent of the vote under the partnership norm set out in the Article.

Although there is virtually no law on the topic, "ordinary matters" for these purposes should include such ministerial decisions as replacing office equipment as it wears out. Other matters, such as the removal of the office, a change of name, or a change of direction of the business, would not be considered "ordinary". As to matters that are not "ordinary", unanimity is required. PEL Article 31 contains a list of seven acts that no partner has the actual or apparent authority to perform, even absent dissent. In other words, these seven acts require unanimous approval before they can be effected. Specifically, no partner can

(1) Dispose of the partnership's real property.[60]

(2) Change the name of the partnership.[61]

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(4) The right to veto specific decisions. Matters such as disposal of the firm's real property, change of the firm's name, disposal of the firm's intellectual property rights , guarantees for outside parties in firm's name, etc. I.d., Article 31.

[60] PEL, Art 31(1).

(3) Assign or dispose of the partnership's intellectual property rights or other property rights.[62]

(4) Apply to carry out registration of changes with the enterprise registration authority.[63]

(5) Provide guarantees for outside third parties in the name of the partnership.[64]

(6) Engage non-partners to serve as management personnel of the partnership.[65]

(7) Transact other matters as stipulated in the partnership agreement that require unanimous consent of the partners. [66]

Attention must be paid to these because they may cover more than would be expected at first glance. For example, since PEL Article 31(1) states that a partner cannot, without express authorization, dispose of the real property of the partnership, the partner, presumably cannot transfer the property, and perhaps cannot grant a lease to use the property.

These restrictions on a partner's ability to affect the partnership's business directly are not the only limitations. PEL Article 44 confirms that no one partner, not even a majority of the partners, can authorize another person to become a partner. [67]

b. Impact of Partnership Agreement

Under PEL, a partnership also enjoys great freedom to establish a different management structure. The management rules provided by the PEL are "default" rules.

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[61] I.d., Art 31(2).
[62] I.d., Art 31(3).
[63] I.d., Art 31(4).
[64] I.d., Art 31(5).
[65] I.d., Art 31(6).
[66] I.d., Art 31(7).
[67] The limitation also is perfectly consistent with a partner's inability to assign his share of interest in the partnership without the approval of all the partners.

Thus, for the most part, the management structure and each of the management rights may be altered by agreement among the partners. [68]

Taking first voting rights, both the per capita norm and unanimity rule described above are susceptible to modification by agreement. For example, an agreement signed by the two partners in a two-member partnership could grant 90 percent of the votes to a partner who had contributed 90 percent of the partnership's capital. The partnership agreement could also specify that one of the partners acting alone does have the authority to take acts described in PEL Article 31 that require the unanimous consent of all the partners, as well as other acts that are otherwise not within a partner's actual authority. By together signing an agreement to that effect, the partners would have unanimously agreed that those acts could be taken by one or the other. The agreement could be an authorization by each partner of the other.

Another action that can be taken only upon a unanimous affirmative vote is the inclusion of a new partner, as is mentioned above. Here, too, the partnership agreement can effect a delegation of the voting rights of one or more of the partners to a smaller body of one or more partners. Theoretically, there is no reason why the partners could not delegate that authority to persons who are not even partners, although psychologically that could be surprising.

6. Allocation of Income and Losses

The statutory norm for allocation of income and losses is PEL Article 32, which states that " profits and losses shall be shared equally between the partners." "Profits" are not clearly defined, although the intent to create them constitutes an essential

[68] A change from default rules does not change the individual liability of the partners for partnership obligations.

element of a partnership. Basically, profits mean the excess of assets over liabilities; the partners' contributions of capital are included as a liability. In this context, "capital" means the property or services [69] contributed by the partners to start or continue the partnership business and intended by the partners to be risked. As noted at the outset of this section, PEL Article 32 provides that each partner is to share equally in the profits. That means that each partner's share of income will be determined on a per capita basis, regardless of the proportionate amount contributed by that partner, and regardless of that partner's control over the operations of the business. Even if a partnership agreement delegates all actual authority for management to a particular partner, the managing partner receives only that partner's per capita share of partnership income unless the agreement expressly varies that norm.

As to the allocation of losses, the concept iterated by PEL Article 32 is basically as follows: each partner shares equally in the partnership's losses. In the absence of an agreement to the contrary, each partner must bear his proportionate share of losses incurred in the proper management of the business. Losses must, of course, be paid first out of the profits. If the profits are not sufficient to pay losses, then the burden must next fall on the capital of the partnership. So it is only in case of failure of the assets of the partnership to meet losses that the partners can be held individually, as between themselves, to bear such losses.

Each of the above two statutory norms of profits and losses sharing is subject to change by agreement. Therefore, an agreement can provide that a partner receives only 10 percent of the profits and losses, or that he receives 10 percent of the profits but is liable for 20 percent of the losses. An agreement could also specify that the partner who

[69] See previous discussion of formation of partnership.

is more active in the operation of the business receives a salary in addition to a profit share. However, the agreement may not stipulate that a partner receives all of the profits, or that he bears all of the losses.[70]

7. The Incoming Partner and Dissociating Partner

a. The Incoming partner

Under Article 44 of the PEL , no person can become a partner in a partnership without the approval of all the existing partners. In addition, a written agreement is required concerning the admission of the new partner into the partnership. The concept, essentially, is that given the extraordinary liability the new partner can, in that capacity, impose on the existing partners, each partner should be able to veto the entry of a new partner.

On the practical level, however, that doctrine does not necessarily require a unanimous affirmative vote each time a new partner is to be accepted; the partners can agree unanimously in advance that less than unanimity will, in the future, be required to permit a new partner to join.Conceptually, any such agreement amounts to a delegation or a waiver by each partner of a right of veto that, each partner is accorded by law.

