March 22, 2022

Select Proposed Changes to the Company Law of the People's Republic of China

By Liza L.S. Mark and Sarah Sheng

The current version of the *Company Law of the People's Republic of China* was passed by the Standing Committee of the National People's Congress ("***NPCSC***"), and became effective on October 26, 2018 (《公司法》, hereinafter the "***Current Version***") with 13 sections and 218 articles in total. On December 24, 2021, the *Company Law of PRC (Draft Revision)* (《公司法（修订草案）》, hereinafter the "***Draft Revisions***") was released by the *NPCSC* for public comment. The final version will be subject to the review and approval of the *NPCSC* and the schedule for its final adoption is currently not specified.

This Draft Revision is seen as implementing the principles laid down during the 18th CCP Congress to "make major decisions and deployments to deepen the reform of state-owned enterprises, optimize the business environment, strengthen the protection of property rights, promote the healthy development of capital markets, and promote the further improvement and development of the company's system and practices." Given the length of changes in the Draft Revisions, this note intends to briefly summarize the proposed changes to the Company Law that would be relevant to multi-national companies ("***MNCs***") with operations in China.

I. Corporate Governance

1. Change in Board of Directors ("BoD") Requirements

(1) *For "small sized" limited liability companies, a BoD will not be required.*

Under the Current Version, a BoD is a necessary management authority of a company and is required to be established. In the Draft Revision, Article 70 and Article 130 suggest that a relatively small company can appoint a sole director instead of a BoD and if such company is incorporated with limited liability, it can just appoint a general manager and may not need a BoD. For some small sized wholly foreign owned enterprises ("***WFOE***"), the management arrangement could be streamlined accordingly, which may reduce the complexity of registration documents. Please note that the definition of what is considered "small sized" is not clear in the Draft Revision.

(2) *Employee representative in BoD is required for a company with over 300 employees*.

Previously, an employee representative being a part of a BoD was only required for a wholly state-owned company in the Current Version. The Draft Revision introduces the requirement for one or more employee representatives on the Board for companies with over 300 employees, which might be a challenge for labor intensive MNCs.

(3) *Powers and functions of the BoD are no longer specified by law*.

The Current Version specifically enunciated the BoD's powers and functions. The Draft Revision replaces that with a general statement in the Draft Revision that the BoD has all powers and functions other than those reserved for the shareholders by the Draft Revision and the companies' articles of association ("***AoA***"). This will allow the company the flexibility to decide the specific scope of the BoD's powers by contemplating it in the AoA. Foreign invested companies incorporated before 2020 which are required to amend their AoA by the end of 2024 due to the *Foreign Investment Law of PRC (《外商投资法》)* effective January 1, 2020, should take this change into account when revising their AoA.[1]

2. Effectiveness of Written Resolutions

Article 74 of the Draft Revision states that "if no shareholders' meeting or board meeting is held to adopt a resolution, the resolution of the shareholders' meeting or the BoD shall be null and void." In practice, many officers of MNCs travel between or are based in different regions, therefore, passing resolutions by written action rather than by meeting is quite common and generally specified in a MNC's AoA. This stipulation of requiring technical meetings for both shareholder action and Board action in the Draft Revision bears watching.

3. Supervisor/Supervisory Board is not required (with conditions)

Previously, MNCs were required to appoint a Supervisor or a Supervisory Board for their Chinese subsidiaries. The Supervisor or Supervisory Board has the power to oversee the company's finances and supervise the actions of the BoD and the officers, and he/she may also call a temporary shareholder's meeting in the event the BoD doesn't perform such obligation. The Supervisor also may make proposals to the BoD and bring suit against the BoD or the officers of the company, although in practice, such powers and functions are rarely exercised. According to the Draft Revision, a Supervisor or Supervisory Board is not required if: (1) a limited liability company has set up an audit committee under the BoD, which consists of more than one director; or (2) a joint stock company has set up an audit committee under the BoD and more than half of the committee members are non-executive directors. In other words, the function of the Supervisor/Supervisory Board could be replaced by an audit committee.

4. Personal Liabilities for Officers and Directors

The Draft Revision significantly expands directors' and officers' liabilities – where a director or officer causes any damage to others intentionally or due to gross negligence while performing his/her duties as a director or officer of the company, such director or officer shall bear joint and several liability with the company. The standards for this liability currently are not clearly fleshed out, but the potential for directors or officers taking personal liability will have an effect on D&O insurance for directors/officers of the MNCs.

II. Shareholder rights

1. Expanded classes of shares allowed for joint stock companies

"Same stock, same rights" used to be the principle of the Current Version, with the State Council only allowing high-tech innovative companies and companies listed on the Science and Technology board of the Shanghai Stock Exchange to issue shares with different voting rights. The Draft Revision, for the first time, specifies that a

---

[1] As stipulated in the Foreign Investment Law of PRC (《外商投资法》) effective January 1, 2020, the Company Law of PRC (《公司法》) shall apply to the organizational form, the organizational structure and the guidelines for the activities of foreign invested companies, highlighted as part of the national treatment, while such relevant regulations are different from those formerly applicable to foreign invested companies. The given transition period for foreign invested companies to make the changes and amendments are five years, to expire by December 31, 2024.

joint stock company may issue other classes of shares besides ordinary shares. The other types of shares that are allowed under the Draft Revision include (i) preferred shares (but only related to preference in dividend distribution or liquidation of assets); (ii) inferior shares; (iii) shares having more or less voting rights than ordinary shares; (iv) shares where their transfer is subject to the consent of the company; and (v) other classes of shares prescribed by the State Council. Note than unlike in the US, other preference rights for shares are not allowed.

