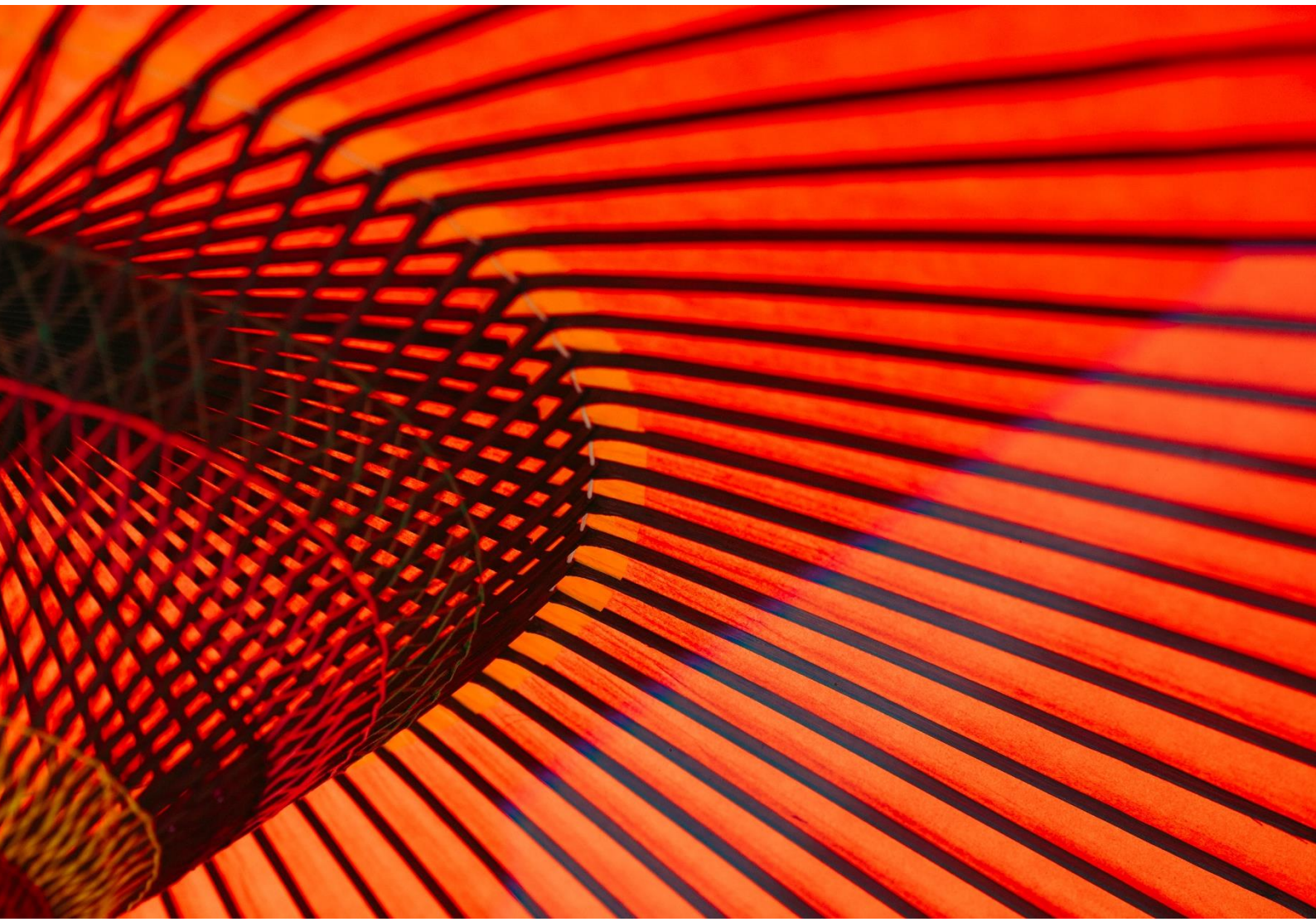


MdME

INSIGHT

*Key takeaways of China's New Company Law (Part 3):
Changes to the Companies' Corporate Governance and Deregistration*



MdME

Introduction

In this three-part update, we provide key takeaways and insights regarding China's New Company Law. In case you missed it, you can read part 1 here covering Changes related to the Companies' Capital Contribution.

Changes to corporate governance structure

The 2023 Company Law also brings substantial changes to corporate governance requirements, enhancing the rights and liabilities of shareholders and internal management bodies, but also promoting transparency and accountability in business operations.

To start with, introduces the requirement to include an employee representative - elected by the company's employees themselves - on the board of directors if the company has more than 300 employees (Article 68).

Additionally, companies can now establish a dedicated audit committee within the board of directors, which would then exercise the powers and functions of the supervisors (Article 69). If an audit committee is established, it would then exempt the company from having a supervisory board or individual supervisors.

The latest revision also removes the upper limit on the number of directors of an LLC. The managing body of such companies could be the board of directors with a minimum of 3 members, or 1 director for a limited liability company with a smaller scale or fewer shareholders (article 68 and article 75).