Upon admitting the new partner, the existing partners shall have the responsibility to inform him or her of the state of the business and financial affairs of the partnership.[71] As to the liability of a new partner, PEL Article 45 provides that the incoming partner

[70] PEL, Art 32.

[71] Id., Art 44. Information, which the new partner should be acquainted with, includes information on the investment, production, supply, sales, income, profits, assets, liabilities and equity of the partnership.

shall be jointly liable for partnership obligations that arise before his admission as a partner. [72]

b. The dissociating partner

Dissociation is generally classified into the following two categories:

(1) Voluntary Dissociation

If the partnership agreement did not specify a fixed term for the partnership, a partner can withdraw from the partnership upon giving a month's notice to the other partners. [73] If the partnership has a fixed term, the right of withdrawal of a partner may only be exercised upon either of four conditions: (i) the event has occurred which is specified for withdrawal in the partnership agreement; (ii) all the partners agree to the withdrawal; (iii) the event has occurred which made it impossible for the partner to remain in the partnership; or (iv) other material breaches by the other partners of the obligations specified in the partnership agreement.[74] In other than the above four situations, a partner's withdrawing from a partnership shall constitute contravention of the partnership agreement, and he shall be liable for any damage thus caused to the other partners.

(2) Involuntary Dissociation

Involuntary dissociation occurs against the dissociating partner's will, and is prescribed by law. PEL Article 49 defines four situations in which a partner must dissociate from the partnership.

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[72] Joint liability is generally interpreted to mean that the new partner's liability for pre-existing obligations will be limited to his contribution to the partnership property.
[73] I.d., Art 47.
[74] I.d., Art 46.

First, death or the pronounced death of a partner is recognized as an event dissociating the deceased partner from the partnership. [75] Death is classified as natural death and pronounced death pursuant to the Civil Law. Natural death is the end of a person's life by illness, accident.etc. Pronounced death means that a person who has been lost for a certain period of time shall be pronounced dead by the court upon request of the parties concerned.[76]

Second, incapacitation of a partner shall cause him to dissociate from the partnership. [77] The reason is obvious. In order to constitute a valid partnership there must be a meeting of minds of the persons assuming the partnership. Each member has a right to the rational advice and aid of his copartners, in the absence of a contract or a rule of law to the contrary. Each has the right to the protection and the care which a reasonable person would or could bestow. Thus, if a partner is afflicted with incapacity, and is incapable of attending to his duties in the partnership, he has no reason to remain in the partnership.

Third, if a partner is insolvent, he must withdraw from the partnership.[78] When a partner is unable to pay his personal debts as they fall due in the ordinary course of life, or his total assets are insufficient to satisfy his total liabilities, he is deemed insolvent, and thus must leave.

Finally, if the creditors of a partner obtained a judgment against his entire share of interest in the partnership, that partner must exit the partnership.[79] In this case, the share

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[75] I.d., Art 49(1).
[76] Under the Civil Law, a person who has been lost for four years will be pronounced dead by the court upon request of the concerned parties.
[77] I.d., Art 49(2).
[78] I.d., Art 49(3).
[79] I.d., Art 49(4).

of interest of the partner shall be sold to a third party or the remaining partners, and the proceeds from the sale shall be applied to pay the creditors.

In addition, involuntary dissociation can also be caused by the expulsion of a partner from the partnership. The right of some partners to expel a partner can only be exercised upon the following events: (1) the partner's failure to make his capital contributions; [80] (2) the partner's intentionally, or negligently in a gross manner, causing losses to the partnership; [81] (3) the partner's misconduct in the carrying out of the partnership affairs; [82] or (4) other events as specified in the partnership agreement.[83]

8. Dissolution and Termination

Dissolution is not defined in PEL, but it is generally interpreted to mean the point in time when the partners cease to carry on the business together due to the occurrence of some events either specified in the partnership agreement or in the Law. Upon dissolution, the partnership will enter into the process of winding up. Termination comes in the wake of completion of the winding up.

a. Dissolution

PEL Article 57 describes seven causes of dissolution, i.e., which result in the partners ceasing to carry on the business together.

PEL Article 57(1) states that a partnership will be dissolved upon the expiration of a term unless the partners agree otherwise. For example, the partnership agreement could stipulate that the partnership will terminate at the end of ten years. If the partners agree to continue the business after the period expires, dissolution will certainly not occur.

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[80] I.d., Art 50(1).
[81] I.d., Art 50(2).
[82] I.d., Art 50(3).
[83] I.d., Art 50(4).

PEL Article 57(2) provides that a partnership will be dissolved upon the occurrence of the grounds for dissolution stipulated in the partnership agreement. For example, the partnership agreement could stipulate that dissociation of certain members of the partnership will dissolve the partnership.

PEL Article 57(3) restates an obvious event of dissolution. It provides that if all the partners agree to dissolve the partnership, that will be an event of dissolution that does not breach any agreement. That result is not surprising: The partnership relationship is a consensual one, and the partners can therefore unanimously consent to put an end to their relationship. As always is the case, the provision also means that the partnership agreement can include an express delegation by some of the partners to one or more of their copartners. In other words, the partners could unanimously agree in their agreement that one named partner is authorized to dissolve the partnership at any time even though, for example, the partnership is for a specified term.

Under PEL Article 57(4), if the number of the remaining partners is less than two, the partnership will, as a matter of course, dissolve, and the remaining partner thus becomes a sole proprietor.

