



# Major Issues in PRC Company Law A comparative analysis with English Company Law

中国公司法主要问题  
与英国公司法的比较研究



# Business Organizations 商事组织的分类

## Chinese Law:

- Business Partnership 商合伙
  - General Partnership 普通合伙
  - Special General Partnership 特殊的普通合伙企业
  - Limited Partnership 有限合伙
- Business Legal Person 商法人
  - Company 公司企业
  - State-owned Enterprise (“SOE”) 国有企业
  - Collective-owned Enterprise 集体企业





# Foreign Investment Enterprise 外商投资企业

- **Sino-foreign Equity Joint Ventures (EJV) 中外合资经营企业**
- **Sino-foreign Contractual Joint Ventures (CJV) 中外合作经营企业**
- **Wholly Foreign-owned Enterprises (WFOE) 外商独资企业**

## EJV \ CJV → WFOE

- The other investors' consent 合营、合作的各方同意
- Approval authority : the one approved the establishment of the enterprise 审批机关
- Authority for registration: the original registration authority 登记机关

# Corporate Management 公司管理



- Appointment of directors 董事任命
- Board of supervisors 监事会
  - Representatives of shareholders and 1/3 should be the representatives of employees
  - Convene interim shareholders meetings; check financial affairs; bring proposals to remove directors or senior management; initiate actions against directors or senior management
- Legal Representative 法定代表人
  - Chairman of the board of directors, an acting director or a manager
  - Responsibilities: sign the paper form stocks, issued bonds and other corporate contracts
  - Shareholders meeting, general meeting or board of director passes a resolution to remove the legal representative.



## Duties and Liabilities of Company Directors 公司董事的义务和责任

- Declare shareholdings & changes

### 股票交易

- During their terms of office, not more than 25% of the shares they hold can be transferred within a year.
- Restriction from assignment of shares lasts until half a year after their leaving.
- Listed companies: 1-year locked-up period after the listing date; prohibition of short-term (6 months) trading





# Duties of directors

## 董事义务

- Duty to keep within its powers **不得超越权限**
  - not providing loans or guarantee to any other person with the company's fund w/o approval
  - unauthorized disclosure of corporate secrets
- Duty not to obtain a personal profit **避免利益冲突**
  - not signing a contract or trading with his company
  - not seeking business opportunities for himself
  - not operating any like business
  - not taking commissions of corporate transactions
- Duty to use director's powers for a proper purpose **为正当目的行使权利**
  - not assisting bidders in acquisition
  - not misappropriating funds
- Duty of care and skill **勤勉义务**
  - providing time and attention to fulfill obligations
  - answering inquiries, presence at the meeting
  - understanding responsibilities



# Duties and Liabilities of Company Directors 公司董事的义务和责任

- Approval for breaches of duty by shareholders' meeting 经股东大会批准董事可以违反义务的行为
  - provision of loan or guarantee to any other person with the company's fund
  - signing a contract or trading with the company
  - usurping company opportunities
  - operating for himself or any other person a like business
- CSRC punishment of breach of duties 惩罚
  - Directors of listed companies; directors of a listed company's holding company; other liable persons deemed by the CSRC as having violated relative laws
  - Prohibited from engaging in any securities practice or holding any post of director, supervisor or senior manager in the original organization and any listed company within a prescribed term or for life.
  - Securities practice: brokerage; investment consulting; financial advising; underwriting; self-operation of securities; asset management.

# The Company's Articles of Association 公司章程



- Amendment 变更
  - CJV: unanimous agreement of the members in BOD or Joint Management Committee  
Major revision needs approval.
  - EJV: unanimous agreement from directors present in BOD; requires approval.
  - WFOE: requires approval from the approval authority which approved the establishment
- Validity 效力
  - Valid upon approval
  - CJV: Joint Venture contract prevails the articles of association. (Art.10, Detailed Rules On the Implementation of the Law of People's Republic of China On Sino-Foreign Joint Cooperative Ventures)



# Enforcement of Corporate Rights 公司权利的行使



- Statutory Derivative Actions 法定派生诉讼
  - Defendant(s): art. 150, 152
    - a director or senior manager who violates any law, administrative regulation, or the bylaw during the course of performing his duties and causes any loss to the company
    - a person whose conduct impairs the legitimate rights and interests of the company and causes any loss to the company
  - Plaintiff(s): shareholders who separately or aggregately holding 1% or more of the total shares of the company for 180 days or more
  - Practice: company is named as a second defendant or a third party in the lawsuit.

