

NAVIGATE THE REVISED CHINA COMPANY LAW

What companies and shareholders need to know:
a selection of the most important changes
German Centre Beijing

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AGENDA

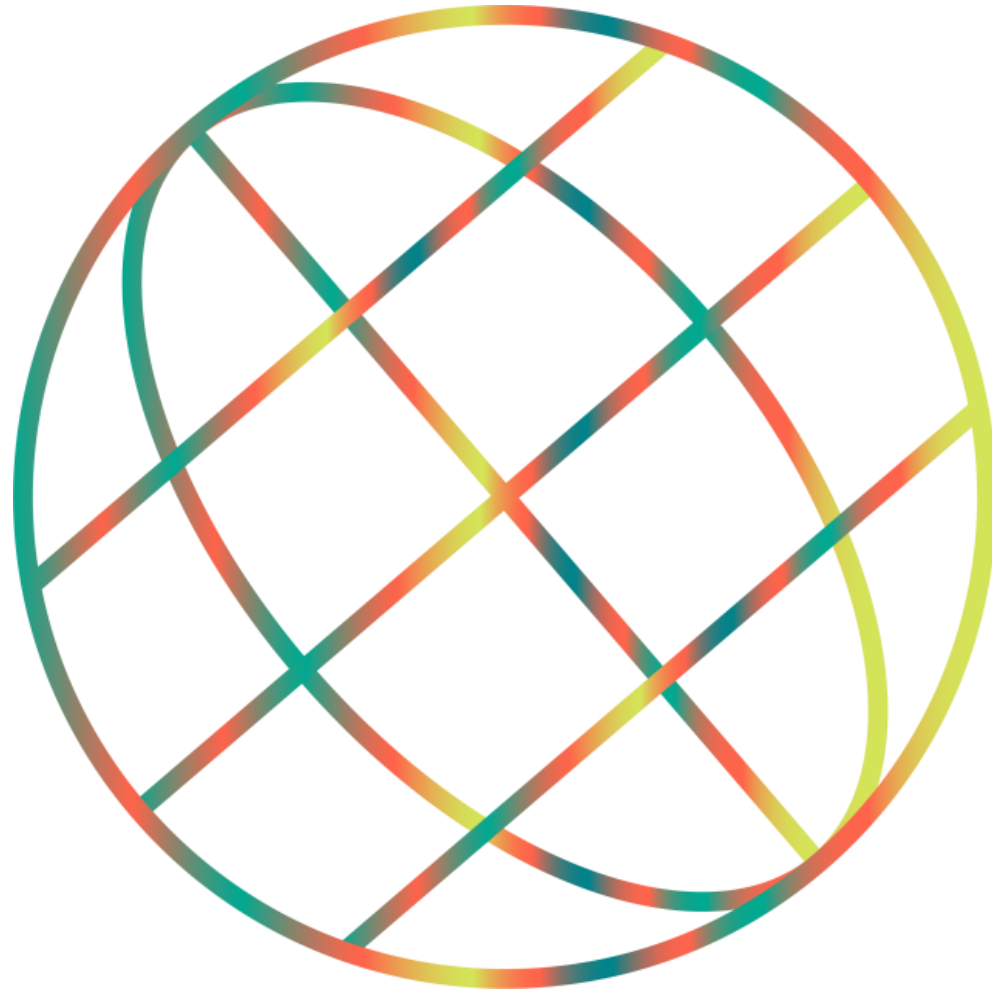
1. Introduction
2. Registered capital
3. Corporate organs
4. Duties of loyalty and care
5. Shareholder rights
6. Restructuring
7. Further changes
8. Recommendations

1 INTRODUCTION

Introduction

- Amendments adopted by National People's Congress on December 29, 2023
- Entry into force on July 1, 2024 (exactly 30 years after first version of law came into force)
- Long development history: several draft publications in recent years, including opportunity for public comment
- A total of 266 articles in revised Company Law (old 218 articles): approx. 100 articles added and/or revised
- A large number of extensive changes, following is **limited to a few key areas of limited liability companies**: changes to provisions on registered capital, corporate organs, fiduciary duties and duties of care, shareholder rights, restructuring
- **In this context also very import**: by end of 2024 organizational structure of WFOE and JV must be adapted in accordance with (“new”) Foreign Investment Law