According to PEL Article 57(5), the partnership will be dissolved if the purpose of the partnership as stipulated in the partnership agreement has been realized or cannot be realized. Partnership is a form or means by which the partners achieve a purpose; if the purpose has been achieved, or cannot be achieved , the need for the partnership ceases to exist.

Revocation of the business license is an event of dissolution under PEL Article 57(6). A business license is the permit granted by the authority to business

organizations to engage in profit-making activities. If the partnership's license has been revoked, the partnership shall no longer be able to engage in business, hence, its existence has no valid legal justification.

Pursuant to PEL Article 57(7), other events specified in other laws and administrative regulations can also cause dissolution of the partnership. For example, if a partnership has been acquired by or merged into another business entity, it shall, as a matter of course, be dissolved.

b. Winding up

A partnership that has dissolved continues in existence for the purpose of winding up its affairs and remains as such, with the partners retaining their obligations to one another and to the partnership, until the time the liquidation is completed and the partnership is terminated.

Upon dissolution, all the partners will serve as liquidators, or the partners can unanimously agree to appoint one or more of the partners , or third parties, as liquidators. [84] Liquidators can also be appointed by the court upon request of the partners or other concerned parties. [85]

Once dissolved, the first thing the liquidators should do is to inform the partnership's creditors of the dissolution of the partnership by notice and public announcement. [86] Notice may be given by verbal statement or delivery by mail. But the mere mailing of notice, without evidence of receipt, is not sufficient. Notice to an agent of the creditor is usually sufficient, if the agent is acting within the scope of his authority, although not communicated by the agent to the principal. Publication in a newspaper of notice of

[84] PEL, Art 59.
[85] I.d.

dissolution constitutes public announcement. Notice and public announcement of dissolution should contain the following information: (1) that the partnership has been dissolved, (2) that liquidators have been appointed, and (3) the deadline the creditors should report their claims to the liquidators.

During the winding up period, the liquidators have no authority to enter into new transactions except as involved in the liquidating process. They only have the necessary power and authority to wind up the partnership or to complete the transactions unfinished at dissolution.

c. Order of Payment

PEL Article 61 governs distribution of assets upon termination. The Article is a mandatory rule, which cannot be changed by contrary agreement by the partners. It provides that "after payment of the liquidating expenses, the partnership property shall be used to make payments in the following order:

(1) the wages owed to and the labor insurance fees for the employees of the partnership;

(2) any unpaid taxes;

(3) the obligations of the partnership; and

(4) the capital contributions of the partners.

Any remaining assets shall be distributed in accordance with the ratio specified in PEL Article 32(1) Hereof".[87]

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[86] I.d., Art 58.
[87] I.d., Art 61.

A partner owed compensation for his labor services is on par with the partnership's employees in order of priority. Also a partner who has extended credit to the partnership is treated the same as other creditors of the partnership. In the event that the assets of the partnership are insufficient to pay its obligations, the partners shall be jointly and severally liable for such obligations. [88] Termination of the partnership will not terminate the partners' liability for the obligations of the partnership unless the creditors have not submitted their claims to the original partners within five years after dissolution. The partnership is terminated after the liquidation is completed, and a liquidation report is submitted to the registration authority for deregistration. [89]

[88] I.d., Art 62.
[89] I.d., Art 64.

CHAPTER IV

PROBLEMS AND LIMITS OF CHINA'S PARTNERSHIP LAW

A. Lack of Uniformity

With several laws and regulations dealing with the same issue of partnership, conflicts, confusion, and overlaps are almost inevitable, especially in case of lack of more careful drafting. Taking the most obvious example, the newly enacted PEL does not answer the question whether the provisions of the Civil Law have been entirely superseded by it, or whether existing partnerships duly constituted under the Civil Law may continue to exist, or even whether new partnerships will be able to be formed under the Civil Law. The PEL has no transitional provisions stating explicitly to what extent the Civil Law's provisions will survive, nor does it require existing partnerships to register.

B. Unfavorable Status

Although the partnership entity is legally recognized through the above-mentioned legislative efforts, it also falls into the category of privately owned enterprise. [90]

China's Constitution also [91] treats private enterprises as a supplement to the national economy, but in reality, it's very hard for them to compete with state and collective enterprises. For example, it's nearly impossible for them to get money from banks which has a tendency to disfavor private businesses, to enjoy tax breaks given to state and collective enterprises, and to engage in areas not open to private enterprises. That explains why so many investors are racking their brains to register their individual partnerships as collective enterprises.

A fake collective enterprise may not only bring some benefits to the private investors, but also some unexpected legal risks. Partners can distribute the profits as they agree. Once a partnership was registered as a collective enterprise, the investors who also hold managing positions in the enterprise will run the risk of being charged with the crime of graft and embezzlement if they privately take property from the enterprise, in spite of the fact that they are co-owners of the property. [92] In one case,[93] six persons established a partnership enterprise in 1986, which was registered as a collective enterprise. The local township government was, in name, the sole investor

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[90] In the past, the laws and regulations on business organizations were organized in accordance with the nature of ownership. China still has separate laws in force governing state-owned , collectively owned and private-owned enterprises respectively.

[91] Article 7 of the Constitution provides that "the State-owned economy, namely, the socialist economy under ownership by the whole people, is the leading force in the national economy". The same article affirms that "the State ensures that the consolidation and growth of the state-owned economy", aiming at maintaining the dominant position of this economy within the whole national economy and maintaining the socialist nature of China. Article 8 stipulates that the State protects the lawful rights and interests of the urban and rural economic collective ownership and encourages, guides and helps the growth of the collective economy. As to private economy, Article 11 of the Constitution has words like this: "the State permits the private sector of the economy to exist and develop within the limits prescribed by law. The private sector of the economy is a complement to the social public economy. The State protects the lawful rights and interests of the private sector of the economy, and exercises guidance, supervision and control over the private sector of the economy." Differential wording of the Constitution indicates that state
enterprises are favored over collective enterprises, and collective enterprises over private enterprises in China.

