China introduces favorable changes to its Company Law

Key Takeaways of the New Company Law

Following four rounds of review and public consultation over the past five years, the National People's Congress of the People's Republic of China officially approved the sixth amendment to the Company Law on December 29, 2023. The New Company Law, effective from July 1, 2024, will impact all companies in China, including foreign-invested enterprises.

With fifteen chapters and 266 articles, including 112 newly added or revised articles, the New Company Law brings significant changes in areas such as corporate governance, capital contribution, rights and obligations of shareholders, corporate information disclosure, transfer of equity interests, corporate bonds, company registration, and liquidation. This article provides a summary of key changes, offering in-depth insights to both foreign investors and their subsidiaries in China.

At a Glance
The New Company Law reinstates a maximum timeline of five years for capital contribution, post-company establishment.
In Joint Ventures, foreign shareholders may contemplate seeking indemnification or requesting a capital decrease from the Chinese party, if the partner falls short of its capital contributions.
The New Company Law introduces significant adjustments to corporate governance rules.
The New Company Law mandates at least one employee representative on the board of directors for companies with more than 300 employees.
Equity transfer rules are simplified, eliminating the majority approval requirement.
More clarity is provided on matters and procedures related to company establishment, change, deregistration, and public announcement.

1. Limited Liability Companies: Capital Contribution Period Limited to 5 Years

Article 47 of the 2023 Company Law introduces a requirement for shareholders of Limited Liability Companies (LLCs) to pay their registered capital in full within five years of the company's establishment. The registered capital, which can also be referred to as the subscribed capital, must be registered with the company registration authority at the company's inception.

To address issues of over-subscription and excessively long payment terms, a transitional period is allowed for companies established before the new law takes effect, enabling them to gradually adjust their contribution periods. Alongside the time limit, the 2023 Company Law mandates new disclosure requirements for companies regarding their registered capital, imposing increased penalties for non-compliance.

Article 40 specifies the information to be disclosed through the National Enterprise Credit Information Disclosure System, including details of capital contribution, method and date of contribution, and changes in equity and share information. Failure to truthfully disclose this information may result in penalties ranging from RMB 10,000 to RMB 50,000 or in serious circumstances or cases of gross negligence, RMB 50,000 to RMB 200,000. Fines for individuals who are directly involved in the misdirection or gross negligence may also be imposed, which may range from RMB 10,000 to RMB 100,000 according to Article 251.

2. Reinforced Rights and Responsibilities for Outstanding Capital Contributions

Under the New Company Law, in the event of a shareholder failing to fulfill its capital contribution as per the articles of association or if the in-kind contribution value significantly falls below the subscribed registered capital, the remaining shareholders bear joint and several liability for the deficit to the company. In Joint Ventures where the Chinese party falls short of its capital commitment, foreign shareholders may consider pursuing indemnification from the Chinese party or proposing a capital decrease.

3. Restructuring of Corporate Governance Framework

The New Company Law introduces substantial adjustments to corporate governance rules, leading to a partial reconstruction of organizational structures and a reallocation of governance powers within companies.

Employee Representation as either Supervisor or Director:
The New Company Law expands the requirement for employee representatives on boards to mid-large scale non-state-owned companies with at least 300 employees. The employee representative must be elected by the company's employees through the employees' congress or meetings.

Audit Committee as a Substitute for the Board of Supervisors:
The New Company Law introduces the option of an audit committee under the board of directors, consisting of directors. This committee may exercise the powers and authorities of a board of supervisors, consolidating decision-making and supervisory obligations within the directors. A minimum of 3 members must be appointed to the committee, and more than half of the members must not have any relationship with the company that could affect their judgement.

Executive Personnel as Legal Representative:
Under the current Company Law, the chairman, executive director, or general manager of a company can serve as the company's legal representative, regardless of their involvement in its day-to-day operations.

The New Company Law mandates that the legal representative must be a director or general manager actively engaged in the company's business operations. It also stipulates that the resignation of a director or general manager who acts as the legal representative automatically constitutes resignation from the legal representative position. In the case of such resignation, the company must appoint a new legal representative within thirty days.

4. Changes in Rights and Obligations for Shareholders

The New Company Law brings about substantial changes to the rules surrounding corporate governance, reshaping the organizational structure and reallocating governance powers within companies. Notably, it extends the requirement for at least one employee representative on the board of directors in mid-large scale, non-state-owned companies, with a minimum of 300 employees.