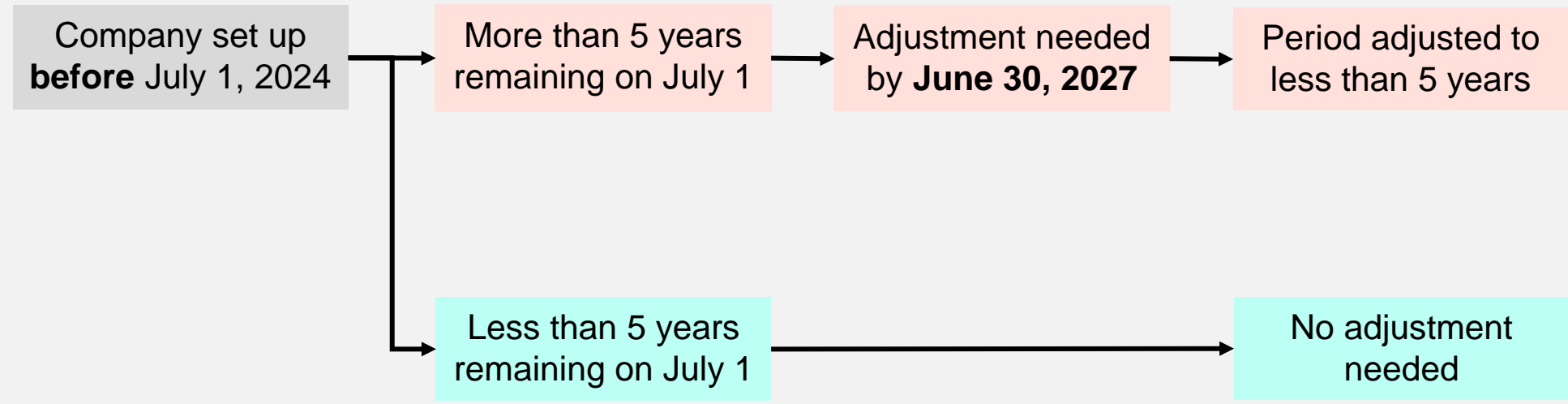
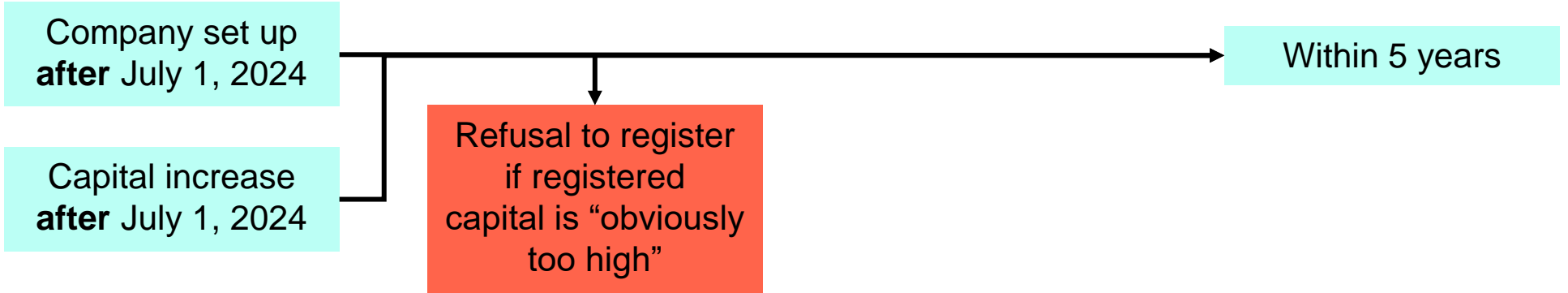
2 REGISTERED CAPITAL