[92] The managers of state-owned and collective enterprises are deemed to be the State personnel and the property of these enterprises are property of public ownership. According to China's criminal law, State personnel will be convicted of graft and embezzlement if they possess property of public ownership.

[93] 7 Selected Cases of the People's Court, Publishing House of the People's Court (1995) at 201-205.

and "supervisory body".[94] From 1986 to 1990, the six drew more than 38,00,00 Yuan out of the profits of the enterprise. Soon they were charged with graft, and then convicted. One was sentenced to death, and five others to twelve years' imprisonment. On appeal, all defendants were acquitted. The court reasoned that the enterprise was in fact an individual partnership, and that distribution of the profits of a partnership did not constitute embezzlement of collective property. [95]

C. Legal Blank

Many law firms, accounting firms and clinics adopting the partnership form have no clear laws to govern them. For example, beginning in 1988, partnership law firms were allowed by the Department of Justice. [96] Although they are called cooperative law firms in the official documents, they have all the characteristics of a partnership: more than two lawyers contribute money and property, they make all major decisions, and draw most of the firm's profits, etc. But they are excluded from the application of the PEL in that the government is not willing to recognize that their main purpose is to make profits. But the fact is, the lawyers associate to use their legal knowledge for the sole purpose of making money.

D. Blind Spot

Another large number of partnerships left governed by the present partnership laws are those which had neither a written partnership agreement nor registered at the relevant authority. They also possess all the characteristics of a partnership: two or more persons each contributing funds, property, labor, etc to carry on a business for profit.

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[94] A collective enterprise is supposed to have a governmental body to supervise its activities.
[95] There are also some cases in which members of individual partnerships were convicted of graft despite the fact that their "collective enterprises' are fake.

All the above-mentioned laws require a written partnership agreement for a partnership to validly exist. Absence of an agreement will cause the courts to deny the association's partnership status, which often leads to unjust conclusions contrary to the investors' expectations. In one case,[97] two persons agreed to transport some oranges to a town where the price of oranges was much higher than where they resided, and to share any profits equally. One, a driver, contributed a truck, and the other provided 400,00 Yuan. When they arrived at the town, the price had sharply fallen due to superfluous supply. They thus had to sell the oranges at a great discount and incurred a loss of 100,00 Yuan. The money contributor brought an action seeking repayment of the money from the driver. Lack of a written agreement led the court to conclude that a lender-borrower relationship existed between the two, and the driver should pay back the 100,00 Yuan.

E. Application Dilemma

Adding to the above problems is application of the law of partnership in China. Having a law which is not being properly enforced is no better than having no law at all. Inherent imperfection combined with ineffective and unjust application make the partnership law even more unreliable.

Three factors may account for the situation. First, independence of the judiciary is still lip service in China; it is common that the Communist Party and government agencies use their power to unreasonably exert influence on the judgment of the judges. In fact, most of the judges are members of the Party. It's unimaginable that they will go

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[96] Law firms in China are divided into two categories: state-owned firms and non-state-owned firms. By June 1994, there were about five thousand eight hundred and eighty-five law firms in the whole country, among them, six hundred twelve were non-state-owned firms. The number of non-state-owned firms is increasing year by year.

[97] 10 Selected Cases of the People's Court, Publishing House of the People's Court (1997) at 105-108.

against the will of their Party leaders. In one example, [98] a partnership borrowed 50,00,00 Yuan from a state-owned financial company. In the following suit, the company disputed with the partnership over the amount of interest. Under the influence of a Party official of the city where both enterprises were located, the judge ruled against the partnership. Second, local protectionism often tilts the balance of law against the partnerships which were not locally registered. Local governments not only impose more fees and other unreasonable burdens on partnerships operating with their boundaries, but also interfere with the conduct of their business. Finally, lack of legal knowledge and training on the part of the judges is also a contributing factor to the improper implementation of the law. Due to historical reasons, [99] there are still a lot of judges who had neither received legal education nor had any legal experience when entering the judiciary. This inevitably leads to bad and mistaken judgment in the application of the partnership law.

[98] Xu Jinghe & Liu Shuqiang, Explanations of Partnership Enterprise Law (1997) at 170.

[99] During the Cultural Revolution between 1966-1976, legal education was totally abandoned. Judges were selected from those politically closer to the Party and could be trusted by the Party. It's still common that local governments choose judges from military retirees who are believed to be "politically reliable".

CHAPTER V

PROPOSED MEASURES TO REFORM CHINA'S PARTNERSHIP LAW

As previously discussed, in China partnership law has had a relatively short period of the development of partnerships. Inexperience, unwillingness to draw upon lessons from Western nations, combined with lack of careful drafting skills made the present law on partnership imperfect in many respects. Therefore, in proposing measures to improve China's partnership law, a significant portion of this section will be reserved for detailed discussion of some relevant areas of United States partnership law which are new to China, and which are so developed and sophisticated as to deserve to be taken as a model for the future legislation on partnership in China.

