New Company Law in China: 10 key changes you should know about

On 29 December, the last working day of 2023, the Standing Committee of the National People's Congress (***NPCSC***) of China concluded its seventh and final session of the year and passed a number of legislations. Most remarkably, the Company Law was finally amended after three drafts were published in as many years seeking public comments. By coincidence (or not), the amendment was enacted on the 30th anniversary of the Company Law, which was first adopted by the NPCSC on 29 December 1993, and will take effect on 1 July 2024, also exactly 30 years after the effective date of the first iteration.

The new Company Law comprises 266 articles, with more than 70 articles being added to or substantially rewritten of the current 218 articles. It is the first major overhaul of the Company Law since 2005 and has made various significant changes to China's corporate law regime. It would be mission impossible to summarise all these changes in a blog-sized article, but here are the 10 key changes you should know about:

1. Capital contribution

Capital contribution by shareholders is probably the area where the most changes were made. For example, under a heavily debated new provision, shareholders of a limited liability company (***LLC***) must now pay their entire subscribed capital contribution within five years from the date of establishment of the company, unless otherwise provided in other laws and regulations (Art. 47). Such requirement seems to apply to capital increases as well (Art. 228). In addition, if the company becomes insolvent before the due date of any capital contribution, the company or its creditors may require the shareholders to accelerate the contribution (Art. 54).

Before the 2023 amendment, there was no time limit on the schedule of capital contribution, which could be agreed between the shareholders at will. Whilst such unhindered flexibility led to a boom of new companies in the past decade, it was also abused in certain instances – there have been companies with registered capital of trillions of Renminbi but also with a 100-year contribution schedule. The new requirement was hence introduced to add more credibility and relevancy to a company's registered capital by imposing a statutory longstop date on the contributions.

Notably, there is no grandfathering for existing companies. If the schedule of capital contribution of an existing LLC exceeds 5 years, it shall be adjusted in due course to comply with the new requirement, for which the State Council is tasked to issue implementing regulations (Art. 266). It can be expected that companies with an astronomical registered capital amount will decrease their capital shortly.

Besides, a previous judicial interpretation was codified (with clarificatory modifications) into the new law: if a shareholder fails to pay its subscribed capital on time, in addition to the liabilities to pay such capital and indemnify the company against losses caused by such failure, it will, after a grace period and upon resolution by the board of directors, forfeit its right to the unpaid equity interest which shall be transferred, cancelled or paid in by the other shareholders (Art. 52).

The new Company Law also adopted other changes to make the company's registered capital more transparent and plausible. For example, not only is an LLC required to publish its subscribed capital, but it is also required to publish the paid-in amount of the subscribed capital in the National Enterprise Credit Information Publicity System (Art. 40). If a shareholder fails to pay its capital contribution when an LLC is established, the other shareholders at the time of establishment shall be jointly and severally liable for the shortfall (Art. 50). Lastly, if a shareholder transfers its equity interest in an LLC before its capital contribution is fully paid, the buyer and the seller shall be jointly and severally liable for the outstanding amount (Art. 88).

2. Legal representative

Every Chinese company must have a legal representative who has the statutory power, subject to any limitation imposed by the articles of association and/or shareholders' meeting, to represent the company in its civil activities.

Before the 2023 amendment, only the chairman of the board of directors (or the sole executive director if the company did not have a board of directors) or the general manager of the company could serve as legal representative. Now, any director who carries out the company's affairs on its behalf or the general manager can be the legal representative (Art. 10), which gives the company more flexibility in designating its top representative.

Meanwhile, considering the potential personal liabilities attached to the role of legal representative, the new Company Law also provides for a clear exit mechanism to address the concern that the legal representative may be permanently fixed to the position if no successor is appointed. If a director or the general manager who serves as legal representative resigns his position, he shall be deemed to have resigned as legal representative at the same time, in which case the company shall appoint a new legal representative within 30 days from the date of resignation (Art. 10).

3. Shareholders' meeting

The shareholders' meeting remains the highest authority within a company, but its duties and powers have been streamlined and optimised by the recent Company Law amendments. Most importantly, two powers that have caused confusion and difficulties in practice were removed from the shareholders' meeting, being: (i) the power "to determine the company's operating strategies and investment plans" (which was confusingly vague, especially in light of the board's power to determine "operating plans" and "investment proposals") and (ii) the power "to review and approve the company's annual financial budget plan and final accounts plan" (which was not necessarily required for every company and, even if required, might not be appropriate for the shareholders' meeting to review and approve). In addition, the shareholders' meeting can authorise the board of directors to decide on the issuance of bonds now (which previously required the shareholders' meeting to decide) (Art. 59).