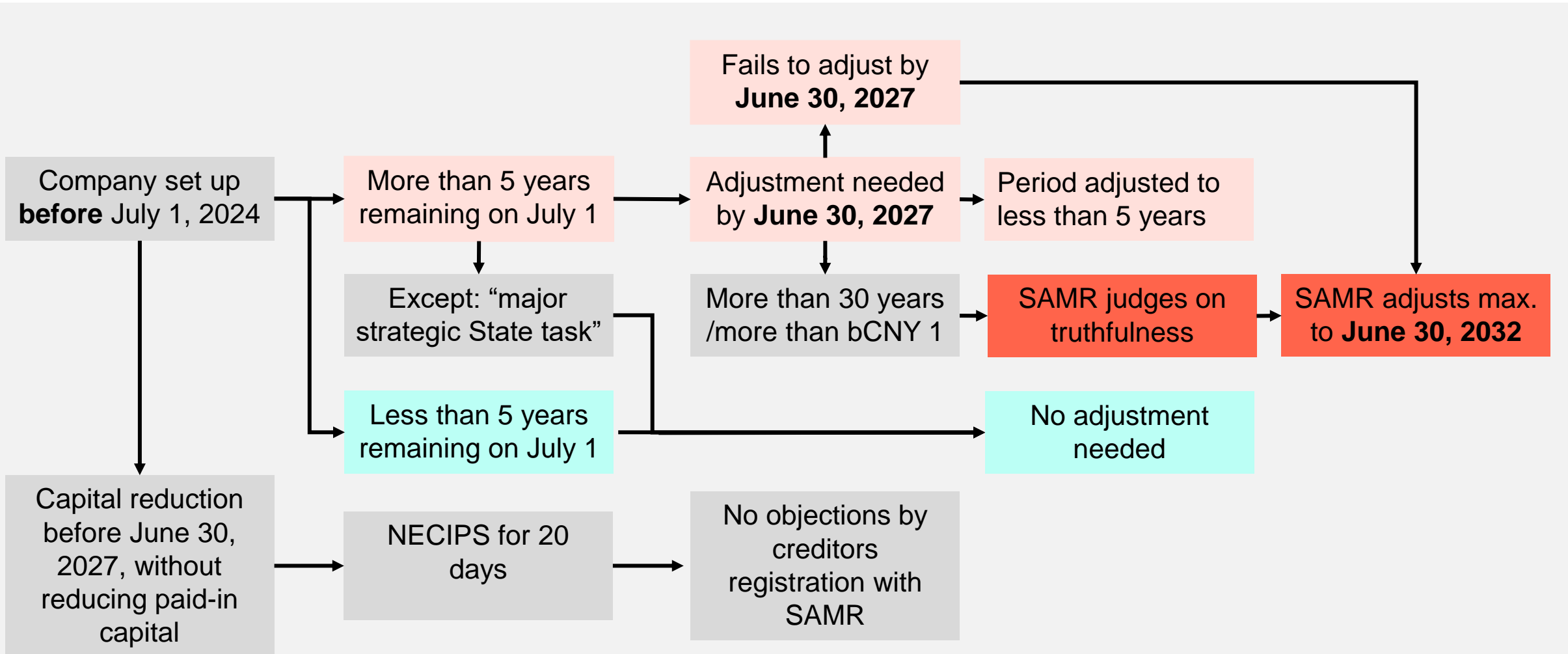
Payment, payment deadline and transition periods

- After amendment of Company Law in 2013, no more regulations on minimum amount of registered capital and payment deadlines
- Now payment within 5 years of formation
- Apparently same payment deadline for capital increases
- Publication obligation for registered capital and currently paid-up capital in *Corporate Social Credit System*
- In the event of unpaid claims against the company before expiry of the contribution deadline: company and/or creditor can demand early payment
- Capital contribution can be made in cash, or in physical objects, intellectual property rights, land use rights, equity, **creditor's rights** and other non-monetary property that can be valued
- On **February 6, 2024** State Council published DRAFT of the „Implementation of the Company Law Provisions of the Regulatory System for the Registration of Capital” which stipulates transition period of 3 years until June 30, 2027

DRAFT RULES ON TRANSITION PERIOD



DRAFT RULES ON TRANSITION PERIOD



Legal consequences of outstanding registered capital

- Joint and several liability of other shareholders if a shareholder does not make his contribution on time or in full or if his contribution in kind is valued significantly lower than his subscribed capital
- Obligation of Board of Directors to verify capital contributions:
 - In event of default: request by company to defaulting shareholder to make contribution within not less than 60 days
 - In event of non-payment: order to revoke „unpaid“ equity (subsequent transfer of equity or capital reduction or, after 6 months, liability of other shareholders to make contribution)
 - Loss of shareholder rights of affected shareholder regarding revoked equity
- Differentiated regulation for equity transfers:
 - In case of overdue registered capital, joint and several liability of seller and buyer for outstanding capital contribution amount to the company (unless transferee is bona fide)
 - For registered capital not yet due: only supplementary liability of seller if buyer fails to contribute in time