A. Promulgate a Uniform Partnership Law

In an explanation on the draft of PEL, Mr. Huang Yicheng, vice chairman of the Committee of Finance and Economics of the National People's Congress, pointed out that the present laws and regulations did not conform to the international standard, and a uniform law is necessary to regulate partnerships. But the provisions of the later published PEL betray the objective of formulating uniform rules. The PEL does not eliminate the situation that different forms of partnership are regulated by different laws and regulations under different circumstances; individual partnerships which are named and registered are regulated by PEL, unregistered and unnamed partnerships with a written agreement are governed by the Civil Law; joint ventures between

Chinese entities are also governed by the Civil Law, and sino-foreign contractual joint ventures are regulated by the Contractual Joint Venture Law. [100] In view of the above situation, a new uniform partnership law is urgently needed to put those different forms of partnership under its rule.

B. Allow Legal Persons to be Partners

In the process of drafting the PEL, whether to allow legal persons to be Partners was the most heatedly debated issue. The question, of course, has been settled with the promulgation of the PEL, Article 11 of which states that only those persons who bear unlimited liability can be partners.[101] Enterprises including state-owned enterprises, which bear limited liability are excluded from being qualified to become partners. This prohibition is not only contradictory to common practice of the world, but also detrimental to the development of China's market-oriented economy.

First, whether legal persons can become partners depend on whether legal persons have the right to dispose of their property. Joining in a partnership is a civil act taken by legal persons in the capacity of an owner and on the basis of its own will and benefit. Recognition of the status of a legal person inevitably leads to recognition of a legal person's capacity to engage in civil acts, including making investment in a partnership.

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[100] Contractual Joint Venture Law was adopted on April 13, 1988.
[101] PEL, Art 8(1).
[102] Article of the Company Law provides that the amount of investment made by a company shall not be more than 50 percent of its registered capital.

Moreover, the Company Law does not prohibit companies from investing in a partnership. [102]

Second, companies as partners shall be jointly and severally liable for the debts of the partnership. This does not affect the limited liability borne by the shareholders to the companies. Companies and shareholders are two different independent bodies, and the two are not to be implicated as to their rights and obligations to outside third parties. The unlimited liability of a company as a partner is not the liability of its shareholders. The notion that the limited liability of a shareholder will become unlimited after the company joins in a partnership is groundless. Third, some people fear that the joining of a company in a partnership will weaken the ability of the board of directors to control the company. That fear is invalid for the reason that any form of association, not limited to partnership, will to some degree affect the board's control over the company.

Fourth, another fear is that partnerships between legal persons and individual persons will probably provide a convenient opportunity for the managers of the legal persons and the individual partners to collude in illegally transferring state-owned property. That claim also cannot stand on its merits. The property of the partnerships are co-owned by the legal persons and the individual persons, and without the unanimous agreement of all the partners, no property will be allowed to be divided, transferred or otherwise disposed of . This stability of the assets of the partnerships can effectively prevent the "leakage" of state-owned property. Moreover, the government may promulgate separate laws to penalize illegal transfers of state-owned property.

Finally, allowing legal persons to engage in partnership should have a positive practical effect on the national economy. Entering into partnerships can provide legal persons with varieties of investment opportunities and channels, through which they can easily gather funds to make quick decisions in the competitive market to gain more economic benefits. In the meantime, legal persons' partnering with one another may also promote horizontal economic cooperation by making the most of their strengths to offset each other's deficiencies. Moreover, forming large corporate groups, especially transnational groups, is one of the prime objectives of China's enterprise reform in the future. One way to achieve it is for large companies to engage in partnership ventures.

C. Legalize and Promote Limited Partnerships

As a distinctive form of business, limited partnerships originated in Italy, migrated to France, and flourished in the United States. Like a general partnership, a limited partnership is an association of two or persons to carry on as co-owners a business for profit. However, to be a limited partnership, an association must have at least one general partner and one limited partner. To create a limited partnership, the general partners must execute a certificate of limited partnership, setting forth certain basic information about the partnership, and then file the certificate with the secretary of state in the jurisdiction of choice. The filing requirement theoretically protects creditors by giving them access to basic information about the limited partnership. Additionally, it is contemplated that the parties will enter into a written agreement specifying many of the terms of the relationship, particularly the economic terms. A limited partnership differs markedly from a general partnership in the following characteristics:

1. Separation of ownership and management functions.

In a limited partnership, ownership and management functions are divided among the firm's general and limited partners. Under statutory default norms, limited partners have essentially no management power and no authority to act as agents in carrying out the partnership's business. General partners are the active participants in the firm, empowered to make and carry out the firm's business policies.

2. Limited liability.

Limited partners are not personally liable for the limited partnership's obligations unless they take part in control. General partners, as in a general partnership, are jointly and severally liable for the firm's obligations.

3. Continuity and adaptability to changed circumstances.

Under limited partnership default norms, general partners may withdraw from the partnership at will. Unlike in a general partnership, however, such withdrawal does not automatically or necessarily trigger dissolution and liquidation of the limited partnership. A limited partner must give six month's notice before withdrawing his interest from the partnership, and in no event will such withdrawal cause dissolution of the firm. Decision-making rules also favor the firm's adaptability. As in general partnership law, general partners make ordinary decisions by majority vote and extraordinary decisions unanimously. Unlike general partnership law, however, a limited partnership need have only one general partner; in most cases that is the norm, and prevents the possibility of deadlock.

A limited partnership also has significant advantages over alternative forms of business entities, such as companies and general partnerships.

First, limited partners enjoy limited liability. It is doubtful that limited partnerships would be used frequently as investment vehicles if they did not have limitations on the liability of limited partners. The Revised Uniform Limited Partnership Act provides in Section 303(a) that "a limited partner is not liable for the obligations of a limited partnership unless he[or she] is also a general partner or , in addition to the exercise of his [or her] rights and powers as a limited partner, he [or she] participate in the control of the business, ..." This does not mean that a limited partner can have no say in partnership affairs. In many jurisdictions the limited partners may approve certain major decisions, such as significant sales of assets, financings, changes in management and dissolution, without risk of losing limited liability.