For companies that only have one shareholder, the shareholder can decide on matters that would otherwise have required the shareholders' meeting to decide, provided that the shareholder's decision is made in writing, and is signed or stamped by the shareholder and deposited with the company (Art. 60).

4. Board of Directors

The powers of the board of directors are largely unchanged except that, in line with the changes to the powers of the shareholders' meeting, the board of directors does not have "to formulate the company's annual financial budget plan and final accounts plan" anymore, although it retains the power to "determine the company's operating plans and investment proposals" (which itself is no longer bifurcated between the shareholders' meeting and the board of directors). Also, besides other powers to be provided in the articles of association, it is also clarified that the board of directors can exercise powers authorised by the shareholders' meeting, such as the issuance of bonds (Art. 67).

Additionally, the previous limits on the number of directors were partly scrapped. For both LLCs and joint stock companies (JSCs), the board of directors shall comprise at least three directors and there is no upper limit. If a company's scale is small or the number of its shareholders is limited (Small Enterprise), regardless of whether it is an LLC or a JSC, it can have a sole director to exercise the powers of the board of directors (Art. 75, 128).

Usually, employee representatives are optional for the board of directors. However, at least one employee representative on the board of directors is required: (a) in wholly state-owned companies (Art. 173); or (b) if the company has not less than 300 employees and there is no employee representative on the supervisory board (Art. 68, 120).

5. Supervisors

Chinese companies have a so-called "two-tiered" governance structure, i.e., besides the board of directors, there shall also be a supervisory board (comprising no less than three members with at least one third of the members being employee representative(s)). But unlike some other civil law jurisdictions, the supervisory board in Chinese companies does not make business decisions and only supervises the board of directors and senior managers for their compliance with laws and regulations, as well as the articles of association.

Before the 2023 amendment, a company could be exempted from the requirement of having a supervisory board only if it was an LLC and a Small Enterprise, in which case it could have one or two supervisors to exercise the powers of the supervisory board. The new Company Law provides for more exceptions: first, the Small Enterprise exception is extended to JSCs. If a JSC is a Small Enterprise, it can have one supervisor (but not two supervisors anymore as there was ambiguity as to how two supervisors should exercise their powers) (Art. 133). Where an LLC is a Small Enterprise, it can also have one supervisor or, if unanimously agreed by the shareholders, even no supervisor at all (Art. 83).

Another exception is that if an audit committee, which shall comprise only directors, is established under the board of directors to exercise the powers of the supervisory board (regardless of whether it is an LLC or a JSC), then there is no need to have a supervisory board or supervisor (Art. 69, 121). This exception will help companies that are already required to have an audit committee (e.g., certain listed companies and financial institutions) to streamline their governance structure. The exception's effectiveness, however, may be dubious since the audit committee is made up of directors and may have a conflict of interest when supervising the directors.

6. Joint Stock Company

The new Company Law relaxed various requirements for JSCs (which is still the only corporate form of business entity that can be listed). First, it abolished the stringent requirement that the founders of a JSC shall not transfer their shares within one year from the date of establishment of the company (previous Art. 141). Such requirement used to be a potential obstacle in pre-IPO restructurings, no matter whether the JSC is newly established or converted from an LLC.

Another change is that JSCs do not require at least two founders anymore, so a single person can incorporate a JSC if the other conditions are met (Art. 92).

The new law also allows a JSC to authorise its board of directors, under the articles of association or by the shareholders' meeting, to issue new shares within three years not exceeding 50% of the shares that have been issued, provided that: (a) the issuance of shares for non-cash consideration must be approved by the shareholders' meeting; and (b) the board of directors' resolution on such authorised issuance shall be approved by at least two thirds of all directors (Art. 152, 153). So general mandates are now possible for Chinese listed companies.

Lastly, for the first time, JSCs are permitted (but not required) to issue shares without a par value, provided that all the shares of a JSC should either be shares without par value or shares with par value. If a JSC issues shares without a par value, at least one half of the proceeds from the issuance of such shares shall be accounted as registered capital. A JSC may also convert all its issued shares with par value into shares without par value, or vice versa, in accordance with the articles of association (Art. 142). Shares with no par value effectively give the company an option to issue shares at discount.

7. Multiple classes of shares

Another important change for JSCs is that each JSC can issue multiple classes of shares now, which used to be permissible only if the JSC met the conditions laid out in the special regulations made by the State Council, e.g., financial institutions and hi-tech companies (previous Art. 131).