Finally, considering the currently effective Company Law, companies can either have a board of supervisors, consisting of three or more supervisors, or, if the number of shareholders or the scale of its business operations is rather small, it may elect to have one or two supervisors.

The 2023 Company Law now changes this, stating that companies that are not required to have a board of supervisors may either have one

MdME

supervisor or, if all shareholders agree, no supervisor (article 83). Having two supervisors, however, will no longer be an option. This should give more flexibility, particularly to those companies, especially foreign-invested ones, who may have been lacking the suitable personnel on the ground. However, this also means that companies with two supervisors may have to adjust, which may be particularly complicated for joint ventures, with two shareholders instead of having a board of supervisors, where each party gets to nominate one.

Broader possibilities to appoint the company's Legal Representative

Every Chinese Company must have a Legal Representative ("LR"), authorized with the rights to engage in civil activities on behalf of the company. This is a very unique position under the Chinese company law and a key role. Even if the LR acts beyond his or her authority, those acts may still bind the company. The LR is also the default responsible person in case the company is involved in any civil lawsuits, criminal investigations, employment, and tax law violations, etc. Up until now the LR needs to be a natural person, and the position has to be filled either by the chairman of the board, by the executive director (for companies without a board) or by the general manager. The 2023 Company Law broadens the pool of candidates for this position, permitting any director or manager who carries out the company's affairs on its behalf to serve as its legal representative (article 10).

Liabilities of Controlling Shareholders, Actual Controllers, Directors, Supervisors and Senior Management

The concepts of controlling shareholders and actual controllers remain unchanged under the 2023 Company Law.

However, under the 2023 Company Law, the duty of loyalty and duty of care, as the obligations assumed by the directors, supervisors and senior management of the company have been extended to the

MdME

controlling shareholders and actual controllers who are not a director of the company.

The duty of loyalty requires that the controlling shareholders and actual controllers take measures to avoid conflicts between their own interests and those of the company, and not to utilize their position to gain improper interests. The duty of care requires that they perform the duties with the reasonable care normally expected of a manager in the best interests of the company (article 180).

In addition, the 2023 Company Law expressly stipulates that when a director or senior management causes damage to others in the course of performing his duties, the company shall be liable for the compensation and such director or senior management shall also be liable in case any damage is caused by his or her willfulness or gross negligence, the controlling shareholders or actual controllers of the company who instructed the liable director or senior management to engage in acts detrimental to the interests of the company or the shareholders of company shall also be held jointly and severally liable (articles 191 and 192).

Dismissed Directors – Compensation

The term of office of directors must be determined in the articles of association of a company, with the maximum term allowed for directors, being 3 years.

The 2023 Company Law, however, now states that the director may be removed by the shareholders' meeting, but that in case this happens before the expiration of its term of office and "without a legitimate reason", the director may request compensation (article 71).

Simplified deregistration procedures and forced deregistration

Deregistering a company in China could, up until now, often be even more bureaucratic and time consuming than incorporating one.

The 2023 Company Law introduces new "simplified deregistration procedures" for companies that have not incurred any debts during

MdME

their existence or have paid off all debts. This, however, can only be done upon the commitment of all shareholders. (Article 240)

The simplified deregistration procedures are carried out by announcing the deregistration through the National Enterprise Credit Information Disclosure System, for a period of at least 20 days. After the expiration of the announcement period, the company may apply to the company registration authority to deregister the company within 20 days, if no objection has been received.

In addition, the 2023 Company Law clarifies that the directors should serve as liquidators, in the case of liquidation, and are also members of the liquidation committee by default unless the company's articles of association or the shareholders' resolution has designated other liquidators. If the liquidation obligor fails to perform the liquidation obligations in time and causes losses to the company or creditors, they shall be liable for compensation.

A "forced deregistration" mechanism has also been added, to deal with the prevalence of "zombie companies". If a company does not complete its liquidation within three years of having its business license revoked or being ordered to close down, the company registration authority may move to deregister the company (article 241).

MdME

Conclusion

As highlighted above in this article series, the new Company Law of the People's Republic of China presents substantial changes to the previous versions. Although the specific application and interpretation of the relevant provisions are yet to be put into practice, and there are currently still uncertainties and room for interpretation regarding some of the changes, it is foreseeable that it will have a significant impact on companies in this jurisdiction. We believe that this interim period is therefore a golden transition period for companies to take measures or adjust in order to comply with the requirements of the 2023 Company Law, and for investors to reconsider their investment strategy under the same context.

DISCLAIMER:

The content of this alert is for information purposes only and does not constitute legal advice or legal reliance in any continuing sense. Should you have any inquiries, please feel free to contact us.

Our Contributors:



Diogo Garcês Reis
International Counsel
diogo.garces@mdme.com



Michelle Sio
Trainee Lawyer
michelle.sio@mdme.com