Second, limited partnerships enjoy single taxation. The principal tax advantage is that it is not subject to income taxation at the entity level. Instead, taxable income from a partnership's business is allocated among its partners and the tax attributable to the income is payable directly by the partners. Thus, a partnership's profits are taxed at only one level. In contrast, a company's profits are generally taxable to the company and, to the extent distributed as dividends to stockholders, to the stockholders as well.

Finally, limited partnerships enjoy flexibility in structuring of management. and defining the overall business relationships of their owners. Partners can designate a single managing general partner with clearly defined authority, rather than having a board of directors with general authority. In limited partnerships with more than one general partner, it is common for the authority of the general partners to be divided based on each general partner's economic interest in the partnership, and to require the

approval of a majority in number of the general partners to take any action or to delegate exclusive authority over certain matters to one of the general partners.

D. Recognize Fiduciary Duties among Partners

Although some provisions of the PEL resemble the fiduciary duties in the U.S. partnership law, they are neither explicitly defined nor given as much emphasis as they deserve. A fiduciary duty is the most fundamental duty owned by partners to one another. [103] The Uniform Partnership Act provides that " every partner must account to the partnership for any benefit, and hold as trustee for it any profits derived by him without the consent of the other partners from any transaction connected with the formation, conduct, or liquidation of the partnership or from any use by him of its property." [104] Although a basic purpose of this provision was to give excluded partners priority over the personal creditors of the disloyal partner as to traceable usurped assets, [105] it is also generally seen as the basic statutory embodiment of the fiduciary role of partners among themselves. The fiduciary duties begin when the parties first become partners and continue even after dissolution through the process of winding up. [106]

Revised Uniform Partnership Act went a step further to expressly limit the fiduciary duties to those of loyalty and care and spell out what the stated duties entail. [107]

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[103] The duty is frequently divided into the separate but related duties of loyalty and care. In their simplest forms, the duty of loyalty requires that the fiduciary place the interests of the beneficiary ahead of the fiduciary's own, and the duty of care impose a prudent person standard on the fiduciary.

[104] UPA Section 21 (1).

[105] An explanation of this situation is offered by the Official Comment:

A, B and C are partners; A, as a result of a transaction connected with the conduct of the partnership, has in his hands, so that it may be traced, a specific sum of money or other property. A is insolvent. Is the claim of the partnership against A a claim against him as an ordinary creditor, or is it a claim to the specific property or money in his hands? The words "and to hold as trustee for the partnership any profits" indicate clearly that the partnership can claim as their own any property or money that can be traced.

[106] See generally J. Crane & A. Bromberg, Law of Partnership at 389-97 (1968).

[107] RUPA Section 404.

1. Duty of Loyalty

The fiduciary duty the UPA explicitly recognizes is that of loyalty. Chief Judge Cardozo made the most famous exposition of this principle in Meinhard v. Salmon: [108]

"Joint adventurers, like copartners, owe to one another...the duty of the finest loyalty. Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions.... Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. "

Frequent areas of concern regarding the application of the duty of loyalty are as follows:

i. Using Partnership Property – As mentioned above, a partner has the right to possess partnership property only for partnership purposes.[109] This restriction overlaps with the fiduciary duty not to use partnership property for the partner's own benefit. Classic examples are using partnership employees, office space, or land for a partner's own business, [110] diverting partnership funds or proceeds of a loan secured by partnership

[108] 249 N.Y. 458, 164 N.E.545 (1928).
[109] See UPA Section 2.02(2).
[110] E.g., Coklin v. Randolph, 204 Neb. 332, 281 N.W. 2d 913 (1979); Veale v. Rose, 657 S.W. 2d 834 (Tex. Civ. App. – Corpus Christi 1983, writ ref'd n.r.e).

property to the partner's own uses, [111] or using partnership information and trade secrets. [112]

ii. Self-dealing – Problems commonly arise when a partner supplies inputs to the partnership's business, is a customer of the partnership, or provides services under nominally independent management arrangements. Partners who deal directly indirectly [113] do so at their peril. The transaction very well may be scrutinized to see whether the partner reaped a profit. If so, that profit ordinarily belong to the partnership. [114]

iii. Competition – A partner may not compete with the partnership.[115] In addition to obvious examples, such as operating a nearby retail outlet selling similar merchandize,[116] partners in an oil and gas exploration or production partnership risk being characterized as competitors in their other dealings in the industry, primarily if their nonpartnership activities occur in the geographic area in which the partnership operates but also if they compete for buyers of production. [117] A partner may engage in noncompeting enterprises [118]but will become liable if devoting time and effort to them

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[111] E.g., Curley v. Brignoli Curley & Roberts Assocs., 746 F. Supp. 1208 (S.D.N.Y. 1989) (applying Delaware law), aff'd, 915 F. 2d 81 (2d Cir. 1990); Welker v. Langtry Farm Partnership, 463 N.W. 2d 97 (Iowa App. 1990).

[112] E.g., Latta v. Kilbourn, 150 U.S. 524 (1893) (partner used partnership information regarding real estate market); Tri-Growth Center City v. Silldoff, Bardman, Duigon & Eisenberg, 216 Cal. App. 3d 1139, 625 Cal. Rptr. 330 (1989) (use of confidential information violates fiduciary duty, even if agreement allowed competition with partnership).

[113] Partners can be subject to liability for transactions between the partnership on the one hand and corporations and other partnerships in which they own interests on the other. E.g., Van Deusen v. Crispell, 114 A. D. 361, 99 N.Y.S 874 (1906).