3 CORPORATE ORGANS

Shareholders/Shareholders' Meeting

- Position and powers essentially unchanged
- Elimination of two competencies:
 - **Competence to determine the company's operational guidelines and investment plans**
 - Now: authority of Board of Directors to determine business plans and investment plans
 - **Competence to review and approve the company's annual budget and final accounts**
 - Now: Company Law only states that company must prepare a financial accounting report and have it audited at end of each financial year, to be provided to shareholder(s) (without mentioning an approval requirement)
- Possibility to authorize Board of Directors to issue corporate bonds

Board of Directors

- Powers essentially unchanged
- At least 3 members (as before), but no upper limit on number of members
- "**Director**" (formerly "Executive Director"): still possible for small companies instead of Board
- **Employee representative** to be democratically elected to Board if:
 - company has **more than 300 employees**, and
 - if there is no Supervisory Board with employee representatives (wording not entirely clear)
 - requires election by employee assembly, employee representative assembly or another form of democratic election
- Establishment of an **Audit Committee within Board of Directors** that can replace Supervisory Board or Supervisor
- Compensation obligation of company in event of premature dismissal of a Director "without good cause" (unclear how compensation shall be determined, for example like labor severance payment?)

Employee Representative

- In practice several issues will arise, e.g. how best to proceed in a 50:50 JV with more than 300 employees and a 2:2 Board?
 - Option 1: Additional inclusion of an employee representative on Board (2+2+1) - employee representative would then be “tie-breaker”
 - Option 2: No shareholder will want to give up a board seat, so no 1+1+2
 - Option 3: Shift all matters except HR / Employment to the shareholders' meeting, i.e. the Board is completely reduced in its function and then e.g. 2+2+1
 - Option 4: Establish an employee supervisor on (new) Supervisory Board – seems to be suitable solution
- GM, CFO and HR manager as Employee Representative – seem to be not suitable due to obvious potential conflict of interest

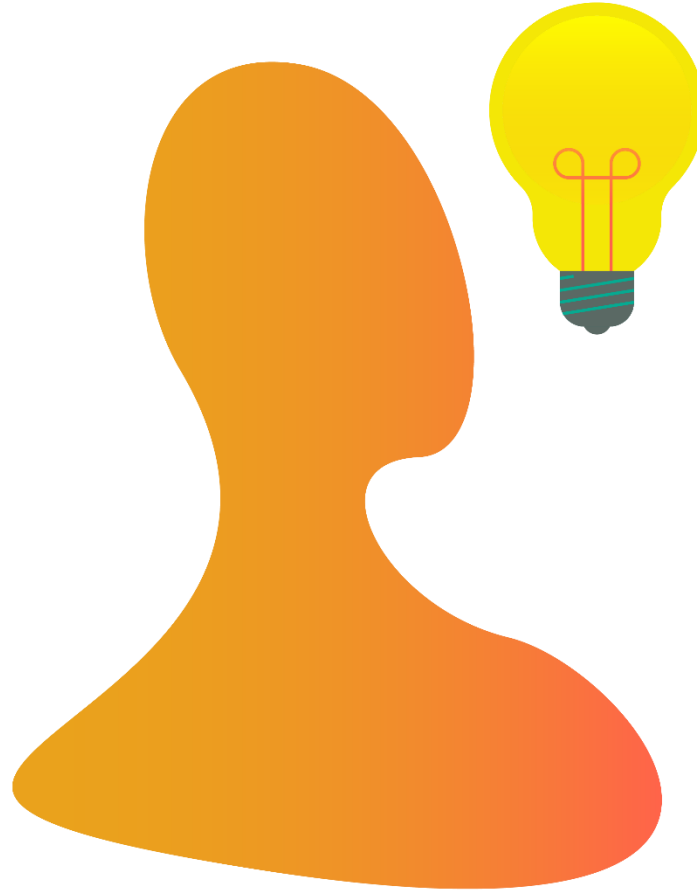
Supervisory Board/Supervisor and Audit Committee

