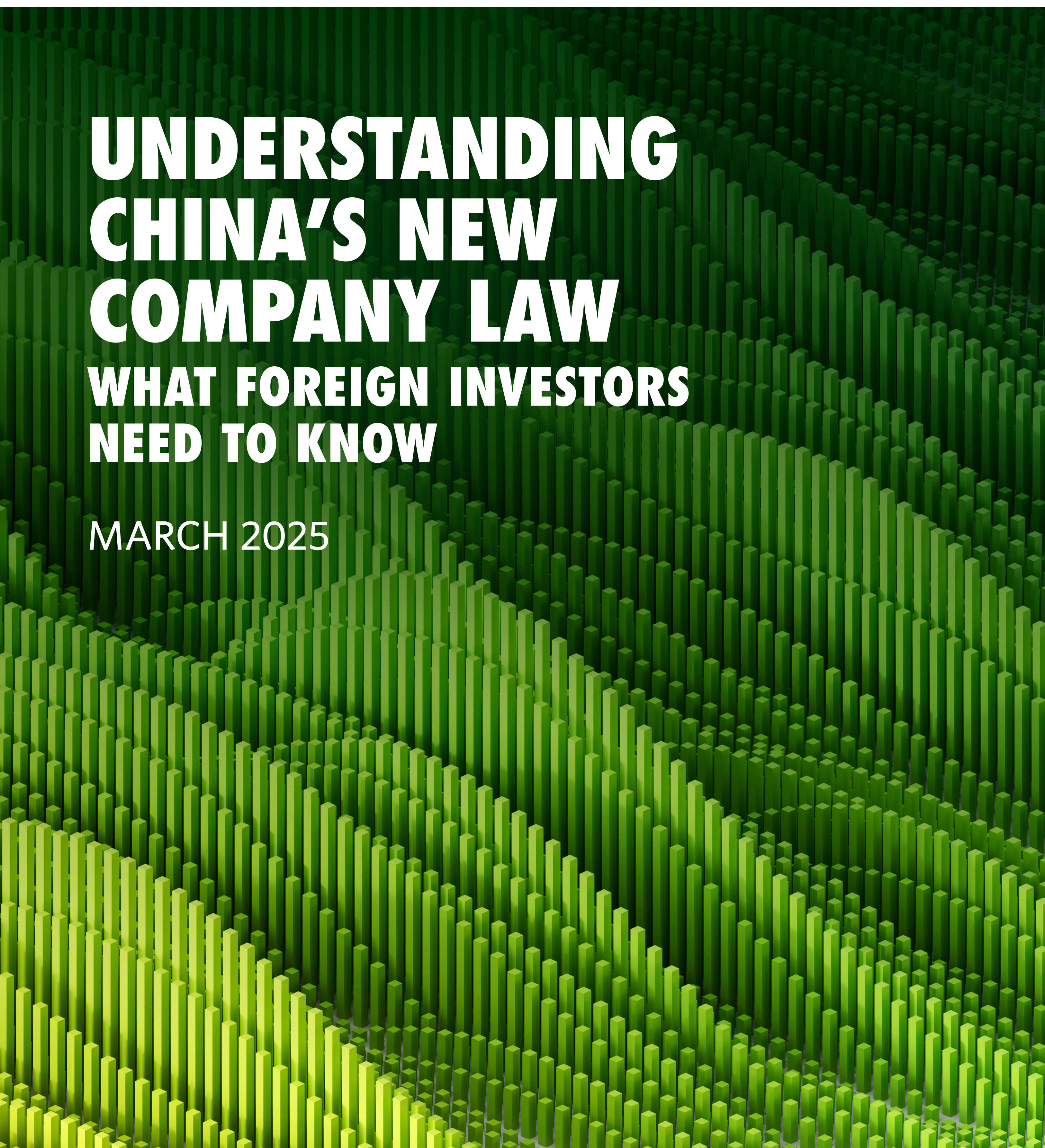
Morgan Lewis

REPORT



UNDERSTANDING CHINA'S NEW COMPANY LAW

WHAT FOREIGN INVESTORS NEED TO KNOW

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UNDERSTANDING CHINA'S NEW COMPANY LAW: WHAT FOREIGN INVESTORS NEED TO KNOW

