

## Piercing through the draft amendments to the PRC Company Law from perspective of foreign investor

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The National People's Congress of China has made substantive changes to the current PRC Company Law (2018 version) in the draft Amendment to the Company Law ("Draft Amendment") published for public consultation on 24 December 2021. The Draft Amendment, upon implementation, will directly affect existing foreign-invested enterprises taking the form of limited liability companies and companies limited by shares ("FIE") conducting business in China in a number of aspects.

With the replacement of the three previous laws (the Chinese-Foreign Equity Joint Venture ("EJV") Law, the Chinese-Foreign Cooperative Joint Venture ("CJV") Law and the Wholly Foreign Owned Enterprise Law) governing foreign investment by the PRC Foreign Investment Law ("FIL") which took effect on 1 January 2020, FIEs are subject to the

PRC Company Law which applies to both domestic and foreign invested companies. Under the FIL, FIEs (especially the EJV and CJV) have a five-year transitional period (up to 31 December 2024) to adjust their corporate governance structure in accordance with the Company Law. We will discuss several key aspects that FIEs should pay attention to in the Draft Amendment.

### **1. Enhancing company capital structure, capital contribution**

Apart from contribution in the form of cash, equipment, intellectual property rights, land use rights, a shareholder can choose to make its capital contribution in the form of equity and creditor's rights under the Draft Amendment.

Further, the Draft Amendment allows a company limited by shares to issue

different types and classes of shares other than ordinary shares, such as preferred shares, subordinated shares, special voting shares, and shares subject to transfer restrictions. This provides FIEs with greater flexibility on investment and financings and reflects that China is taking steps to align with international standards.

## **2. Corporate Governance and organisational structure**

The three-tier governance model (shareholders' meeting, board of directors/executive director, board of supervisors and managers) under the current Company Law may be rather burdensome for smaller scale FIEs.

The Draft Amendment provides flexibility in that:

- it introduces the option of a single-tier organizational structure where only a board of directors is to be established without a board of supervisors or supervisors, provided that an audit committee consisting of directors (more than half being non-executive directors for a company limited by shares) is set up for supervision of the company's finance and accounting matters;
- for small-scale companies, it allows the appointment of a director or manager in lieu of a board of directors and, for a limited liability company, one or two supervisors instead of a board of supervisors.

## **3. Change of director**

One of the common concerns of the foreign investors is the liability of company executives during the process of change of directors in FIEs. FIEs may need to change their personnel due to changes at the level of the foreign headquarter and the process may be lengthy due to the time gap between changes at the foreign headquarter and the actual filing procedures in China.

A new addition in the Draft Amendment requires a director of a limited liability company to inform the company in writing of his/her resignation as director, which takes effect on the date of receipt by the company. Such resignation also applies to a director acting in the capacity of the legal representative (and director). The provision clarifies to a certain extent the liabilities of a foreign resigned director.

## **4. Reinforcement and tightening of responsibilities of corporate executives**

In view of previous judicial practice and court cases, the Draft Amendment includes several provisions on strengthening the duties and liabilities of directors, supervisors and senior management to safeguard the interest of the company. These include:

- If directors, supervisors or senior

management know or should have known that a shareholder is involved in withdrawal of its capital contributions (which is not allowed under the current Company Law) but still fails to take necessary measures and hence cause damage to the company, they will be personally liable to compensate the company.

- Directors, supervisors or senior management will be held jointly and severally liable with the company if they commit wilful misconduct or gross negligence during their performance of duties and thus caused damages to third parties.
- Directors or senior management personnel will also be jointly and severally liable with the controlling shareholder or actual controller of the company who makes use of its influence on the company to instigate the directors or senior management personnel to engage in acts that are detrimental to the company or the shareholders, which result in losses to the company or the shareholders.

## **5. Simplified procedures for expedition of liquidation**

Under the existing Company Law, the normal liquidation of a company may be

challenging for FIEs' shareholder as the procedures are time-consuming and involves handling by different government authorities.

A simplified dissolution mechanism under the Draft Amendment allows a company to cancel its registration upon all shareholders' undertaking that the company have no debts or that all debts have been duly paid off. If existing unpaid debts were discovered after the dissolution, all shareholders will have joint and several liability to settle the same. This new provision allows foreign investors to dissolve the FIE in a more efficient way and provides a flexible option for market players to exit the business.

## **Conclusion**

During the second plenary meeting of the Fifth Session of 13th National People's Congress held in early March 2022, it was indicated that further revisions to the Draft Amendment may be made this year. We will monitor and provide further updates. In any event, investors planning to establish business operations in China and FIEs with existing operations in China should take note of the possible impact of the Draft Amendment and cater for the same.