- Optional complete elimination of Supervisory Board/Supervisor for "small" companies by unanimous consent of all shareholders (to be seen in practice if this also applies to existing companies)
- Optional replacement of Supervisory Board/Supervisors by Audit Committee within Board
- Audit Committee:
 - Located below Board of Directors
 - Members are Directors
 - Unclear competencies, as directors may act in an executive capacity and might then have to control themselves at same time (conflict of interest)

Legal Representative

- Extension of group of persons who may be appointed as Legal Representative: in addition to a manager, also a member of Board of Directors, insofar as either of them manages business of company (previously only Chairman of Board or General Manager), thus more flexibility
- Statutory resignation mechanism: if a member of Board of Directors or General Manager who is also Legal Representative resigns, Legal Representative position is deemed as resigned on the same date
- In event of (unilateral) resignation of Legal Representative, the company is obliged to appoint a new Legal Representative within 30 days

4 DUTY OF LOYALTY AND DUE DILIGENCE



Duties of loyalty and care

- Group of persons included: Directors, Senior Officers, Supervisors, Controlling Shareholders, and Actual Controllers
- **Duty of loyalty:** taking measures to avoid conflicts between own interests and interests of company; no use of powers to obtain unfair advantages
- **Duty of care:** observance of care normally expected of managers in performance of their duties in best interests of company
- Further details can be set forth, e.g., in internal regulations, like in compliance code of conduct, in management by-laws, or employee handbook; such internal regulations can also define permitted activities and processes to solve identified or suspected conflicts of interest

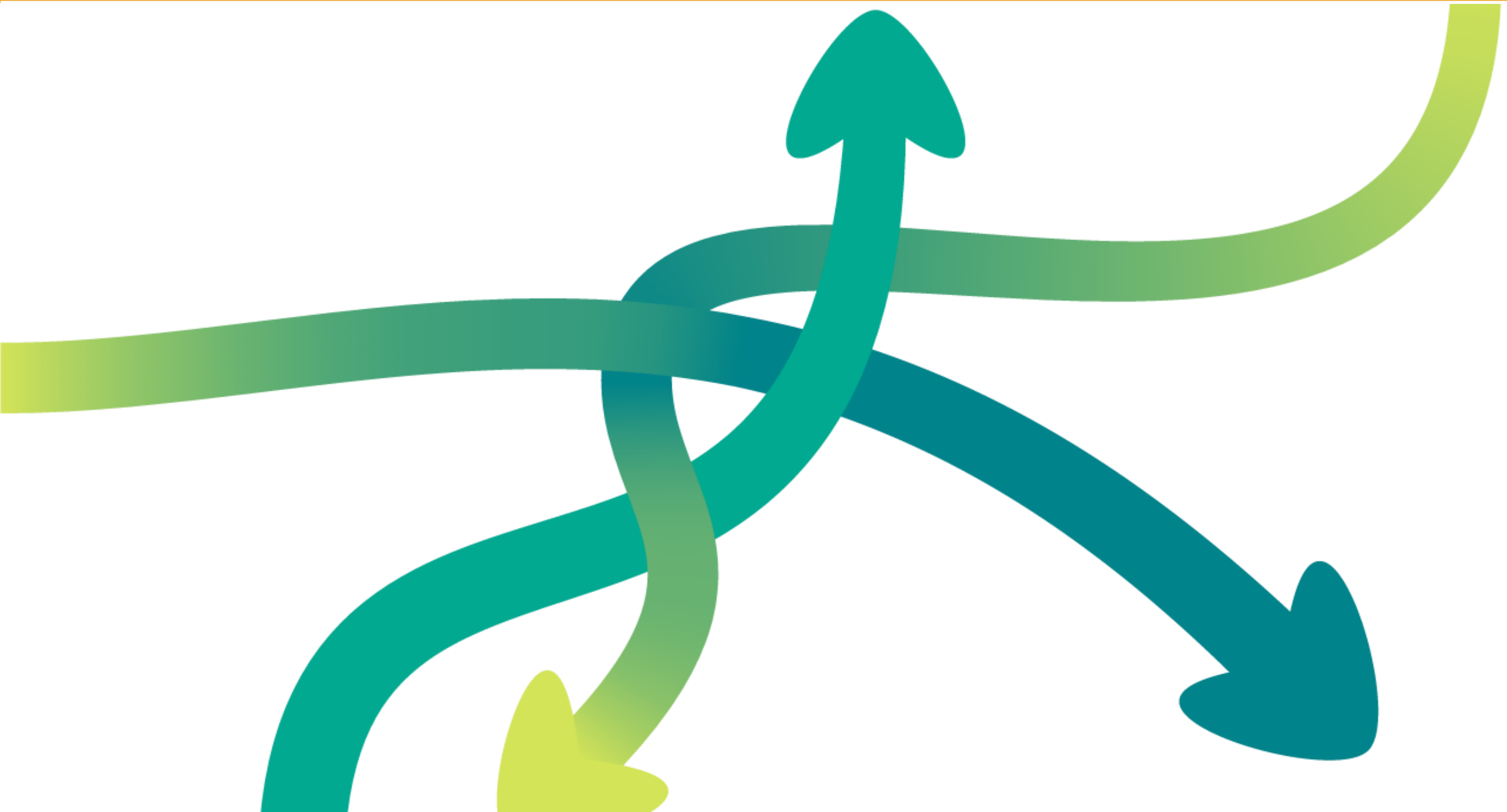
Specific duties of Directors, Senior Officers, Supervisors