The rights of a class of shares may differ from the rights of ordinary shares as follows:

(1) preferred or subordinated distribution of profits or residual assets;

(2) greater or fewer voting rights per share (except that for the election and replacement of supervisors or audit committee members, the voting rights of each class of shares including ordinary shares shall be the same);

(3) transfer (of the shares) subject to restrictions, such as the consent of the company; and

(4) other differences as specified by the State Council.

A listed JSC can only issue shares in items (2) and (3) above prior to its IPO (Art. 144), among other restrictions under the relevant listing rules, e.g., the maximum number of additional votes that each share can carry.

After the regime becomes universally available, JSCs will provide structural options to more founders and other shareholders to set out their rights (and obligations) in relation to the company, rather than relying on contractual arrangements which have been commonplace for special shareholders' rights so far. JSCs will probably become a more popular corporate form, for this reason as well as the relaxation of other requirements as mentioned above, despite its more rigid establishment and governance requirements.

8. Financial assistance

Until this round of amendments, financial assistance was a grey area under Chinese law and there have been conflicting practices and court cases which caused disturbing uncertainty for market players. The new Company Law sets out the basic rules of financial assistance for the first time.

A company shall not provide gifts, loans, guarantees or other financial assistance to another person to acquire shares of the company or its parent company, unless: (a) it is to implement employee stock ownership plans; or (b) it is for the benefit of the company, as resolved by the shareholders' meeting or the board of directors (in accordance with the articles of association or the authorisation of the shareholders' meeting, and with the affirmative votes of not less than two thirds of all directors) and the cumulative total amount of financial assistance shall not exceed 10% of the issued share capital (Art. 163).

Notably, the provision does not differentiate between unlisted and listed companies in terms of whitewash procedures, nor does it spell out the exact approval requirement of the shareholders' meeting (including when it is mandatorily required and, if so, the voting threshold). These details are expected to be provided in future judicial interpretations and/or listing rules.

9. Fiduciary duty

The new Company Law elaborates on the fiduciary duty of directors, supervisors and senior managers which, under Chinese law, is divided into two related concepts: the "duty of loyalty" and the "duty of diligence".

Under the duty of loyalty, directors, supervisors and senior managers shall take measures to avoid conflicts between their own interests and the interests of the company, and shall not use their powers to seek improper benefits. Under the duty of diligence, directors, supervisors and senior managers shall exercise reasonable care normally expected of managers in the best interests of the company when performing their duties (Art. 180).

There are also more specific requirements on directors, supervisors and senior managers under the new law. They shall report their contracts and other transactions with the company (including those of their close relatives and affiliates) to the shareholders' meeting or the board of directors and seek its approval as required under the articles of association (Art. 182). They shall not take advantage of their positions to seek business opportunities belonging to the company for themselves or other persons, unless the company cannot pursue such opportunities or it is reported to and (as required under the articles of association) approved by the shareholders' meeting or the board of directors (Art. 183). Lastly, they shall not engage in the same type of business as that of the company for themselves or other persons without reporting to and (as required under the articles of association) getting approval from the shareholders' meeting or the board of directors (Art. 184).

10. Controlling shareholder and actual controller

Illegitimate interference by controlling shareholders and actual controllers is a common issue in the governance of Chinese companies. The new Company Law made various changes in an attempt to resolve this issue.

First, the rules for piercing the corporate veil have been strengthened. Besides "vertical" piercing (i.e., holding shareholders accountable for the company's liabilities), now "horizontal" piercing is also possible: if a shareholder abuses the legal personality and shareholders' liability limitation of two or more companies under its control, so as to evade debts and seriously damage the interests of the companies' creditors, each company shall bear joint and several liability for the debts of the other companies. In addition, if a company has only one shareholder and the shareholder cannot prove that the company's assets are independent of the shareholder's own assets, then the shareholder shall bear joint and several liability for the company's debts, i.e., the burden of proof is reversed (Art. 23).

Moreover, there are also additional potential labilities for controlling shareholders and actual controllers. If the company's controlling shareholder or actual controller does not serve as director of the company, but actually carries out the company's affairs, it shall also owe a duty of loyalty and a duty of diligence to the company (like directors, supervisors and senior managers) and bear liabilities for any breach (Art. 180). If a company's controlling shareholder or actual controller instructs any director or senior manager to engage in behaviours that damage the interests of the company or its shareholders, it shall be jointly and severally liable with the director or senior manager (Art. 192). Lastly, if an LLC's controlling shareholder abuses its shareholder rights and seriously damages the interests of the company or the other shareholders, the other shareholders shall have the right to require the company to acquire their equity interests at a reasonable price (Art. 89).

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