



LEGAL NEWS

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IMPACT OF THE NEW CHINESE COMPANY LAW – CHANGES TO THE CORPORATE GOVERNANCE AND MANAGEMENT RESPONSIBILITY

INTRODUCTION

As outlined in our latest newsletter, the revised Chinese Company Law will officially **take effect on July 1st, 2024**.

Having presented the changes in contribution of share capital and transfer of shares in the last week, this second newsletter will now focus on the key changes in area of **Corporate Governance** and **Management Responsibility** related to the Limited Liability Company (“LLC”). These changes will of course also apply to foreign-invested enterprises (“FIEs”) and their management.

WHAT ARE THE NEW REQUIREMENTS FOR THE LEGAL REPRESENTATIVE?

Under the current Company Law, the **"Chairman of the Board of Director"**, **"Executive Director"** or **"General Manager"** can assume the **position of the "Legal Representative"** of the LLC, regardless of whether this person actually controls and manages the business of the LLC on site. According to the New Chinese Company Law, the person holding the position of legal representative must now actually manage the local business.

The law itself does not currently specify how this actual management is to be carried out. Of particular importance is the question of whether (and if so, for what durations) the Legal Representative must be physically present on site. Clarifications on this are expected in the near future as part of the

enactment of implementing provisions for the New Chinese Company Law.

In addition, the New Chinese Company Law now provides for a **period of 30 days** for reappointment if the legal representative resigns from office.

Given the shortage of European executives in the Chinese market, the new regulations on the position of Legal Representative will become a challenge for European companies. If the Legal Representative actually has to be on site and this position may have to be replaced, companies will in future have to design the management provisions and approval requirements for the activities of the Legal Representative in much greater detail.

WHICH CHANGES APPLY TO THE DUTY OF CARE AND THE LIABILITY OF MANAGEMENT

The New Company Law specifies the **duties of loyalty and care of directors, supervisors and officers** to avoid **personal conflicts of interest** and to comply with standards of care which could be comparable to the **"Business Judgement Rules"**. The new law expressly stipulates that:

- Directors, supervisors and officers must take all necessary steps to avoid conflicts between their own interests and those of the LLC and should not use their authority to



obtain improper advantages for themselves.

- Directors, supervisors and officers should perform their duties in the best interests of the LLC with the reasonable care normally expected of an officer.

In addition, the New Chinese Company Law provides that the **management of the controlling shareholders** who exercise effective control over the LLC without serving at the same time as directors or general managers are subject to the same scope of duties and standard of liability to the LLC as its directors and general managers (similar to the "**de facto management**" model under German law).

If the management of the majority shareholder issues instructions to the directors and general managers that are detrimental to the interests of the company or its shareholders, **joint and several liability** arises together with the management of the LLC for the damages and losses incurred to the LLC in connection with the implementation of these instructions.

WHICH EXTENSION APPLIES IN THE AREA OF EMPLOYEE REPRESENTATION?

Currently, only state-owned companies are required to have employee representatives on their supervisory boards.

Under the New Company Law, the requirements for the implementation of employee representatives will be extended to medium-sized and large non-state-owned companies. Accordingly, companies with **300 or more employees** (limited liability companies and public limited companies) must have at least one **employee representative in the board of directors**, unless the company has a **supervisory board with an employee representative**.

The employee representative must be elected by the company's employees at employee meetings.

If the companies concerned want to avoid employee involvement at Board of Directors level, a corresponding Board of Supervisors would have to be implemented. The number of persons and the procedural rules for those bodies would then have to be defined in such a way that employee rights do not have a substantial impact on the company's decisions.

WHAT IS THE ALTERNATIVE TO THE SUPERVISORY BOARD / SUPERVISOR?

The Under current company law, the LLC must have a **supervisory body** that **monitors and controls the activities of the management** of the LLC. In practice, however, this office is not actively exercised, meaning that the statutory monitoring does not actually take place.

As an alternative to the supervisory system in medium-sized and large companies, the New Chinese Company Law now provides for the formation of an **audit committee** under the board of directors. This largely consolidates the rights of the supervisory board and the rights of the board of directors. In fact, this leads to a number of uncertain legal questions that are currently not answered by the New Chinese Company Law. In particular, this concerns the **right of shareholders to request the audit committee to initiate legal proceedings** against directors who have committed breaches of duty and caused damage to the LLC. However, if these directors then have significant influence in the Audit Committee, the enforcement of the shareholders' rights is likely to become a de facto nullity. It remains to be seen how the implementing provisions for the New Chinese Company Law, which are to be issued in the near future, will respond to this.



For **small LLCs**, the New Chinese Investment Law now provides for the possibility of abolishing the supervisory board.

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