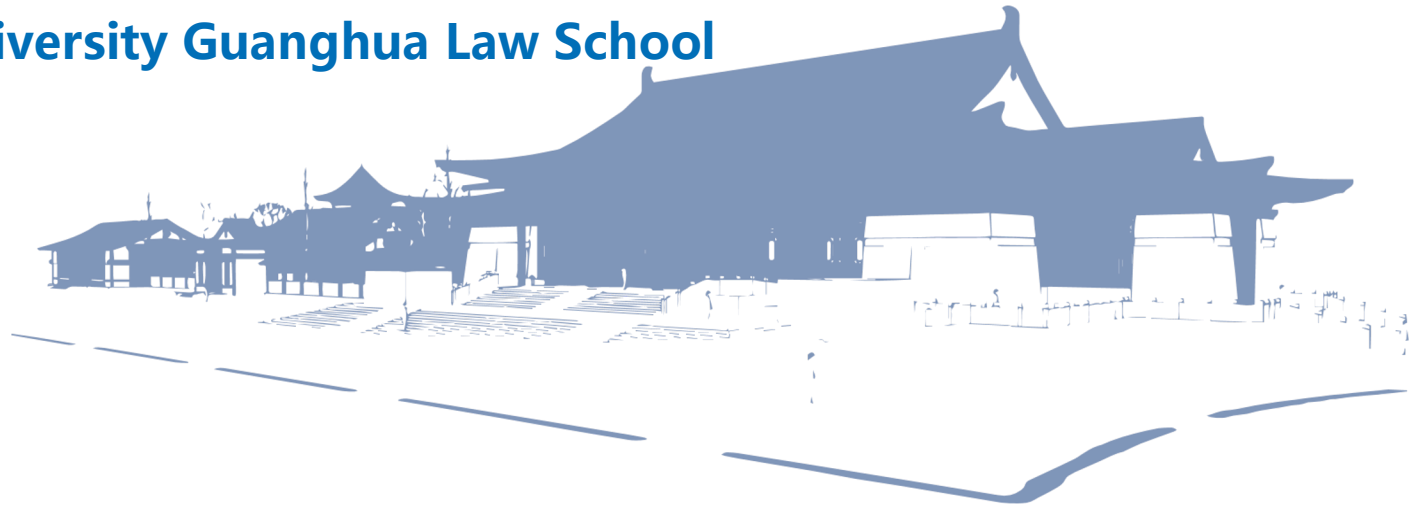




The Draft Revision of PRC Company Law: Prospects and Challenges

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- **The 1993 Company Law**

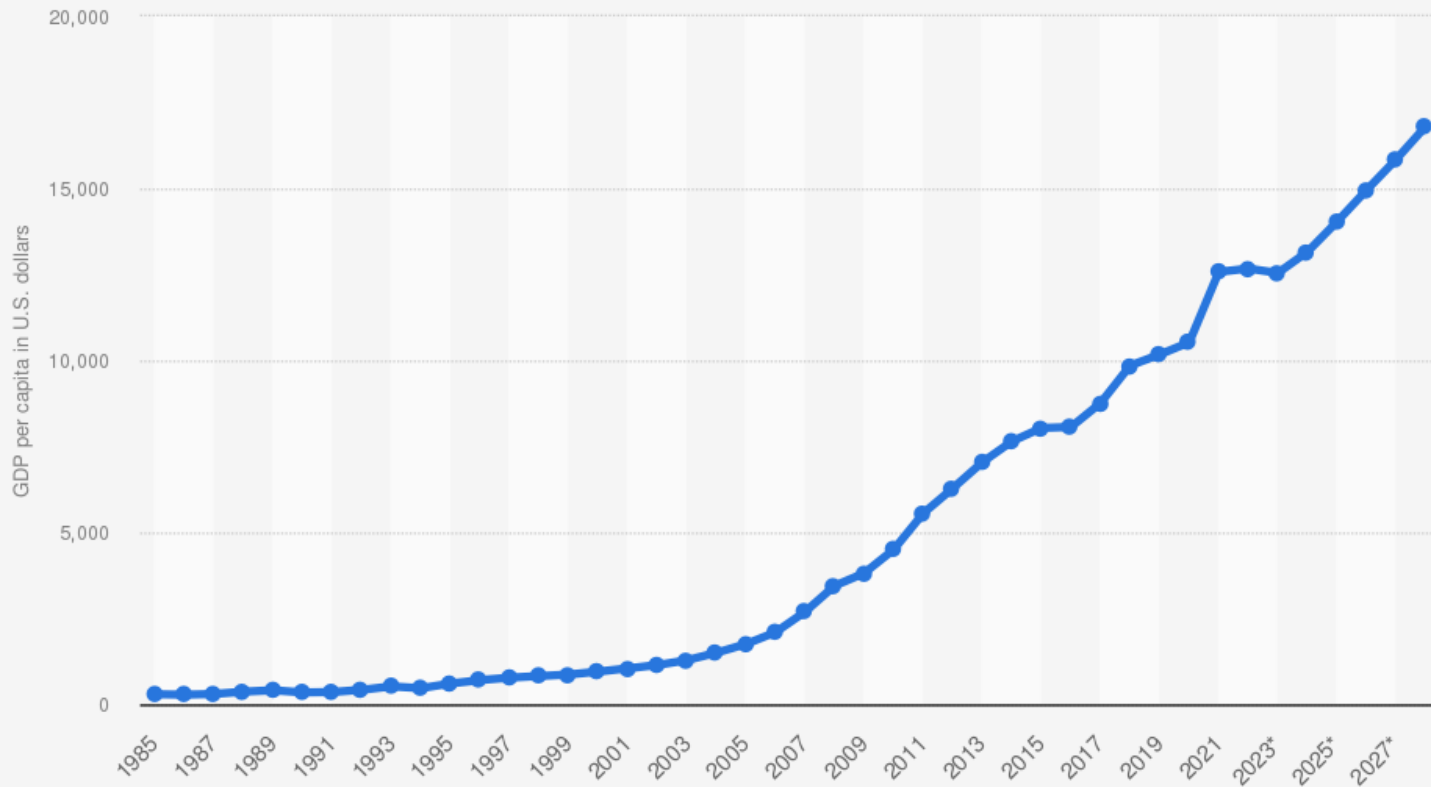
- established the legal framework for limited liability companies and joint stock companies
- delineated the fundamental legal system for the establishment, operation, management, and dissolution of companies.

- **The 2005 Company Law**

- adding 44 new articles, deleting 13 articles and amending 91 articles out of a total of more than 200 articles of the 1993 Act.
- the 2013 Amendment liberalized company registration procedures, particularly concerning legal capital.
- the 2018 Amendment loosened requirements on share repurchase of joint stock companies.