[114] E.g., Tucker Authony Realty Corp. v. Schlesinger, 888 F. 2d 969 (2d Cir. 1989).

[115] E.g., Shulkin v. Shulkin 301, Mass. 184, 16 N. E. 2d 644 (1938) (no competition found).

[116] See Van Deusen v. Crispell, 114 A. D. 361, 99 N. Y. S. 874 (1906).

[117] See, e. g., Palmer v. Fuqua, 64, F. 2d 1146 (5th Cir. 1981) (applying Texas law; general partner's acquisition of oil and gas lease on contiguous property violated partnership agreement requires offer of leases in partnership's "area of interest").

[118] E.g., Truman v. Martin, 212 Neb. 52, 321 N.W. 2d 420 (1982) (partner in restaurant business who also engaged in bar, tree-trimming, and irrigation supply business held not liable to his restaurant partner for profits earned in separate business).

diverts the partner from the partnership and breaches any obligation undertaken to contribute time and effort to the partnership.[119]

iv. Partnership Opportunities – Closely related to the duty not to compete is a partner's obligation to share with the other partners the right to acquire any property or other business opportunities related to the partnership's business that come to the partner's attention. Common examples include the fee or reversionary interest in real estate leased to the partnership [120] or in neighboring real estate if helpful to the partnership's business [121] or an expansion of it [122] even if the latter would be beyond the scope of that individual partner's authority because of its extraordinary nature.[123] Opportunities of which a partner learns because of his involvement in the partnership [124] or because the partnership developed them [125] also may fall in this category. The analysis often turns on the scope of the partnership's business.[126] Courts generally have held that a partner may not defend taking the opportunity without consent solely on the basis that the partnership or the other partners were unlikely or unable to participate; the partner instead becomes, in effect, a constructive trustee for the benefit of the partnership.[127]

RUPA continues the general notion of the duty of loyalty but clarifies its application in some respects. Th duty would be specifically limited to accounting for and holding for the partnership benefits derived from a partnership property, to refrain from dealing

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[119] E.g., Neilson v. Holms, 82 Cal App. 2d 315, 186 P. 2d 197 (1947) (partner's nonpartnership activities held not to have prevented himself from giving "all the attention advantages" to the partnership).

[120] E. g., Bakalis v. Bressler, 1 Ill. 2d 72, 115 N. E. 3d 323.
[121] Dixon v. Trinity Joint Venture, 49 Md. App. 379, 431 A. 2d 1364 (1981).
[122] This was the situation in Meinhard v. Salmon.
[123] Wartski v Bedford, 926 F. 2d 11 (1st Cir. 1991) (applying Massachusetts law).
[124] E.g., Stark v. Reingold, 18 N. J. 251, 113 A. 2d 679 (1955) (partnership held a car rental franchise in one county; partner later became franchisee in a neighboring county).
[125] E. g., Leff v. Gunter, 33 Cal. 3d 508, 658 P. 2d 740, 189 Cal. Rptr. 377 (1983); Fulton v. Baxter, 596. P. 2d. 540 (Okla. 1979). This notion is akin to use of partnership property.
[126] See Fouchek v. Janicek, 190 Or. 251, 225 P. 2d 783 (1950).

with the partnership as or on behalf of an adverse party, and to refrain from competition.[128]

2. Duty of Care

The fiduciary duty of partners also embraces some obligation to act carefully in conducting partnership affairs. Just what standard is applied, however, has been the subject of some debate. Some plaintiffs have argued a partner must act with the degree of diligence, care and skill that ordinarily prudent persons would exercise under similar circumstances in like positions. This parallels the standard of ordinary skill and care to which an agent is held.[129] Generally, however, courts have held partners to the lower standard of "culpable negligence", bad faith, or fraud.[130] Some courts have applied the business judgement rule, holding that courts will not second-guess a partner's decision in managing the business if made in good faith and not wholly unreasonable under the circumstances.[131] Others have refused to follow the business judgement rule.[132] Of course, if a partner acts outside the scope of authority or in breach of the provisions of a partnership agreement, that partner nonetheless will be liable for any losses caused.[133]

RUPA requires a partner to conduct the partnership's business in a manner that does not constitute gross negligence, recklessness, willful misconduct, or knowing violation

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[127] E.g., Warkski v. Bedford, 926 F. 2d 11 (1st Cir. 1991) (applying Massachusetts law).
[128] RUPA Section 404(b).
[129] See Restatement (Second) of Agency Section 379 (1957).
[130] Johnson v. Weber, 166 Ariz. 528, 803 P. 2d 939 (Ariz. App. 1990); Ferguson v. Williams, 670 S. W. 2d 32) (Texas. App. – Austin 1984, Writ ref'd n.r.e). The lower standard makes more sense for a partner than for an agent: a partner is liable for partnership losses, but an agent is not. Indeed, some have argued that a duty of care is unnecessary among partners, who have other incentives to perform well. Ribstein, A Mid-Term Assessment of the Project to Revise the Uniform Partnership Act, 46 Bus. Law. 111, 140-41 (1990).
[131] E.g., Newberger, Loeb & Co. v. Gross, 563 F. 2d 1057 (2d Cir. 1977) (applying New York law), cert. denied, 434 U.S. 1035 (1978); Wyler v. Feuer, 85 Cal. App. 3d 392, 149 Cal Rptr. 626 (1979).
[132] Roper v. Thomas, 60 N. C. App. 64, 298 S. E. 2d 424 (1982), review denied, 308 N.C. 191, 302 S.E.2d 244 (1983).

of law.[134] Failures to use ordinary skill and care do not breach this duty. Errors in judgment do not by themselves constitute a breach of this duty, and a partner is presumed to have met this duty if the partner acts in good faith and in a manner reasonably believed to be in the partnership's best interest.