At this moment, under the current Company Law, companies are required to have a supervisor or a board of supervisors to oversee operations and protect company interests. However, this system often proves ineffective in non-state-owned companies, with many supervisors being inactive.

The New Company Law introduces an alternative in the form of an audit committee. This committee, comprised of directors, can be established under the board of directors, and is granted powers similar to those of a board of supervisors. This shift consolidates decision-making and supervisory responsibilities within the directors.

Alongside this, in a move to foster the rights of minority shareholders, Article. 57 of the Company Law 2024 broadens shareholders' access to information in limited liability companies. Shareholders are now entitled to review not only the shareholder register but also various business-related records and receipts, a privilege previously restricted to accounting books.

Moreover, the law explicitly permits the engagement of external advisors, granting them access to financial records and business documents without the need for a shareholder representative to be present. This provision notably facilitates foreign co-shareholders in exercising their rights to information and inspection in Sino-foreign joint venture companies.

5. Changes of rules on transfer equity interest

The New Company Law has introduced enhancements to the regulations governing the transfer of equity interests in a limited liability company.

Changes in equity transfer requirements
In the current Company Law, obtaining approval from a majority of other shareholders is necessary when transferring equity to an individual who is not currently a shareholder.
According to the New Law, unless stated otherwise in the Articles of Association (AoA), transferring equity interest in an LLC from a shareholder to a third party won't require consent from other shareholders anymore. However, these other shareholders still retain the right of first refusal concerning such equity interest.

Capital Contribution Liability for Transferred Equity Interest
The New Company Law provides specific rules for allocating capital contribution liabilities in cases where a shareholder transfers equity when the corresponding registered capital is not fully paid. If the outstanding capital contribution is not due at the transfer time, the transferee is liable.

The New Company Law provides specific guidelines regarding how the liabilities for capital contributions are allocated between the party transferring the ownership stake (transferor) and the party acquiring it (transferee). If, at the time of the transfer, the required capital contribution hasn't yet become due according to the schedule outlined in the company's articles of association, the transferee becomes responsible for fulfilling the outstanding capital contribution. If the transferee fails to meet their obligation to contribute the required capital by the due date, the original shareholder (transferor) remains as the secondary obligor, meaning they are still responsible for making up for any outstanding capital contribution. The transferee is jointly and severally liable, except in cases where bona fide transferees are unaware of the outstanding contribution status.

6. Adjustments to company registration and liquidation

The new amendment to the Company Law introduces a new chapter dedicated to company registration, providing clarity on matters and procedures related to company establishment, change, deregistration, and public announcement. It mandates the company registration authority to optimize the registration process, enhancing efficiency and convenience. Additionally, companies are required to ensure that information disclosed through the National Enterprise Credit Information Disclosure System is true, accurate, and complete.

These changes strengthen the company's information disclosure obligations and authenticity requirements, accompanied by legal responsibilities. Such provisions aim to bolster the safety and reliability of transactions, ensuring better protection for the interests of companies, creditors, and the public.

Relaxed rules on company registration
The new company law allows individuals a greater scope with regards to the types of companies they are permitted to open. The changes are aimed at reducing the barriers for individuals to start a business.

Simplified liquidation process
The New Company Law also strengthens the company liquidation system by clearly stating that directors bear responsibility during liquidation proceedings. It describes their duties and roles throughout the liquidation process.

Furthermore, the new amendment introduces a simplified liquidation procedure, allowing companies without debts or fully settled debts, guaranteed by all shareholders, to undergo deregistration through an expedited process. A company wanting to the simple deregistration process can carry out the process by making an announcement through the *National Enterprise Credit Information Disclosure System.* The announcement must be made for a period of no less than 20 days, after which the company may apply for deregistration if no objection has been received.

Conclusion
The New Company Law is introduced amid China's dynamic reforms, in an effort to develop existing regulations and promote an improved business environment. It aims to enhance capital adequacy, protect rights, optimize governance, streamline transactions, improve transparency, and simplify procedures. These changes seek to reduce disputes, facilitate transactions, and enhance efficiency. Anticipating additional guidelines from relevant authorities, foreign investors should seek professional counsel to ensure their Chinese subsidiary remains compliant.