Legislative History Overview

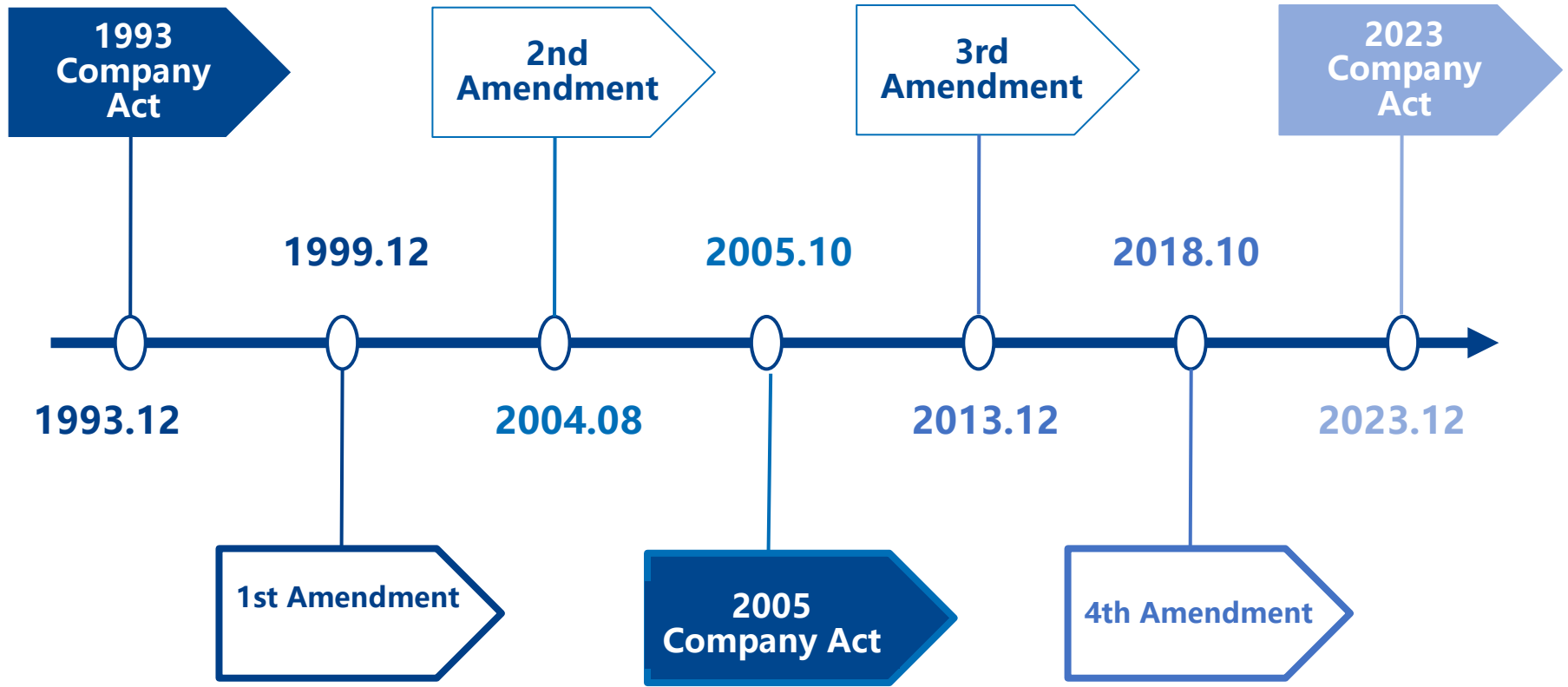
Gross domestic product (GDP) per capita in current prices in China from 1985 to 2022 with forecasts until 2028 (in U.S. dollars)



Source
IMF
© Statista 2023

Additional Information:
China; 1985 to 2022

Timeline



- **Factors**

- the enactment of PRC Civil Code
- the Enactment of Securities Law
- the new requirements of SOE governance reform
- the World Bank “Ease of Doing Business Assessment”

- **Principles**

- To regulate corporate organization and behavior
- To safeguard the legal rights and interests of companies, shareholders and creditors
- To enhance China's distinctive modern corporate system
- To promote entrepreneurial spirit

1. Basic Framework

- a) **Company Classification by publicity**
- b) **Company Classification by ownership structure**

2. Corporate Finance

- a) **Capital Structure**
- b) **Multiple rounds of equity finance**
- c) **Multiple classes of shares**

3. Corporate Governance – Shifting Toward a Board-Centric Model

A Glimpse on Key Amendments

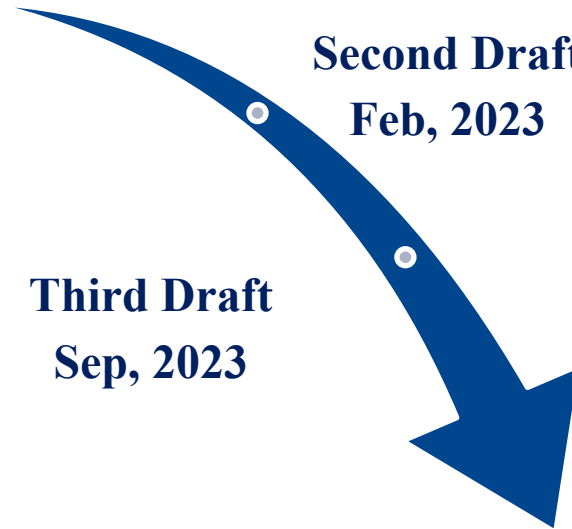
- **Corporate Finance**
- **Corporate Governance**
- **Shareholder Rights**
- **Responsibilities of Directors and Senior Managers**
- **Liabilities of Controlling Shareholders and De facto Controllers**
- **Others**

First Draft
Dec, 2021

Second Draft
Feb, 2023

Third Draft
Sep, 2023

Fourth Draft, ?



