

A Comprehensive Analysis of China's New Company Law Impact on Foreign-Invested Companies

On December 29th, 2023, the PRC National People's Congress formally approved the sixth amendment to the Company Law of the People Republic of China, representing a significant review of the legal framework governing enterprises.

The new Company Law, scheduled to come into effect on July 1st, 2024, introduces significant changes to the framework of limited liability companies, primarily in the areas of capital contribution, governance structure, and other crucial aspects of corporate governance.

As we analyze the most significant changes introduced by the new Company Law, we will specifically examine the provisions applicable to Chinese limited liability companies (also "LLCs"). In particular:

CHANGES ON COMPANY CAPITAL'S PROVISIONS

- ***Capital Contribution Obligation:***

A notable change introduced by the new Company Law is the requirement for shareholders to fully pay their subscribed capital within five years of company establishment. Previously, shareholders had the flexibility to determine the capital payment schedule without specific deadline for the entire capital injection.

Effective from July 1st, 2024, shareholders must fully pay their invested capital within the specified timeframe of five years. Additionally, LLCs are now required to publicly disclose their registered and paid-in capital, along with the terms and conditions of contribution, in the National Enterprise Credit Information Publicity System.

For existing LLCs who do not comply with the new 5-year requirement, the new Company Law generally requires that such companies should gradually adjust. However, clarifications and further guidance will be issued by the implementation rules by the State Council.

- ***Rights and obligations against unpaid capital***

The new legislation provides for joint and several liability of the other founding partners if a partner fails to contribute the subscribed capital within the prescribed period. This allows creditors to sue all founding shareholders (including the defaulting shareholder) for the full amount not contributed. Directors now have a clear obligation to notify

defaulting shareholders in writing of their compliance with their capital contribution obligations. If they fail to do so, they may incur liability for any loss suffered by the company due to their negligence. Directors may also grant defaulting shareholders a grace period of at least 60 days to make their capital contributions.

- ***Consequences of Shareholder Default***

If a debtor shareholder fails to remedy the unpaid capital within the established grace period, the company, by resolution of the board of directors, may deliver to the shareholder a written notice of forfeiture. This notice may result in the transfer or cancellation of the defaulted shareholder's shares, potentially reducing the company's total share capital. If the unpaid capital is not covered within six months of the notice of lapse, the remaining shareholders are obliged to contribute their proportional share to cover the shortfall.

- ***Accelerated Payment in Case of Insolvency***

The new regulations specifically address situations in which a company becomes insolvent before the deadline for the full capital contribution has expired. In such cases, the company or its creditors have the right to require shareholders to accelerate their capital contributions.

REVIEW ON COMPANY GOVERNANCE

- ***Director***

The new Company Law permits the appointment of a single director for limited companies, departing from the prior requirement of an executive director. Additionally, this director is designated to exercise the full authority of the board of directors.

- ***Board of Supervisors/Supervisor***

The previous Company Law mandates the establishment of a board of supervisors or the appointment of 1-2 supervisors. However, under the new Company Law, an LLC is not obliged to set up a board of supervisors or appoint supervisors if:

1. The company has an audit committee, consisting of board members.
2. When shareholders unanimously agree not to establish one.

- ***Legal representative***

Strictly speaking, the new Company Law expands the range of individuals eligible to serve as the legal representative. Nevertheless, the definition of "representing a company to execute company affairs" remains unspecified in the 2023 Company Law.

- **Voting Procedure of Board of Shareholders**

The previous Company Law mandates that resolutions concerning extraordinary matters require approval from shareholders holding 2/3 or more of the voting rights.

In contrast, the new Company Law not only establishes a legal voting procedure for resolutions on extraordinary matters, but also stipulates that other shareholder resolutions must be approved by shareholders holding more than half of the voting rights. The previous Company Law lacks provisions for establishing a quorum to conduct a board meeting and does not specify a legal voting procedure for passing board resolutions.

In contrast, the new Company Law not only establishes a quorum requirement for board meetings (mandating more than half of all directors' attendance) but also introduces a legal voting procedure for passing board resolutions (requiring approval from more than half of all directors).

In summary, China's new Company Law represents a major rethinking of the legal framework for companies, with impact on foreign-invested companies. The introduction of a requirement for timely and complete capital contributions, along with the strengthening of director liability, are signs of a shift towards greater corporate transparency and accountability. As new regulations and clarifications are expected, companies operating in China should remain vigilant and adapt to the evolving legal landscape.