

**China Releases Draft Revisions to PRC Company Law**

7 January 2022

On 24 December 2021, draft revisions to the *PRC Company Law* (“**Draft Revisions**”) were released for public comments. The proposed revisions touch on the corporate governance, potential legal liability faced by directors, supervisors, senior officers and shareholders, processes for liquidation and deregistration, and numerous other aspects of potentially every kind of PRC company (including foreign-invested ones). Although several of the revisions represent only a high-level codification of already existing judicial rules or practices and administrative regulations, others could, if and when passed substantially as currently drafted, result in changes to how companies in China are run. The key revisions proposed for limited liability companies (the corporate form for most foreign investment)<sup>1</sup> are summarized below.

Topic	Draft Revisions to Company Law	Existing Company Law
<i>Composition and Functioning of Board of Directors</i>		
Number of Board Members	There is no maximum number of members of a board of directors; a company must have a board with at least three members, unless the company is of “relatively small scale and number of shareholders”, in which case it can have just one director (called “sole director” instead of the current title “executive director”).	A board cannot have more than 13 members; in other respects, existing law is the same as under the Draft Revisions (except that “sole director” is currently called “executive director”).
Employee-Representative Director	A company with 300 or more employees must have at least one director selected by the employees and acting as their representative.	Only a company established by two or more state-owned enterprises must have an employee-representative director.
Powers/Functions of Board	The board is the executive authority of the company, entitled to any and all powers not ascribed to shareholder meetings under either the company’s articles of association or the Company Law.	The board has (only) the following powers/functions: <ul style="list-style-type: none"> <li>• call for shareholder meetings and report on the board’s work;</li> <li>• execute shareholder resolutions;</li> <li>• determine the company’s operational plans and investment plans;</li> </ul>

<sup>1</sup> This Newsletter does not address rules relating specifically or only to other corporate forms, e.g., companies limited by shares, or state-owned entities.

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		<ul style="list-style-type: none"> <li>• formulate the company’s annual budgets and final accounts as well as plans for profit distribution, loss recovery, the increase or reduction of its registered capital, the issuance of corporate bonds and any combination, division, dissolution or transformation of the company;</li> <li>• make decisions on the establishment of the company’s internal management departments;</li> <li>• make decisions on the appointment or dismissal of the company’s manager and his remuneration (and to a certain extent the deputy manager and chief financial officer);</li> <li>• develop the company’s basic management system; and</li> <li>• any other function or power specified in the articles of association.<sup>2</sup></li> </ul>
Minimum for Quorum and Voting of the Board	<p>More than half of all the directors of a board must be present to constitute a quorum for a meeting of the board.</p> <p>The affirmative votes of more than half of the directors of a board are required to pass a resolution or decision of the board.</p>	<p>Quorum and resolution requirements are not set out in the law, but rather are to be set out in the articles of association.</p>
Optional Establishment of Audit Committee and Abolishment of Supervisor(s)	<p>A company may set up an audit committee comprised of an unspecified number of directors of the board and responsible for supervising the company’s financial and accounting matters; if done, the company does not need a supervisor or board of supervisors.</p>	<p>A company must have a supervisor or board of supervisors, with duties specified in the Company Law; there is no rule concerning any audit committee.</p>
Composition of Liquidation Committee	<p>Unless other persons are appointed under the articles of association or by shareholder resolution, the directors of a company’s board will be the</p>	<p>The shareholder(s) of a company will be the member(s) of the liquidation committee, though the shareholder(s) may then appoint others (including</p>

<sup>2</sup> Notwithstanding this (typical) catch-call provision, some PRC authorities have restricted the powers and functions of directors to those expressly included in the above list from the Company Law.

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	members of the liquidation committee, which upon a liquidation event manages the company and liquidation.	but not necessarily directors) to handle specific liquidation work.
Resignation of Directors	A director must notify the company, in writing, of his/her resignation, which will be effective upon the company's receipt of the notice.	No rule.
Indemnification for Dismissal of Directors	A director is entitled to indemnification for being dismissed without reasonable cause prior to the end of his/her term.	No rule.
<i>Functions of General Manager</i>		
General Manager Powers/Functions	The general manager has the powers and performs the functions as specified in the company's articles of association or as delegated by the company's board of directors.	<p>The general manager has (only) the following powers/functions:</p> <ul style="list-style-type: none"> <li>• oversee the business operations of the company and organize implementation of the resolutions of the board of directors;</li> <li>• organize implementation of the company's annual operational plans and investment plans;</li> <li>• draw up plans on the establishment of the company's internal management departments;</li> <li>• propose the company's basic management policies;</li> <li>• formulate the company's specific rules and regulations;</li> <li>• propose the appointment or dismissal of any deputy manager and financial principal;</li> <li>• decide on the appointment or dismissal of executive personnel other than those whose appointment or dismissal is to be decided by the board of directors; and</li> <li>• any other function or power conferred on the manager by the</li> </ul>

