

PRC law update

china's new company law

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The new PRC Company Law will take effect on 1 January 2006. Much awaited, this foundation of China's corporate legal infrastructure is aimed at delivering commercial and governance improvements. It has met with support for the steps taken but some key aspects remain unresolved and already, pressure exists for further reform.

Steps in the right direction ... but do they go far enough?

Relaxed Incorporation requirements

The new PRC Company Law (New Law) aims at simplifying the incorporation process by:

- reducing the minimum registered capital requirement for a limited liability company to Rmb30,000;
- removing the connection between industry sector and minimum registered capital;
- reducing the minimum registered capital for a company limited by shares from Rmb10 million to Rmb500,000; and
- reducing the minimum number of promoters required to establish a joint stock limited company from five to two.

It is a step in the right direction, but in practice these low figures are at best indicative and government officials will often ignore them and instead require a company to own funds sufficient to carry on its intended business, so substantially higher capital amounts may be requested. In addition, regulations specific to foreign investment in certain industries often require higher investments.

Higher non-cash contributions to registered capital

The New Law enables investors to contribute up to 70 per cent of registered capital of companies in "non-cash assets which can be monetarily valued and legally transferred". It was widely expected that the New Law would end the ambiguity relating to the status of shares as a contribution to the registered capital of a company but this remains unclear. The New Law has similarly deflated expectations by failing to expressly enable structuring a company's share capital into common and preferred shares.

Single shareholder company allowed

The New Law allows a domestic limited liability company to be established by one shareholder. Domestic residents may only establish one such company and a single-shareholder company is not allowed to invest in, or establish, another company.

Inter-company investment and upstream security

There is no longer a cap on investment by a company in other companies, leaving the limit of any investment to the discretion of the shareholders. However, a company cannot undertake joint liability for an invested entity's debts.

Previously, the 50 per cent limit on such investments sometimes deterred companies from setting up subsidiaries or acquiring equity in other enterprises. FIEs need to keep in mind that other industry-specific regulations may set a ceiling on inter-company investments.

The New Law now clearly allows the provision of upstream security. A company can secure the liabilities of its shareholder, or the *de facto* controller of its shareholder, provided it is approved by the board of directors and by non-interested shareholders at a shareholders' meeting.

Improved shareholders rights

The New Law introduces key provisions aimed at protecting minority shareholders' rights. Shareholders may request that the company repurchase their shares:

- when they oppose an acquisition or merger;
- when they oppose the disposal of major assets;
- where the company fails to distribute dividends for five consecutive years (having earned profits for the five years); or
- where they oppose the renewal of the company's term.

Shareholders can bring action against directors, supervisors and/or senior managers for violation of laws, regulations or the company's articles of association. Shareholders holding three per cent or more of the company's

shares may put forward proposals to the board and shareholders holding ten per cent or more of the company's shares may petition the People's Court to liquidate the company in certain circumstances. In practice, these rights may be difficult to exert.

The New Law provides practical means for shareholders to exert supervision over the company through rights to view and copy the company's articles of association, accounts and minutes of board and shareholders' meetings. State Administration of Industry and Commerce loses its discretion in this matter and is henceforth required to provide searching facilities to the public in a substantial step toward transparency.

Catching up with global corporate governance trends

The New Law contains rules on conflicts of interests. The controlling shareholder, effective controller, director, or senior manager of a company may be personally liable for taking advantage of a relationship that damages the interests of the company. Directors of listed companies cannot vote on matters in which they have an interest.

The New Law allows the corporate veil to be lifted where the controlling shareholder of a company abuses the privileges of incorporation including provision for personal liability.

The introduction of the concept of social responsibility of the company is noble and in pace with international trends in corporate law, but academic and unlikely to find any practical application. It will have benign impact without the input of the People's Court to provide substance to the concept and guidelines to directors.

Foreign investors should note that these changes only apply where legislation on FIEs is silent. The New Law reiterates the current position being that, where the laws governing foreign investment differ from the provisions of the New Law, the former prevail.

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