1. Notable Changes in LLCs: from Subscription to Contribution

- **A revert back to the 2005 Company Law**

- **§ 47 The entire capital subscribed by the shareholders of a company shall be paid in full within five years of the incorporation.**

- **Why “five years”**

- **The average “life span” of a LLC is 3-4 years.**

- **The debate**



1. Notable Changes in LLCs: Strengthened Capital Contribution Responsibilities

- **BOD' responsibility to call contributions**
 - Failure to do so can result in directors' liability to the company for damages.
- **Forfeiture of shares**
 - Failure to fulfil contribution obligation within a company given grace period may leads to forfeiture of shares.
- **Accelerated maturity**
 - If a company can't pay immediate debt, either the company or the creditors holding matured claims can request shareholders make contributions in advance.
- **Liability after share transfer**
 - When shares with outstanding contributions are transferred, the responsibility for payment falls upon the transferee.

2. Notable Changes in JSCs: More Discretion in Corporate

Finance

- **Authorized capital system**
 - The articles of association or a general SH meeting may grant the board of directors the discretion to issue up to 50% of the currently issued shares within a three-year timeframe, contingent on obtaining a two-thirds majority vote from all directors.
- **No-par-value shares**
- **Multiple classes of shares**

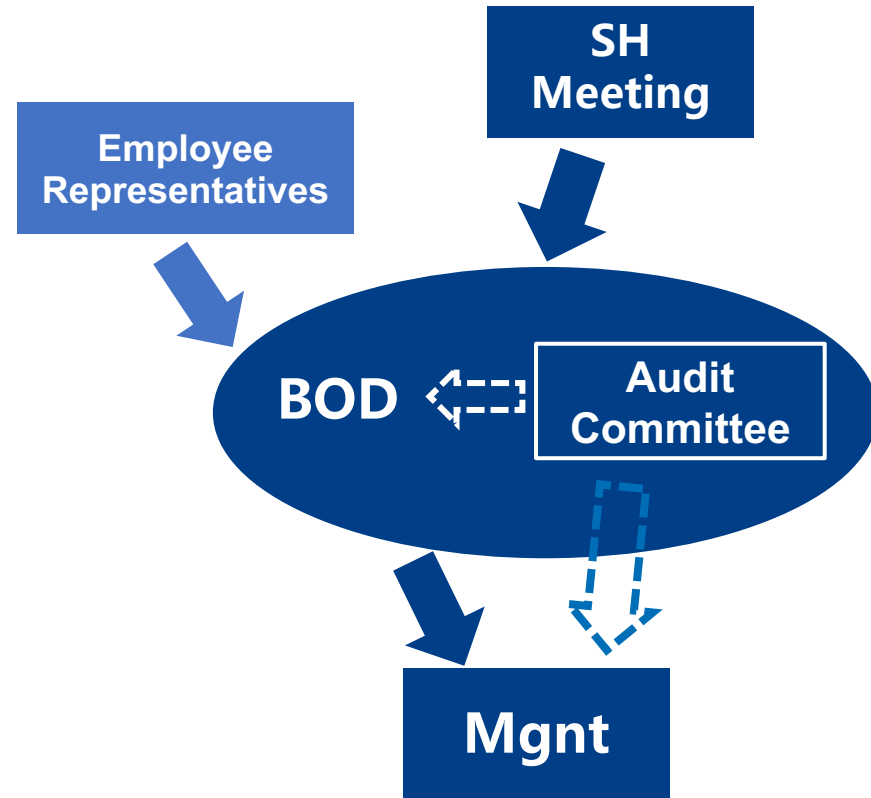
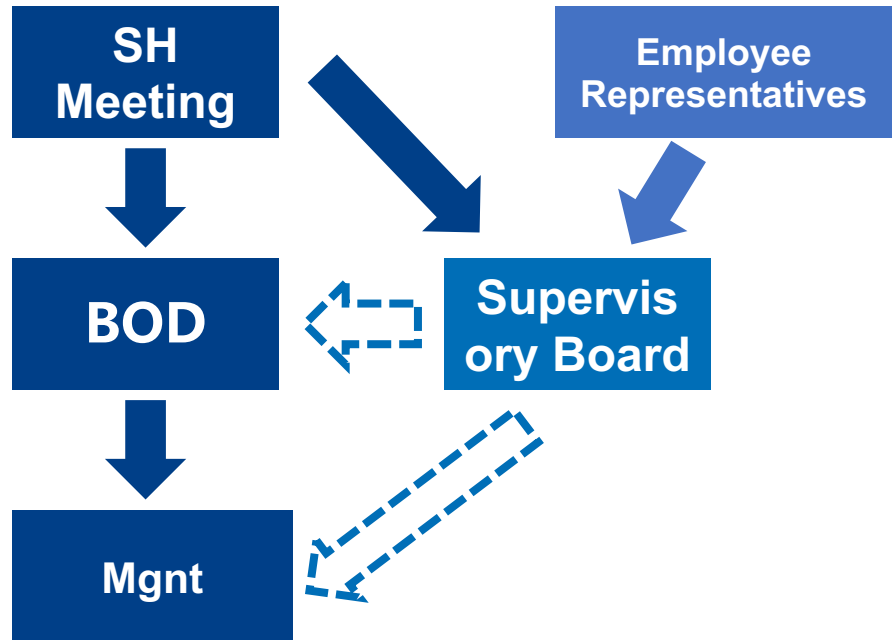
- **Multiple classes of shares**

