

IMPACT OF THE NEW CHINESE COMPANY LAW - CHANGES TO THE RIGHTS AND OBLIGATIONS OF SHAREHOLDERS WHEN CONTRIBUTING REGISTERED CAPITAL AND TRANSFERRING SHARES

INTRODUCTION

On December 29th, 2023, the National People's Congress Standing Committee of China adopted proposed amendments to the PRC Company Law of 2018 version and promulgated the revised Company Law, which will officially **take effect on July 1st, 2024**.

In the following, we will provide you with a summary of key changes related to applicable to the Limited Liability Company ("LLC") in area of **Tightening of Capital Contribution Responsibilities of Shareholders** and **Changes in Share Transfer Rules**. These changes will of course also apply to foreign-invested enterprises ("FIEs").

WHAT IS THE NEW DEADLINE FOR THE CONTRIBUTION OF REGISTERED CAPITAL UNDER THE NEW CHINESE COMPANY LAW?

Under the New Company Law, the registered capital of a LLC must be fully paid by the shareholders **within five years** of the company's establishment ("Capital Contribution Term"). In case of a subsequent increases in the registered capital this amount must also be fully paid by the shareholders within five years of registration.

By contrast, the Old Company Law does not set such a deadline for contribution of the registered capital, and many FIEs have, in

their articles of association, stipulated a long-term for shareholder's contributions of the registered capital.

For existing FIEs which have set capital contribution periods exceeding five years, the New Company Law required these companies to gradually **adjust the articles of association** to align with the Capital Contribution Term.

For FIEs with "significantly abnormal" contribution periods or amounts, the company registration authority may legally require these FIEs to proceed with timely adjustments. However, the New Company Law does impose specific timeline for these adjustments, and the specific implementation measures for the New PRC Company Law will be provided by the State Council in the near future.

For existing FIEs that have not fully paid up the registered capital, we recommend the shareholder to **assess the current outstanding contribution amounts**. If the outstanding contribution amounts are excessively high and it is difficult for the shareholder to replenish the capital within the Capital Contribution Term, the FIEs could consider undergoing a **reduction in the registered capital**.

For newly established FIEs or those undergoing capital increases, we advise setting **reasonable registered capital amounts and subscription periods** (not



exceeding five years) to avoid issues arising from excessively large, registered capital amounts leading to contribution deficiencies.

CAN SHAREHOLDER RIGHTS BE FORFEITED DUE TO DELAYED CAPITAL CONTRIBUTION?

If the shareholder fails to timely and fully contribute capital in accordance with the articles of association, the **board of directors** shall issue a **written demand letter**, urging the shareholder to make up for the deficiency in the capital contribution. The demand letter may include a grace period no less than 60 days.

If the shareholder fails to make up the deficient capital amount, the company, through a board resolution, may **forfeit** the defaulting **shareholder's rights** with respect to scope of the unpaid contributions. This aspect is particularly important for joint ventures, where different interests may arise at shareholder and director level. It is imperative that foreign investors protect their equity rights in this area.

Following the forfeiture of the defaulting shareholder's rights, the company should **transfer the equity interests of disqualified shareholder** or reduce the registered capital corresponding to the equity interests of disqualified shareholder, and register/file the share transfer or reduction with the competent local authorities.

In case that the transfer or cancellation is not completed within six months, the co-shareholders of the company will be required to fully pay the shortfall in proportion to their respectively subscribed contributions.

WHAT SHAREHOLDER LIABILITY ARISES FROM INSUFFICIENT CONTRIBUTIONS?

If a shareholder fails to timely and fully pay the subscribed contributions, he should not only make full payment to the company but also **bear liability for compensation for the losses** incurred by the company.

Where a shareholder does not actually pay the contributions prescribed in the company's articles of association or where the actual value of the contributions in kind is significantly lower than the subscribed capital amount, the co-shareholders are **jointly and severally liable** for the **insufficient contribution**.

DO CREDITORS HAVE A DIRECT CLAIM AGAINST THE SHAREHOLDER FOR PAYMENT OF THE CAPITAL CONTRIBUTION?

The New Company Law introduces a legal provision for the acceleration of shareholder contributions to address situations where the company is unable pay its debts in due time. If the company cannot settle its matured debts, either the company or the **creditors** holding matured debt claims shall have the **right to demand early contributions from shareholders** whose subscribed capital contributions are not yet due for payment.

This new provision could expose shareholders to the risk of being sued directly by company creditors for unpaid company debts. On the other hand, this aspect can also open up new ways of **collecting receivables from Chinese business partners**.

ARE SHAREHOLDERS STILL REQUIRED TO CONSENT TO A TRANSFER OF SHARES?

The New Company Law **removes the provision requiring the consent** of other shareholders, if a shareholder transfers its equity interest to parties outside the existing



shareholders of the LLC. Instead, only **written notification** to other shareholders related to quantity, price, payment method, and deadline for the equity transfer is required.

The other shareholders shall have the **preemptive right for purchase** such equity interest on the same conditions. If a shareholder does not respond within 30 days of receiving such written notice, it is considered as a waiver of such preemptive right.

This mechanism simplifies the process for shareholders to transfer share and provides clear guidelines for shareholders to fulfill the notification obligations. If this system is not preferred by the shareholders, mandatory regulations are required at the level of the Articles of Association.

CAN SHAREHOLDER RIGHTS BE EXERCISED BEFORE THE SHARE TRANSFER IS REGISTERED?

The New Company Law specifies that in the event of a share transfer transaction, the transferor must notify the company to **update the shareholder register** in the company books and register the change of the shareholder with the competent registration authority. If the company does not cooperate, the transferor and transferee may file a lawsuit against the company.

It is clarified that the transferee may exercise shareholder rights from the moment he is recorded in the shareholder register in the company books. This revision contributes to addressing difficulties in changing registration after share transfers in judicial practice. The **shareholder rights** can thus be officially exercised **before the share transfer is registered** with the registration authority.

WHICH LIABILITY ARISES FOR UNPAID CAPITAL CONTRIBUTIONS AFTER THE TRANSFER OF SHARES?

The New Company Law specifies that if a shareholder transfers equity representing subscribed capital contributions not yet due for payment, the transferee assumes the obligation to make the corresponding payment for capital contribution. If the transferee fails to pay the contributions on time and in full, the transferor shall bear joint and several liability for the unpaid amount of subscribed contributions by the transferee.

In cases where a shareholder transfers share without fulfilling the specified contribution date or where the actual value of non-monetary assets significantly falls below the subscribed capital amount, both the transferor and transferee bear joint and several liability within the scope of the deficiency in contributions.

In this context, we recommend that in the case of share transfers, the parties pay greater attention to the post-contractual performance of the contractual partner and include explicit provisions in the transfer agreement regarding the parties' contribution obligations and internal responsibilities.

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