2. Expanded Shareholder Information Rights

Under the Current Version, shareholders have the right to check and review the financial accounting report and accounting books of the company. The Draft Revision expands this information right, providing that the shareholder has the right to access the original accounting vouchers and the shareholder may appoint some third auditing party, such as a law firm or accounting firm to check related documents. For those MNCs in joint ventures, detailed record keeping and maintaining good relationships with the investors becomes more important.

III. Shareholder Obligations and Liabilities

1. Capital Contribution

(1) *Equity Interest and Debt allowed as capital contribution.*

Article 43 of the Draft Revision provides that, in addition to cash, equity interests in other companies and creditor's rights in a debt are assets that can be used as value to satisfy the capital contribution obligation of a shareholder. If the Draft Revision is adopted with this provision, it will facilitate share swap transactions and simplify the process of debt-to-equity conversion. Currently, capital contributions can be made "in cash or in kind, intellectual property, land use rights or any other non-cash property which can be valued and transferred in accordance with the law." However, in practice, cash and land use rights are the most common forms of capital contributions, given the difficulty of establishing the value of the asset contributed.

(2) If Company shares were sold, who bears responsibility for unpaid capital contributions?

If the shares of a Chinese company were sold, but still have unpaid registered capital contribution, under the Current Version, both the buyer and the seller have joint and several liability for paying in the promised registered capital. The Draft Revision clarified that the buyer will, after the sale, have sole responsibility for paying in the promised registered capital. Therefore, any buyers of Chinese companies should carefully confirm that the requisite registered capital contribution have been fully paid, or adjust the purchase price accordingly.

(3) *Equity Reduction and Acceleration of Capital Contribution.*

The Current Version stipulates that the shareholder has an obligation to make its capital contribution. However, the failure to do so will not directly cause the loss of equity of interests. The Draft Revision sets out a procedure, where the shareholder fails to make the capital contribution within a grace period given by the company (no less than 60 days), to transfer the part of equity missing capital contribution or reduce the capital contribution obligation.

In addition, the Draft Revision also clarifies that if the company is unable to pay its debts when due and becomes insolvent, the company or its creditors shall be entitled to require the shareholders to make the promised capital contributions even if the deadline for payment of the capital contribution has not expired yet.

2. Simplified De-registration Procedure

Under the Current Version, a company is required to go through formal liquidation and de-registration procedures to wind down. The Draft Revision introduces a simplified de-registration procedure. If a company is not in debt, it may carry out the process to de-register upon consent of all shareholders and an announcement through the official system after a period of no less than 20 days. The shareholders shall bear joint and several liability for the debts (if any) incurred prior to the de-registration of the company. The process in the Draft Revision therefore shortens the wind down process because it allows for debt free companies to skip the liquidation procedure.

Conclusion

The revision of the Company Law has been listed in the 13th NPCSC legislative plan since 2018. The Draft Revision was then released for public comments in December 2021 (the public comment collection period expired on January 22, 2022). Although its passage was not on the agenda of the latest 33rd Session of 13th NPCSC held in Beijing in February 2022, the Draft Revision is still an affirmative step closer to the final revision on the Company Law. Given that Chinese subsidiaries of MNCs are in the process of revising their charter documents and internal corporate governance procedures to comply with the Foreign Investment Law of the PRC, the changes above in the Draft Revision should be considered as well when contemplating these revisions.

For more information, please visit our **China Updates** page or see the following resources:

- A Snapshot of China's Cyberspace Administration and Data Protection Framework, February 9, 2022
- China Intensifies Regulations on Cryptocurrency Trading and Mining, November 2, 2021
- China's Amended Administrative Penalty Law Took Effect on July 15, October 8, 2021
- China Issues New Rules Regulating Personal Information Collection by Mobile Apps, April 28, 2021
- A New Gateway to China – Recent Policy Developments in the Hainan Free Trade Port, April 6, 2021
- China Issues Measures for the Security Review of Foreign Investments, February 9, 2021
- China Patent Law Fourth Amendment—Impact on Foreign Companies, January 26, 2021
- China Regulators Remove Restrictions on Insurance Fund Investment, December 14, 2020
- China Adopts Interim Provisions on the Review of Concentrations of Business Operators for the Anti-Monopoly Law, November 30, 2020
- China Releases Draft Personal Data Protection Law for Comments, November 12, 2020
- China Adopts Export Control Law, November 5, 2020
- China Releases New QFII/RQFII Rules, October 27, 2020
- China Releases Provisions on Strengthening the Supervision of Private Equity Investment Funds (Draft), October 15, 2020
- China Releases Provisions on the Unreliable Entity List, October 5, 2020
- China Releases Revised Measures on Handling Complaints of Foreign-Invested Enterprises, September 23, 2020
- China Releases Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies, September 10, 2020
- China Releases Draft Data Security Law, September 8, 2020
- China Releases Circular on Further Stabilizing Foreign Trade and Foreign Investment, August 24, 2020
- China Releases Draft Measures for the Administration of Imported and Exported Food Safety, August 18, 2020
- U.S. Listed Chinese Companies: Regulatory Scrutiny and Strategic Options, July 30, 2020
- China Passes Controversial Hong Kong National Security Law, July 9, 2020
- China's Relaxed Financial Sector May Aid Foreign Investors, June 18, 2020

- Is There a Law in China Similar to the US Defense Production Act?, May 8, 2020
- Coronavirus Brings Force Majeure Claims to LNG Contracts, March 4, 2020
- The Rise of China, March 4, 2020
- Coronavirus Fears Cast Cloud Over Dealmaking, February 27, 2020

Additional questions? Please contact Haynes and Boone lawyers Liza L.S. Mark and Sarah Sheng.