

China: Company Law Amended

The 18th Session of the Standing Committee of the 10th National People's Congress adopted the amended Company Law of the People's Republic of China on 27 October 2005. President Hu Jintao promulgated the Law on the same date. The Law, which enters into effect on 1 January 2006, is a significant reform of the Company Law. It simplifies company establishment requirements and statutorily expands the rights of shareholders in PRC companies. The provisions of the Law apply to foreign investment enterprises to the extent that they do not conflict with the statutes governing these investment vehicles, but the amendment does not set forth the application of this provision. Certain provisions of the Law require further clarification and it is expected that in time relevant implementing regulations will be promulgated. Some of the major changes relating to limited liability companies and companies limited by shares are discussed below.

Establishment requirements

The revised Law now permits one shareholder limited liability companies. The minimum capital requirements have also been relaxed requiring a minimum registered capital of at least RMB30,000 for limited liability companies (increased to RMB100,000 for one shareholder companies). The registered capital no longer needs to be contributed in a lumpsum but may be contributed in instalments provided that the first instalment accounts for no less than 20% of the total registered capital and that the registered capital is contributed in full within two years (five years for of an investment company). The capital contributions may be made with cash and non-currency assets, such as in kind contributions, industrial property and land use rights, which can be appraised and denominated in currency and are legally transferable. Cash contributions must account for at least 30% of the registered capital.

The Law now permits a limited liability company to invest in other business entities without limitation provided that it does not assume any joint and several liabilities for the debts of the investee. The old restriction limiting the size of subsidiary investment has been removed.

The legal representative of the Company is no longer limited to the chairman of the board. Under the amended Law, the chairman of the board, an executive director or the (general) manager are each eligible for appointment as the legal representative of a limited liability company.

The Law no longer requires that profit distribution and voting rights be solely based on the capital contribution ratio of shareholders, raising the possibility of preferred shares.

The requirement to allocate a certain percentage of after-tax profits to a statutory welfare fund for employees has been repealed.

Shareholder protection

The Law expands the statutory rights of minority shareholders in limited liability companies. Shareholders in a limited liability company may now request a review of the company's account books and may petition the court if their request is turned down. A minority shareholder may request that the company purchase its shares at a reasonable price in the following circumstances: the company distributes no profits in five consecutive profit-making years, disposes of major assets through merger, division or transfer, or renews its term of operation upon its expiration or continues to operate after a termination event has occurred. A 10% shareholder may petition for the dissolution of a company in the event that the company suffers severe losses which cause material damage to the shareholders. A shareholder holding 3% or more of the issued shares is entitled to submit resolutions at the general meeting. The Law also gives shareholders the right to bring an action against the company in certain prescribed circumstances.

Piercing the corporate veil

The Law provides for shareholders that abuse a company's independent legal status and limited liability status to evade debts and thereby materially damage the interests of the company's creditors to bear joint and several liability for the company's debts. This provision, however, does not clearly specify the circumstances under which the corporate veil can be pierced.

The Law requires a company to register the name and amount of capital contribution of each shareholder in the company registrar and to update the record when there are any changes.

Companies limited by shares

Whereas in the past a company limited by shares required at least five promoters, the Law now requires the number of promoters to be between two and 200. The minimum registered capital of a company limited by shares has been reduced to RMB5 million under the revised Law. A promoter of a company limited by shares is required to retain the shares for one year from the date of incorporation.

The Law allows a company limited by shares to repurchase up to 5% of its issued shares for the implementation of an employee stock option scheme provided that the purchase is funded by after-tax profits and the repurchased shares are transferred to the relevant employees within one year. The repurchased shares held by the company have no right to profit distribution and carry no voting rights.

Whereas previously, directors and senior management were barred from trading company shares during their term of office, the revised Law permits them such trading, provided that the total number of shares transferred each year is not more than 25% of the total issued shares of the company and no transfer shall be carried out within one year following the company's listing or within half a year of leaving office.

Improved corporate governance for listed company

The revised Law requires listed companies to have independent directors. Under a new provision directors are required to abstain from voting on matters involving a party with which they have a connected relationship. Connected relationship is defined in the Law, but elaboration is expected.

The revised Law requires that the appointment and termination of the company's auditor be reviewed and determined by a board meeting or general meeting in accordance with its Articles of Association. The Law requires the periodical disclosure to shareholders of the remuneration of the directors and senior management.