# Enforcement of Corporate Rights 公司权利的行使



## Statutory Derivative Actions 法定派生诉讼

- 1<sup>st</sup>: request in writing to board of supervisors
- 2<sup>nd</sup>: If the supervisor involves in the violation of law , request in writing to board of directors
- 3<sup>rd</sup>: If board of directors refuses to act or fails to act within 30 days, shareholders can lodge a suit directly on their own behalf. (art. 152)
  
- If, in emergency, the failure to lodge an action immediately will cause unrecoverable damages to the interests of the company, the shareholders can lodge an action directly on their own behalf. (art. 152)

# Enforcement of Corporate Rights 公司权利的行使



- Protection of Minority Shareholders  
小股东的保护
  - cumulative voting system: a minority shareholder can multiply his voting rights by the number of candidates and vote them all for one candidate. (art. 106)
  - lodge a lawsuit if any director or senior manager damages the shareholders' interests by violating any law (art. 153)
  - revoke resolutions if the procedure for calling meetings or voting violates any law or bylaw (art. 22)

# Enforcement of Corporate Rights 公司权利的行使

- Protection of Minority Shareholders

## 小股东的保护

- request the company to buy back shares at a reasonable price under the following situations (art. 95)
  - the company has made profits for 5 years and has failed to distribute any dividends for 5 years, or
  - the company is going to merge with others, to be split up, or transfer the major properties, or
  - when the business term expires, the shareholders' meeting makes the company exist continuously by adopting a resolution to modify the bylaw



# Enforcement of Corporate Rights 公司权利的行使

- Protection of Minority Shareholders
  - The shareholder is liable for compensation if he causes loss to the other shareholders due to an abuse of shareholder's rights. (art. 20)
  - No guarantee shall be provided to a shareholder or actual controller unless a resolution is passed by the shareholder's meeting or shareholders' assembly without the interested shareholder's participation in voting. (art. 16)





# Enforcement of Corporate Rights 公司权利的行使

- Protection of Minority Shareholders
  - The shareholders holding 10% of the voting rights can
    - initiate an interim meeting. (art. 40)
    - initiate shareholder's meetings if the board of directors and board of supervisors fail to do so (art. 41)
    - dissolve the company if it suffers unsolvable difficulties in operation and management and will have heavy losses (art. 183)
  - review the minutes of shareholders' meetings, board meetings, supervisors' meetings and financial reports; review accounting books (art. 34)



# Share Capital and Issue 股票资本与发行



- Issuance of Share 发行股票
  - Same class → same rights, same benefit
  - Issue at the same time → same conditions, same issue price
  - Issue price must not be less than the par value
- Public offering 公开发行
  - issue to unspecified persons; or
  - issue to more than 200 specified persons cumulatively
- IPO (art.13 Securities Law) 首次公开发行股票
  - a complete and well-operated organization
  - capable to make profits continuously + a sound financial status
  - no false record in its financial statements over the last 3 years and having no other serious violation of laws

# Listing of Shares

## 股票上市



- Requirements

- The stocks shall have been publicly issued upon the approval of the securities regulatory authority under the State Council;
- Registered capital  $\geq$  RMB 30 million  $\rightarrow$  publicly issued shares  $\geq$  25 % of total shares;
- Registered capital  $\geq$  RMB 0.4 billion  $\rightarrow$  publicly issued shares  $\geq$  10% of the total shares
- The company shall not have any major irregularities over the preceding three years
- there is no false record in its financial statements.

# Insider Trading - Definition

## 内幕交易 - 定义



- U.S. Law
  - buying or selling a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, nonpublic information about the security.
  - also include "tipping" such information, securities trading by the person "tipped," and securities trading by those who misappropriate such information.
- P.R.C. Law
  - Any insider who has access to insider information or has unlawfully obtained any insider information on securities trading may not purchase or sell the securities of the relevant company, or divulge such information, or advise any other person to purchase or sell such securities. (art.76 Securities Law)



# Insider Trading – Rat Trading

## 内幕交易 – 老鼠仓交易

- Rat trading 老鼠仓交易
  - Rat trading occurs when a broker receives an order from a client to buy a share at a certain price. If the broker believes the share will drop, he may be tempted to wait and buy the stock at a lower price through his own account. He then sells the stock to the client at the client's original price and pockets the difference.
  - A fund manager controls "rat accounts" for relatives or friends.
- CSRC Guidelines (drafted) 基金从业人员亲属股票投资报备
  - immediate relatives of fund employees must obtain fund-company permission before investing in stocks
  - these relatives would not be allowed to open trading accounts except at certain, designated securities companies.
- Criminal Law (2009) 刑法第七修正案

Any staff members of fund management companies, securities companies, commercial banks or other financial institutions who make use of the insider information obtained through the convenience of their job to conduct trading related to the information so obtained, or suggest other people to conduct such trading are violating the rules.