- Duty to inform Shareholders' Meeting or Board of Directors about own contracts or other own transactions with company and, in accordance with the articles of association, to obtain their approval for such transactions, which also includes contracts with close relatives or enterprises controlled by them
- Prohibition of using the position to take advantage of company's business opportunities for themselves or other persons, unless the company is not in a position to take advantage of such opportunities or it is reported to Shareholders' Meeting or Board of Directors and, if provided for in the articles of association, approved
- Not to conduct business for themselves or for other persons of same nature as company without notifying Shareholders' Meeting or Board of Directors and (as required by articles of association) obtaining their approval

Liability

- Further specification of the liability of company organs (selection):
 - Recourse by company in event of breaches of loyalty duties and duties of care
 - Recourse of the company in event of actions by Legal Representative that cause damage
 - Liability of Board of Directors members for breach of obligation to check capital contributions
 - Liability for damage to company through transactions with related parties
 - Liability for unlawful distribution of profits
 - Dedicated liability regulations in start-up phase
- Caution: Company's obligation to pay compensation in event of premature dismissal of a board member "without good cause" - meaning unclear: questionable whether reasons contained / supplemented in the articles of association can help to justify this

5 SHAREHOLDER RIGHTS



Extension of rights of access to information

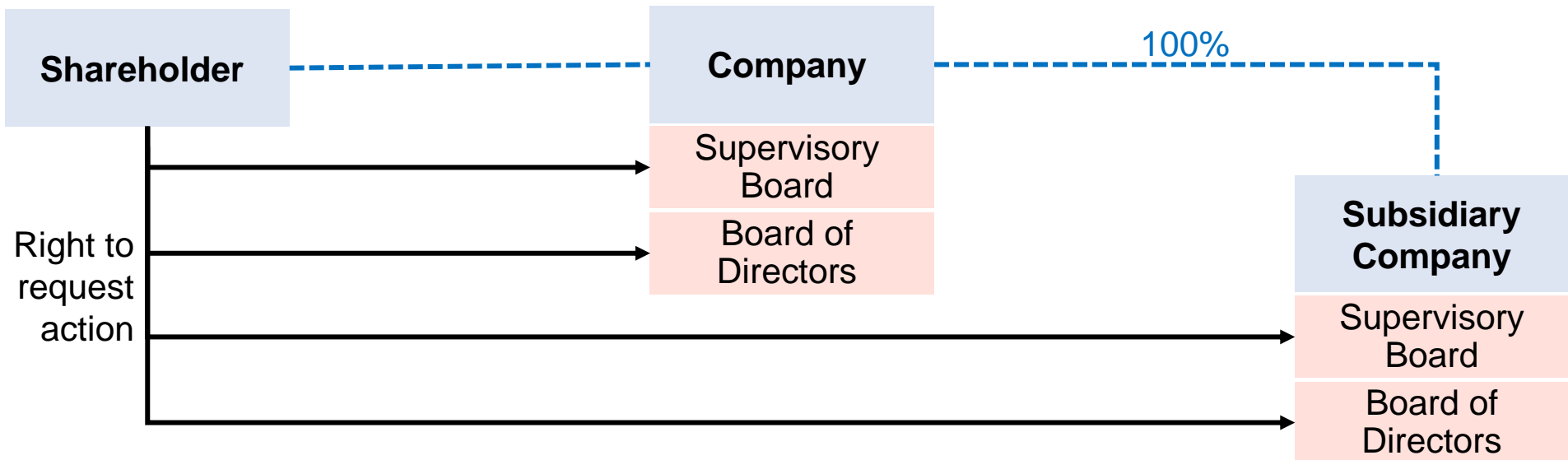
- Inspection and copying of articles of association, list of shareholders, minutes of Shareholders' Meetings, resolutions of Board of Directors and Supervisory Board, financial and accounting reports
- Involvement of authorized representatives such as auditors or lawyers for inspection possible
- Written application required, deadline for decision of 15 days
- Rejection of an application only if there is reasonable suspicion of unlawful use
- Shareholder's right to sue if request for inspection is rejected
- Corresponding application of regulations for inspection of documents of wholly-owned subsidiaries