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		board of directors. <sup>3</sup>
Acting as Board	The general manager may act as, and thereby take the place of, a sole director or board of directors.	A general manager can concurrently serve as a director but cannot act as or take the place of a sole director or board of directors.
<i>Liability of Directors, Supervisors and Senior Officers</i>		
Failure to Pay Registered Capital in Full or in Time by Shareholders	If a director, supervisor or senior officer (1) knew or should have known that a founding shareholder failed to pay subscribed registered capital in full or in time and (2) failed to take necessary preventative measures, s/he will be liable for any losses the company suffers thereby.	Directors and officers are subject to generic duties of care and loyalty. <sup>4</sup> In addition, if a director or officer commits certain specified activities, any income s/he derives therefrom is subject to disgorgement to the company. <sup>5</sup> Furthermore, if a director or officer violates PRC laws or administrative regulations, or the company's articles of association, s/he is liable for any losses the company suffers thereby. <sup>6</sup> As such, while liability for knowing about and failing to take preventative measures against a founding shareholder's failure to pay subscribed registered capital is a possibility under current law, the Draft Revisions expressly provide for it.
Liability for Unlawful Withdrawal of Capital Contributions	If a director, supervisor or senior officer (1) knew or should have known that a founding shareholder was unlawfully withdrawing registered capital and (2) failed to take necessary preventative measures, s/he will be liable for any losses the company suffers thereby.	Same as above.
Liability for Unlawful Profit Distributions	When a company suffers losses due to an unlawful distribution of profits ( <i>e.g.</i> , failing to set aside funds for the statutory common reserve), the directors, supervisors and senior	Same as above.

<sup>3</sup> As in the case of directors, notwithstanding this catch-all provision, the powers and functions of general managers have been limited by some PRC authorities to those expressly included in the above list from the Company Law.

<sup>4</sup> Article 147 of the Company Law. Neither the "duty of care" ("勤勉义务") nor the "duty of loyalty" ("忠实义务") is well defined by PRC legislation, regulation or even judicial interpretation, though official judicial interpretation and court (non-binding) precedents have suggested the set of activities likely to be deemed a violation at least of the duty of care is relatively narrow, *e.g.*: directors failing to (i) form a liquidation committee when they are supposed to, (ii) send requests to shareholders to pay subscribed-for registered capital when the amount is due, or (iii) perform duties required for the company to keep records of board resolutions, board meeting minutes, financial records, *etc.*

<sup>5</sup> Article 148 of the Company Law.

<sup>6</sup> Article 149 of the Company Law.

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	officers will be liable to compensate the company to the extent of their wrongdoing.	
Liability for Unlawful Reduction of Registered Capital	When a company’s registered capital is unlawfully reduced ( <i>e.g.</i> , by not going through the mandatory procedures), the shareholders, directors, supervisors and senior officers will be liable to compensate the company any losses to the extent of their wrongdoing.	Same as above.
Director / Senior Officer Joint and Several Liability with Company/Shareholder	<p>When a third party suffers losses due to an intentional or grossly negligent performance of a director’s or senior officer’s functions, the director or senior officer will be jointly and severally liable with the company to compensate the losses.</p> <p>When a company’s controlling shareholder or actual controller takes advantage of its influence on the company to direct a director or senior officer to act against the company’s or the shareholders’ interests and causes losses to the company or the shareholders, the director or senior officer will be held jointly and severally liable with the shareholder to compensate the losses.</p>	Same as above.
Related Party Transactions	<p>If any of the below parties directly or indirectly is to enter into a contract or to transact with the company, the relevant director, supervisor or senior officer shall report the same to the board of directors or the shareholders, and the contract or transaction cannot be entered into without a board or shareholder resolution:</p> <ul style="list-style-type: none"> <li>• any director, supervisor or senior officer;</li> <li>• any “close relative”<sup>7</sup> of any director, supervisor or senior</li> </ul>	Any controlling shareholder, actual controller, director, supervisor or senior officer of a company who damages the interests of the company by taking advantage of his/her/its “affiliated relationship” will be liable to compensate the losses to the company.