# Market Manipulation

## 操纵证券市场



- Market Manipulation (art. 77 Securities Law)
  - anyone, independently or in collusion with others, manipulates the trading price or quantity of securities by centralizing their advantages in funds, their shareholding advantages or taking their information advantage to trade jointly or continuously;
  - anyone collaborates with any other person to trade securities pursuant to the time, price and method as agreed upon in advance, thereby affecting the price or quantity of the securities traded;
  - trades securities between the accounts under his own control, thereby affecting the price or quantity of the securities traded;



# Joint Ventures 合营企业

- Types 类型
  - EJV: limited liability company
  - CJV: limited liability company or partnership
  - Chinese side must be Chinese companies, enterprises or other economic organizations
- Documentation 主要文件
  - MOU is not compulsory
  - joint venture contract prevails MOU
  - JV contract prevails articles of association (CJV)
- Scope of business 经营范围
  - Foreign Investment Industrial Guidance Catalogue
- Investment capital 出资
  - In EJV or CJV (limited liability company), the capital contribution by the foreign party shall not be less than 25% of the total capital.

# Corporate Finance – Issuance of Stocks

## 公司融资 – 上市发行股票

### Step 1: Restructuring

JV Limited Liability Co. → JV Joint stock Limited Liability Co.  
外商投资有限责任公司 → 外商投资股份有限公司

- Requirement
  - make profits continuously in the latest 3 years
- Procedures
  - Original investors sign agreements and articles of association for the establishment of a joint stock Ltd. Co.
  - submit the documents to responsible departments in the place where JV is located for initial approval, which will then move to MOFTEC for final approval.
  - After approval, the promoters can undergo transformation formalities with responsible departments for registering the companies.



# Foreign-invested Stock Company IPO 外商投资股份有限公司上市发行股票

## • Step 2 : listing 申请上市

### Requirements

- passed the joint annual inspections of foreign-invested enterprises for the last 3 years;
- the scope of business complies with the Interim Provisions on Guiding the Orientation of Foreign Investment and the Catalogue of Industries for Guiding Foreign Investment;
- the proportion of shares held by foreign investors shall not be less than 10% in the total shares after the initial public offer;
- if the foreign-invested stock company shall be controlled by the Chinese parties or there are special regulations governing the holding of shares by the Chinese parties, the Chinese parties shall continue to keep their controlling position or continue to hold the proportion of shares.





# Foreign Enterprise Mergers & Acquisitions

## 外资企业并购



- Mergers between foreign enterprises
  - EJV, CJV with legal person status, WFOE, and foreign-funded joint-stock Ltd. Co.
    - a company absorbs another and remains in existence while the absorbed is dissolved.  $A + B \rightarrow A$
    - two or more companies merge into one new company and the original ones are dissolved.  $A + B \rightarrow C$
  - Applicable law: Regulations on Merging and Splitting of Foreign-funded Enterprises
- Mergers between foreign & domestic companies
  - Regulations on Merging and Splitting of Foreign-funded Enterprises is also applicable.
  - No mergers with domestic enterprises unless the foreign investors have already paid the capital, provided the conditions for cooperation to the foreign enterprises.
  - Foreign shareholdings  $\geq 25\%$  after the merger
  - guarantee full employment of their original staff & have proper arrangement



# Foreign Enterprise Mergers & Acquisitions 外资企业并购

## Liabilities

### • Mergers 合并

- btw foreign and domestic companies: guarantee full employment of original staff
- after merging the existing company shall succeed all creditors' rights and debts of the companies dissolved.

### • Equity Acquisition 股权并购

- The acquirer inherits the creditor's rights and debt of the merged or acquired company.
- The acquirer, target company, the creditors and other persons concerned may reach an agreement on the inheritance of the creditor's rights and debt which is subject to the approval of MOFCOM or its provincial counterparts.

### • Asset Acquisition 资产并购

- the domestic enterprise that sell the assets will bear the original creditor's rights and debt.





# Due Diligence

## 尽职调查

- Group structure and summary of the development and history of the company
- Incorporation documents
  - e.g. business permits and licences
- Capital structure
- Properties
  - real property, titles to land and buildings or lease
  - other fixed assets
- Intellectual properties & intangible assets
- Company's business
- Material contracts and business documents
- Tax
- Employees of the company
- Environmental matters
- Litigation \ Arbitration
- Others
  - e.g. loans, security arrangement

# Foreign Enterprise Mergers & Acquisitions 外资企业并购



- Share swap option 股权交换

Requirement

- The equity is assignable, free from any dispute over ownership, pledge or any other property encumbrance.
- The equity is listed on an overseas exchange.
- The stock price is stable in the current year.

- Anti-monopoly Review 反垄断审查

Notification criteria

- total global revenues > RMB10 billion, and 2 business operators' China revenues > RMB400 million respectively; and
- total China revenues of all business operators > RMB2 billion, and the China revenues of at least 2 business operators > RMB400 million respectively

Approval authorities: MOFCOM, SAIC