E. Impose Liability on Apparent Partners

If limited partnership and fiduciary duties are topics which have been dabbled in by a few Chinese scholars, partnership by estoppel is almost a complete stranger in China, despite the fact that cases involving it have not rarely been seen by the judges. In one notable example,[135] three persons, A, B and C, agreed to contribute 100000, 50000 and 50000 Yuan respectively to set up a department store; profits were to be distributed in proportion to their respective contributions; A acted as manager, B and C as vice managers. After a while, a dispute arose between A, and B, C, and B, C wanted to dissociate. Although due to various reasons, the store was not liquidated, they all agreed that B and C would withdraw, and A would be solely responsible for the store. From then on, B and C never went to the store or participated in its management. After B and C departed, A signed a contract in the name of the store. The contract provided that the store would supply 30000 tons of corn to a factory. Soon after the factory advanced 80000 Yuan to the store, the store closed. The factory thus brought a suit against the store seeking repayment of the advanced money and damages.

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[133] E.g., Belcher v. Birmingham Trust Nat'l Bank, 348 F. Supp. 61 (N. D. Ala.) (applying Alabama law regarding action beyond scope of partner's authority), stay denied, 395 F. 2d 685 (5th Cir. 1968); Roper v. Thomas, 60 N. C. 191, 302 S. E. 2d 244 (1983).

[134] RUPA Section 404 (d).

[135] Shen Guansheng, Civil Liability in Cases Involving Economic interests (1998), Publishing House of the People's Court, at 203.

The trial court held that the store was jointly established by A, B and C, so they should bear joint liability for the debt. On appeal, B and C argued that they had dissociated from the store before it incurred the debt, and A was the sole manager who should be liable for the debt. The appellate court adopted their argument and rendered a judgement against A.

The case is a clear example concerning the liability of apparent partners. Lack of laws governing this is the reason for the two starkly different rulings by the courts. In filling this blank, the rule of partnership by estoppel adopted in the United States partnership law provides a good model to follow.

The UPA provides that "When a person, by words spoken or written by conduct, represents himself, or consents to another representing him to any one, as a partner in an existing partnership or with one or more persons not actual partners, he is liable to any such person to whom such representation has been made, who has, on the faith of such representation, given credit to the actual or apparent partnership, and if he has made such representation or consented to its being made in a public manner he is liable to such person, whether the representation has or has not been made or communicated to such person so giving credit by or with the knowledge of the apparent partner making the representation or consented to its being made ..., "[136] and "When a person has been thus represented to be a partner in an existing partnership, or with one or more persons not actual partners, he is an agent of the persons consenting to such representation to bind them to the same extent and in the same manner as though he were a partner in fact, with respect to persons who rely upon the representation...."[137]

[136] UPA, Section 16(1).
[137] I.d., Section 16(2).

One may have partnership obligations imposed on himself by estoppel when he holds himself out, or knowingly permits himself to be held out, as a partner in a particular firm. The ground of such liability is based upon the principles of general policy to prevent fraud.

Partnership obligations by estoppel can arise in two situations:

First, if one so deals with another that he leads the other to believe that there is, in fact a partnership, he will be held liable if the other acts upon this belief. Intentional representations by the parties which would tend to mislead those with whom they dealt into believing that they are partners in fact, is sufficient to create a partnership liability by estoppel.[138] One who procured a extension of credit to a partnership of which he held himself out as a member, is estopped to deny liability for the debt.[139] And one who received another as partner, and allowed him to conduct the business, is estopped from denying liability as a partner for his acts in managing the business.[140]

Second, if one who knows, or should know, that he has been held out as a partner does not deny such hold out, or is silent, he will be held accountable as a partner. One who is not a partner and has no knowledge of the fact that he has been held out as a partner, or is neither negligent nor at fault in the matter can not be held liable.[141] Similarly, the declarations of a person that another is associated with him in the partnership relation where there is no partnership in fact do not ordinarily bind the

[138] Folks v. Burletson, 177 Mich 6, 142 NW 1120.
[139] Mitchell v. Craig, 11 Ga App 79, 74 SE 716.
[140] Carsey v. Swan, 150 Ky 473, 150 SW 534.
[141] Nofsinger v. Goldman, 122 Cal 609, 55 P 425.

alleged partner when such declarations are not made in his presence or with his knowledge or consent.[142]

In addition, the acts or representations must have been acted upon in good faith by the creditor in order to create an estoppel. If at the time the contract was entered into, the creditor has no knowledge that the person against whom he subsequently sought to enforce liability was being held out as a partner, an estopple does not exist in his favor.

[142] Vanderhurst v. De Witt, 95 Cal 57, 30 P 94, 20 LRA 595.

CHAPTER VI

CONCLUSION

China has pursued a revolutionary pace of reform since Deng Xiaoping's assumption of power in 1978. An important part of the reform movement has been the evolution of a partnership form of enterprise common to free-market Western countries. In contrast with the rapid development of partnerships in China, the legal framework for them has not reached a level of maturity. What's more, the current enforcement agencies are still not quite adequate in making the present imperfect law credible. If the Chinese government is able to overcome ideological barriers, and is bold enough in drawing upon the rich experience of developed countries, it is possible that the next ten years will witness not only a new uniform partnership law, and perhaps a uniform limited partnership law, but also the emergence of the same large-scale sophisticated partnerships in China as we now see in the United States.

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