

New Company Law – 2006

On 27 October 2005 the Standing Committee of the National People's Congress promulgated the new PRC Company Law. The Law will take effect from 1st January 2006.

The new Law remove some restrictions and introduced key concepts, but without amendments being made to laws related to Foreign Invested Enterprises (FIE), applicability of new Company Law to FIE remain uncertain.

Main points are:

- The provision restricting domestic companies (including foreign invested enterprises) from investing more than 50% of their net assets acquiring shares in local enterprises has been dropped completely.
- The restrictions on joint stock companies issuing new shares have been lifted.
- Registered capital requirements have been reduced, and capital contribution by instalments (a 20% initial contribution with the remainder paid within two years) is now permitted - concepts of fully-paid capital and subscribed capital have been adopted.
- The new Company Law provides for a much lower threshold for the capitalisation of companies in the PRC. The minimum registered capital of limited liability companies and joint stock companies has been reduced to RMB30,000 and RMB5 million, respectively.

Another significant change is that the new Company Law permits phased capital contributions, which to date has been a privilege enjoyed exclusively by FIEs.

- The existing requirement that capital contribution in intangible form must not exceed 20% of the registered capital has been dropped, but the proportion constituted by cash contributions must still not be less than 30%.

It will be replaced by a minimum ratio of cash contribution, set at 30% of a company's registered capital. This effectively raises the permitted proportion of capital contribution in the form of intangible assets to 70% of a company's registered capital.

- The concept of different classes of shares has been introduced. The Law open the way to innovative classes, such as preference shares which grant the holder priority rights to dividends or shares which give the holder a fixed return.
- Shareholders can require the supervisory committee or the board of directors to sue senior management.
- The minimum number of promoters for setting up a joint stock company has been reduced to two, and the requirement for provincial level government approval has been dropped.
- A company may repurchase its own shares for the purpose of awarding shares to its employees, which opens up the possibility of setting up stock option plans.
- Under certain conditions, such as a failure for five consecutive years to distribute profits, shareholders may require a limited liability company to buy back their equity interests.
- Companies are no longer required to contribute 5-10% of their after-tax profits to a statutory provident fund

However, this requirement remains in the Enterprise Accounting System (which is also applicable to FIEs). Clarification is needed as to whether or not this is still mandatory.

- Notification procedures have been simplified and waiting periods shortened for mergers, divisions, registered capital reductions and liquidations.
- When a company is in serious operational difficulty, a shareholder holding 10% or more of the shares can apply to the court for termination of the company.

This provision is intended to benefit minority shareholders, offering an alternative exit mechanism where the shares in question lack liquidity.