<sup>7</sup> Per Article 1045 of the *PRC Civil Code*, a “close” relative” is a spouse, parent, child, sibling, paternal or maternal grandparent, or paternal or maternal grandchild.

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	officer; <ul style="list-style-type: none"> <li>• any enterprise directly or indirectly controlled by any director, supervisor, senior officer or any of their close relatives; and</li> <li>• any other party with whom any director, supervisor or senior officer has another “affiliated relationship”.<sup>8</sup></li> </ul>	
Business Opportunities	A director, supervisor or senior officer may take on a business opportunity for himself/herself under the following (new) circumstances: <ul style="list-style-type: none"> <li>• the opportunity has been reported to the board or shareholder meeting and resolutions have been adopted permitting the director, supervisor or senior officer taking on the opportunity;</li> <li>• the opportunity has been reported to the board or shareholder meeting and has been expressly objected to; or</li> <li>• laws, regulations or the articles of association of the company do not permit the company to take on the business opportunity.</li> </ul>	A director, supervisor or senior officer may not seek business opportunities for himself or for any other person by taking advantage of his position in the company, or operate on his own behalf or on behalf of any other person any business similar in nature to that of the company, without first obtaining consent from the shareholders.
Director Liability for Liquidation	When a company or its debtors suffer losses due to a director failing to perform his/her duties as a member of the liquidation committee, the director will be liable to compensate the losses.	No rule.
<i>Liability of Shareholders</i>		
Failure to Pay Registered Capital	When a shareholder fails to pay registered capital in full and on time, the shareholder will be liable for breach of contract to the shareholders who have paid their registered capital in full and on time.	When a shareholder fails to pay the registered capital in full and on time, in addition to paying the full amount to the company, the shareholder will also be liable for breach of contract to the shareholders who have paid their

<sup>8</sup> Under the Company Law and Draft Revisions, “affiliated relationship” is defined as “any relation between the controlling shareholder, actual controller, director, supervisor or senior officer of a company and the enterprise directly or indirectly controlled thereby and any other relation that may enable the transfer of any benefits in the company.”

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	<p>Furthermore, the company shall notify the shareholder to make up the payment within a grace period of at least 60 days; if the shareholder fails to do so, the company may issue a notice of forfeiture to the shareholder, from which time the shareholder's equity corresponding to the unpaid amount will be deemed forfeit.</p> <p>When a founding shareholder fails to pay the registered capital in full and on time, the shareholder shall pay the full amount plus interest to the company and compensate the losses suffered by the company thereby, and other founding shareholders shall be jointly and severally liable for such payments and losses.</p>	registered capital in full and on time.
Unlawful Profit Distribution	When a company distributes profits in violation of the law, the recipient shareholder(s) must return the unlawfully distributed profits, pay interest and pay compensation for any losses to the company.	When a company distributes profits before (1) losses are covered and (2) funds are set aside for the statutory common reserve according to law, the recipient shareholder(s) must return the distributed profits.
<i>Procedures for Certain Corporate Actions</i>		
Resolutions for M&A	<p>In the following circumstances, a shareholder resolution is not required by law:</p> <ul style="list-style-type: none"> <li>• a shareholder resolution of a company being acquired by a parent holding at least 90% of the acquired company's equity, though the acquired company must notify all other shareholders, who then have a right to have their equity purchased at a reasonable price; and</li> <li>• a shareholder resolution of a company for acquiring another company through consideration that does not exceed 10% of the acquiror's net assets.</li> </ul>	Any M&A requires a shareholder resolution.
Reduction of Registered Capital	When a company is unable to cover its losses after using its discretionary,	The company shall, within ten days of the date on which it decides to reduce