Right to request a buy-back of own equity

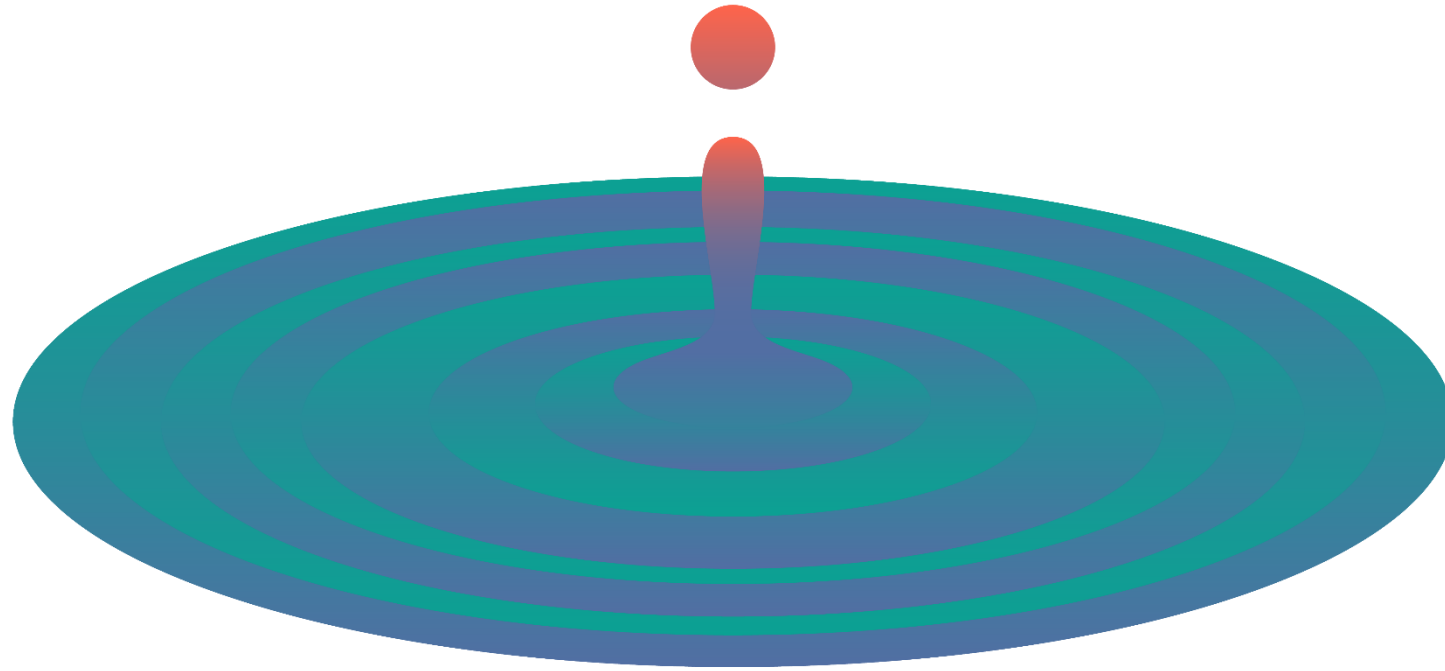
- In event of abuse of shareholder rights by controlling shareholder which results in damages to company and interests of other shareholders
- In following scenarios, if relevant shareholder has voted against respective resolutions at Shareholders' Meeting:
 - No profit distribution in 5 consecutive years despite profits generated and legal requirements for profit distribution being met
 - Merger, split, transfer of material assets
 - End of duration of company (in accordance with articles of association) and resolution to amend articles of association in order to continue the company
 - If no agreement on share buyback within 60 days of resolution, possibility of suing within 90 days of resolution
 - **New:** transfer or canceling of equity required within 6 months of equity buy-back