- **§ 144. A company has the authority, as specified in its articles of association, to issue various classes of shares that possess distinct rights compared to common shares.**
 - Shares with preferential or inferior rights to profit or residual property.
 - Shares with differing voting rights per share compared to common shares.
 - Shares subject to transfer restrictions, such as requiring the Company's consent.

1. Swinging between SH-meeting Primacy and BOD Primacy

- **The SH-meeting Centred Model in 2005 Company Law**
 - § 36. “The shareholders’ meeting is the power authority of the company.”
 - § 47. “The board of directors is the executive organ of the company.”
- **The First Draft Amendment adopted a compromise board-centred approach, providing that residual powers are vested in the board of directors.**
- **The Second Draft Amendment deleted the expression and moved back to the 2005 position.**

2. Selective Supervision Model: Supervisory Board or Audit Committee



- **Governance and control rights**

- Shareholders' right to make proposal

- **Proprietary rights**

- Appraisal rights in closely-held JSCs
- Appraisal (“Withdrawal”) rights in LLCs when there is a control abuse

- **Remedial and ancillary rights**

- Information Rights
 - Rights to inspect books and vouchers, if not with improper purpose.
- Right to sue
 - Double derivative suits

Shareholder Rights

Rights to participate in JSCs

Shares	Right of inspection		Right to initiate SH meeting		Right to propose		Right to vote		Right to sue	
	before	after	before	after	before	after	before	after	before	after
<1%	×	×	×	×	×	×	✓	✓	×	×
1%~3%	×	×	×	×	×	✓?	✓	✓	✓	✓
3%~5%	×	✓	×	×	✓	✓?	✓	✓	✓	✓
5~10%	×	✓	×	×	✓	✓?	✓	✓	✓	✓
≥10%	×	✓	✓	✓	✓	✓?	✓	✓	✓	✓

Directors Duties

Fiduciary duty
to the company

to the third
party??

Duty of
loyalty

Duty of
care

Duty of
care?



- **Duty to the company**

- Duty of loyalty

- Define duty of loyalty as “to avoid conflicts of interest” and “no profit”
- Broaden the concept of “related-party” and adopt “safe-harbor” rules
- Revise the corporate opportunity rule

- Duty of care

- a manager’s reasonable care for the best interest of the company



- **Duty to a third party**

- First draft

- If directors or senior management intentionally or through gross negligence cause harm to others while performing their duties, they should be liable jointly with the company.

- Second draft

- If directors or senior management cause harm to others while performing their duties, the company should bear the compensation liability. If directors or senior management are found to have acted intentionally or with gross negligence, they should also bear the compensation liability.

- **Fiduciary duty of controlling shareholder and de facto controller**
 - **“shadow-director”**
 - Controlling shareholders and de facto controller, though not serving as directors, owe fiduciary duty to their companies when conducting corporate affairs.
 - **“abetting a breach of fiduciary duty”?**
 - If the controlling shareholder or actual controller of the company instructs directors or senior management to engage in activities that harm the interests of the company or its shareholders, they shall bear joint liability with the said directors or senior management.



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Thank for your attention!

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