

# CHINA *journal*

## Implementing Regulations of the Revised Company Law

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December 2005 issue of **CHINA** *journal* carries an overview on the newly revised PRC Company Law. It was noted therein that supplementing rules were forthcoming for a smooth implementation of the new law. This issue of **CHINA** *journal* aims to take a look at the new developments in the aftermaths of the new Company Law and their possible impacts.

### Registered Capital

#### *Schedule for Capital Contribution*

It is clarified that the distinction between “subscribed capital” and “paid-in capital”<sup>1</sup> only exist for the limited liability company (“LLC”) and the joint stock limited company (“JSLC”) that is incorporated by means of promotion. The registered capital for a JSLC incorporated by means of public collection will still have to be fully paid in upon the incorporation<sup>2</sup>.

#### *Specification of Illegible Non-Cash Contribution*

Article 27 of the Company Law foresees that eligible assets for registered capital including cash and non-cash assets such as tangible goods, IP, land use rights etc. The definition is a non-exhaustive enumeration of permissible assets. Literally, it is not clear what kinds of valuables beyond those explicitly listed could also be used as in-kind contribution.

The recent follow-up rules point onwards to the forthcoming rules for clarifying the issue. However, what kinds of assets are not eligible have been confirmed. Those non-cash assets,

in the form of *labour, credit, name of an individual person, goodwill, franchise right* or *any assets burdened with collateral* are NOT permissible as registered capital contribution<sup>3</sup>. In other words, shareholders or investors may not realize the value of these assets by converting them into the equity of their Chinese ventures. As an alternative solution, they may trade these valuables with the Chinese venture through contractual arrangements.

### Domicile

The domicile of a company is at the place of its headquarter that carries out the major operation. The domicile has to be located within the jurisdiction of the in-charging company registration authority. Thus, a company registered with downtown Shanghai commercial registry could no more have its domicile in Waigaoqiao free trade zone, unless the investment is so substantial that a higher level authority becomes responsible for the registration whose jurisdiction covers the whole area in concern.

### Welfare Funds

The Company Law has abolished the mandatory provision of welfare funds that were previously charged prior to profit distribution. Such funds refer to so-called employee bonus and welfare funds in the context of foreign investment enterprises (“FIEs”). It is clarified that from April 1, 2006 onwards, companies (including FIEs) are no longer obligated to allocate welfare funds prior to profit distribution<sup>4</sup>. However, the board

<sup>1</sup> Where upon incorporation, at least 20% of the subscribed capital need to be paid-in and rest could be paid off within 2 years.

<sup>2</sup> The Administrative Rules on the Registration of the Registered Capital of Companies, promulgated by the State Administration of Industry and Commerce on December 27, 2005 and effective as of January 1, 2006.

<sup>3</sup> Article 8, the Registered Capital Rule; Article 14, the Administrative Regulation on the Registration of Companies, promulgated by the State Council on December 18, 2005 and effective as of January 1, 2006.

<sup>4</sup> The Circular on Several Issues on Handling Company Finance after the Coming-into-force of the Company Law, promulgated by the Minis-

of directors of FIEs may opt to continue allocating these funds to be managed under debt account. Companies' purchase-back of their own stocks in the course of employee stock option plan is limited to 5% of total outstanding shares.

## New Rules for Listed Companies

New rules on the general shareholders' meeting<sup>5</sup> and guideline on the articles of association<sup>6</sup> for listed companies in China have been promulgated to reflect the novel features in the Company Law. Focus in these rules has been primarily set on minority protection. Thus, shareholders individually or collectively holding no less than 10% shares continuously for a period of 90 days may summon interim general shareholders' meeting; shareholders with no less than 3% shares are entitled to bring motion into the meeting agenda; the contents of meeting agenda are required to be communicated in a complete and comprehensive manner; and the cumulative voting system is firmly built in.

To enhance the corporate governance, new measures are put into place such that independent director is entitled to suggest the board to summon general shareholders' meetings, associated transaction has to be approved by the majority of un-associated shareholders, the dependent directors should not exceed ½ of the board room, and the mandate of auditor can only be endorsed by a resolution of shareholders' meeting instead of previously that of the board.

## Strategic Investment in Listed Companies by Foreign Investors

For the time being, floating stocks of Chinese listed companies at Shanghai and Shenzhen Stock Exchange, i.e. A shares, are limited to the investment of so-called qualified foreign institutional investors ("QFII"), where only prominent financial conglomerations could qualify. A policy move for solving the historical segregation of floating and non-floating stocks is currently underway, with the final target of full floating of all outstanding shares of Chinese listed companies.

Based upon a recent set of rules<sup>7</sup>, a solid and licit foreign investor with total assets of no less than USD 100 million (or whose mother company possesses total assets of no less than USD 500 million) is eligible to invest into Chinese listed companies that have concluded stock full-floating exercise. The investment could be realised by contractual transfer or by private placement of new shares. The nature of such investment is "strategic" as the shares thus acquired could not be resold for a period of 3 years. The new rules open a door for foreign investors to tap in the nascent Chinese stock market in addition to the currently limited channels.

## Conclusion

Regulations aiming to facilitate the implementation of newly revised Company Law are in general applicable equally to domestic enterprises and FIEs. This endorses the tendency of consolidation of legal provisions that used to be bifurcated between the local and foreign. With the ongoing state-owned enterprise reform, proliferation of private equity investment and reshuffle of capital market, the new Company Law and its supplementing rules would play a pivotal role for corporate practices, as well as for foreign investment in China.

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try of Finance on March 15, 2006.

<sup>5</sup> Rules for the General Shareholders' Meeting of List Company, promulgated by the China Securities Regulatory Committee on March 16, 2006 and effective as of the same date.

<sup>6</sup> Guidelines on the Articles of Association of List Companies (Revision in the year of 2006), promulgated by the China Securities Regulatory Committee on March 16, 2006 and effective as of the same date.

<sup>7</sup> The Administration Method on Strategic Investment in Listed Companies by Foreign Investors, promulgated jointly by MOC, CSRC, SAT, SAIC and SAFE on December 31, 2005 and effective as of January 30, 2006.