5 SHAREHOLDER RIGHTS

Right to Request Action	Infringer	Right Against	Alternatively
Shareholder's right to request an action by the company or the company's wholly owned subsidiary against the infringer	Director, senior manager of company	Supervisory Board	In event of refusal, delay of more than 30 days or in an emergency: action may be brought by shareholders in their own name against infringer
	Supervisor of company	Board of Directors	
	Third party	As above	



6 RESTRUCTURING



Equity transfers

- Exercise of shareholder rights by new shareholder already upon internal registration of new shareholder in list of shareholders
- Majority approval of other co-shareholders is no longer required for planned transfers to third parties, only information about planned sale and its conditions (unless otherwise stipulated in articles of association)
- Statutory pre-emptive purchase right of co-shareholders in the event of a planned transfer to third parties: deemed waiver of the right of first refusal after 30 days (deviating provisions in the articles of association possible)
- Pre-emptive purchase right of co-shareholders in event of a judicially imposed equity transfer in context of foreclosure: exercise period of 20 days

Dissolution/liquidation

- Simplified procedure for de-registration possible if:
 - Company has settled all liabilities or is debt-free
 - Confirmation by shareholder
 - Notification of intention to de-register for at least 20 days in *Corporate Social Credit System*
 - Application for de-registration with registration authority within 20 days of expiry of notification period, provided no objections have been raised
 - If reason for de-registration is not true, joint and several liability of shareholders
- Compulsory de-registration if:
 - No completion of de-registration of company within 3 years after withdrawal of business license or order to close the company
 - Notification by registration authority to *Corporate Social Credit System* with a notice period of at least 60 days
 - Deletion of registration after expiry of notification period if no objections have been raised
 - Liability of shareholders and liquidators remains in place

7 FURTHER CHANGES



Further changes (selection)

- Strengthening of employees' participation, e.g. representative in Board; regarding restructuring, dissolution, application for bankruptcy, or other major issues, and formulation of important rules and regulations, company shall take into account opinions of trade union and suggestions of employees
- Use of statutory reserves to offset losses, to expand business activities, to increase capital
- Judicial review of Shareholder and Board of Directors resolutions and their possible reversal
- Forced temporary continuation of a board position despite resignation of person in individual case
- Regulations on quorum for Board of Directors resolutions
- Provisions regarding majority shareholder and actual "controller" of company, in particular regarding legal responsibility and liability
- Separate regulations for stock corporations
- Joint and several liability of several companies if their controlling shareholder uses their independent legal position and their limited shareholder liability for abuse

8 RECOMMENDATIONS

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RECOMMENDATIONS FOR ACTION

(Very) important	Optional, but recommended
<p>Registered capital:</p> <ul style="list-style-type: none">• Determining when and how share capital must be paid in• If necessary: changes to payment schedule, or making arrangements for accelerated payment	<p>Health Check:</p> <ul style="list-style-type: none">• Can new substantive provisions of new law be met?• Can new formal requirements and documentation requirements be met?• Adjustments to corporate processes / internal regulations necessary?
<p>Employee representative:</p> <ul style="list-style-type: none">• Determining whether employee representative is required• Appointment of an employee representative to Board of Directors (if necessary)	<p>Consider optimization of articles of association:</p> <ul style="list-style-type: none">• Supervisor no longer needed?• Adaptation of articles of association and internal regulations to changed powers of the governing bodies (especially for JV: more powers for Board of Directors)
<p>Review corporate governance (duties and responsibilities of Directors, Managers, Supervisors; internal control mechanisms, reporting lines)</p>	<p>Insurance:</p> <ul style="list-style-type: none">• D&O and other related insurance (e.g. fidelity insurance) required / recommended?
<p>For older WFOE/JV: organizational form and other aspects still existing under old law must be adapted by 31 December 2024 under requirements of Foreign Investment Law</p>	

Questions?



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