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	<p>statutory and capital reserves, it may reduce its registered capital via a simplified capital reduction procedure (by only publishing an announcement in a recognized newspaper or the enterprise information publicity system, without needing to otherwise notify the creditors and wait for 45 days for the next step). However, such capital reduction shall be subject to the following requirements:</p> <ul style="list-style-type: none"> <li>• the reduced capital cannot be distributed to the shareholders;</li> <li>• the shareholders are still obligated to pay for their shares; and</li> <li>• after such capital reduction, the company is not permitted to distribute profits until the accumulated amount of the statutory reserve funds exceeds the registered capital.</li> </ul>	<p>its registered capital, notify its creditors and make a public announcement about the proposed reduction in capital in a recognized newspaper within 30 days of the date on which it decides to reduce its registered capital. Any creditor shall, within 30 days of receipt of such a notice or, where it does not receive a notice, within 45 days of the date of the public announcement, be entitled to require the company to repay its debt in full or to provide a corresponding guarantee.</p> <p>Where a company distributes its after-tax profits for the current financial year, it shall draw 10% of its profits as the company’s statutory reserve funds, provided that a company with an aggregate common reserve of more than 50% of the company’s registered capital may elect not to continue drawing any statutory reserve funds.</p>
Liquidation	<p>The director(s) of a company is/are the “liquidation obligor(s)”: <i>inter alia</i>, he/she/they must form a liquidation committee within 15 days of a dissolution circumstance arising, must serve on the committee unless the articles of association or a shareholder resolution provides otherwise, and will be liable for losses caused to the company or creditors from failing to perform obligations as “liquidation obligor(s)”.</p>	<p>There is no concept of “liquidation obligor”, the liquidation committee must be formed by the company within 15 days of a dissolution circumstance arising and be composed of the shareholder(s), and no liability is provided specifically for the director(s) in relation to a company’s liquidation.</p>
Deregistration	<p>When a company has not incurred any debt or has repaid all its debts, it may (upon the agreement of all its shareholders) apply for simplified deregistration after having published its deregistration information on the enterprise information publicity system for at least 20 days, assuming no creditor or authorities objected in that period; upon such deregistration,</p>	<p>While not provided in the Company Law, the simplified deregistration procedure provided for in the Draft Revisions is already in effect, in practice, throughout the PRC, by virtue of a notice of the State Administration for Market</p>

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	however, the shareholders will be jointly and severally liable for any and all debts incurred prior to the deregistration.	Regulation. <sup>9</sup>
<i>Equity Transfer Restriction</i>		
Other Shareholders' Consent to Transfer of Shares	Current rules eliminated.	Where any shareholder proposes transferring equity to any person other than another shareholder, it is subject to the consent of a majority of the other shareholders. Where the majority disagrees, they must purchase the equity to be transferred; otherwise, the consent will be deemed given.
<i>Sole Shareholder Limited Liability Company</i>		
Investment Restriction and Special Notes	Current rules eliminated.	Any natural person may establish only one sole shareholder limited liability company, and it may not establish a sole shareholder limited liability company.  The company registration and business license of a sole shareholder limited liability company shall each clearly indicate whether the company is funded by a natural or legal person.

## Takeaways

The Company Law is the bedrock of business in China, complemented in many ways by the *PRC Civil Code* (not to mention many laws on more specific areas of law or business); given that the latter came into effect in January 2021 and the former has not been amended since 2018, the Draft Revisions should not come as a surprise. In fact, the Draft Revisions align with adjustments made through the promulgation of the *PRC Civil Code* and rules and practices adopted by various PRC authorities in the last few years.

Most importantly, the majority of the Draft Revisions reflect a liberalization and streamlining of corporate governance and processes. Key examples are the greater flexibility in the composition and powers of boards, in directors taking on business opportunities and in carrying out certain M&A, the elimination of share transfer pre-requisites and limitations on sole shareholder companies, and simplified procedures for capital reduction and deregistration. That said, the Draft Revisions do make some impositions, *e.g.*, quorum and voting minimums and the requirement for any company with at least 300 employees to have an employee-representative director on its board. The Draft Revisions also

<sup>9</sup> *The Notice regarding Further Improving Simplified Procedures for Deregistration and Providing Convenient Exiting Mechanism for Small, Medium and Micro Enterprises* (关于进一步完善简易注销登记便捷中小微企业市场退出的通知), jointly issued by the State Administration for Market Regulation and State Taxation Administration on 3 August 2021.

include numerous rules on director, supervisor, senior officer and shareholder liability, *e.g.*, in connection with unpaid or unlawfully withdrawn capital or with improper deregistration or liquidation, but these largely represent only a codification of existing lower-level rules and practices of PRC courts and regulatory authorities.

At present, companies need not – and in most respects cannot, due to existing law – make changes based on the Draft Revisions. According to the most recently published legislative plan, the Company Law is meant to be amended only before the spring of 2023, making it likely that another round of draft revisions will be released in the coming months; even if the official revisions are issued sooner, whether substantially in the form of the Draft Revisions or not, companies will likely have several months before the amended Company Law would be implemented, *de facto* if not *de jure*.

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