The amended Company Law of China (the **New Company Law**) took effect on July 1, 2024, making substantial changes to existing rules in a wide range of areas including, among others, new timeline requirements for capital contribution, streamlined corporate registration and filing procedures, enhanced corporate governance, and strengthened shareholder rights protections. The law applies to all companies and other covered business in mainland China, including foreign-invested enterprises (**FIEs**).

Following the effectiveness of the New Company Law, the State Council, the Supreme Court of China, and the State Administration for Market Regulation (**SAMR**) promulgated a series of regulations and rules to support its effective implementation. Most recently, to further clarify rules on corporate registration, the SAMR promulgated the Implementing Measures for the Administration of Company Registration (the **Measures**) on December 30, 2024, which entered into force on February 10, 2025.

The New Company Law also introduced changes that may impact the articles of association (**AoA**) of FIEs. For companies that were established before January 1, 2020, when the Foreign Investment Law of China came into effect, they were required to adjust their AoA in conformity with the Foreign Investment Law before January 1, 2025. Companies that have not yet done so shall act immediately to conduct a thorough review of their AoA and make necessary adjustments for the AoA to conform to the New Company Law and, as applicable, the PRC Foreign Investment Law.

We have prepared this report focusing on the latest developments in legislation, insights, and impacts for all companies of all sizes and industries to help foreign investors and FIEs, in particular, familiarize themselves with the New Company Law. We stand ready to help companies analyze the impact of the New Company Law on their operations in China and assist with any related questions.

There are two types of companies with limited liability in China: limited liability companies (**LLCs**, in Chinese 有限责任公司 or 有限公司), which are private companies, and joint stock limited companies (**JSLCs**, in Chinese 股份有限公司) which can be either private or public companies. This report gives more focus on LLCs as it is the most popular corporate structure form of FIEs.

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1. Key Considerations for Corporate Governance of FIEs

2. Enhanced Protection for Shareholder Rights

3. Adapting to Strengthened Capital Contribution Requirements

KEY CONSIDERATIONS FOR CORPORATE GOVERNANCE OF FIES

The corporate governance structure of Chinese companies has its unique features as compared with that of companies in western countries.

This section provides a brief summary of corporate governance requirements, in particular developments under the New Company Law and key considerations for foreign investors and FIEs in terms of appointment of directors, supervisors, and senior management (collectively referred to as D&Os).

What Do Foreign Investors Need to Know About an FIE's D&O Slate?

In general, a Chinese company must have a (1) Legal Representative (Legal Rep), (2) Board of Directors or sole Director, (3) Board of Supervisors or sole Supervisor, and (4) Manager. The company shall file the identification and contact information of the appointed persons with the corporate registration authority.

None of the abovementioned D&Os is required to be a Chinese citizen or be physically stationed in China. Depending on local practice, however, the local authorities and the company's account bank may for some specific purpose require the Legal Rep to be personally present or provide its original identification document, which may cause inconvenience for a person that is not stationed in China.

What Is a Must-Have on the D&O Slate?

Legal Representative

The New Company Law provides that a company's Legal Rep must be the Director or Manager representing the company in executing company affairs "in accordance with the provisions of the company's AoA." (Article 10) There is a difference here compared to the old law, which provides that the Legal Rep can be either the Chairman of the Board of Directors (or the sole Executive Director, if the company does not have a Board of Directors) or the Manager, yet the new rule emphasized that the Legal Rep shall actually manage the company affairs regardless of the person's role in the company.

The New Company Law also fills a long-existing gap in the legislation by allowing the Legal Rep to voluntarily resign from the position. If the Director or Manager resigns, such person shall be deemed as resigning from the Legal Rep role at the same time. Upon resignation by the Legal Rep, the company shall appoint a new Legal Rep within 30 days. (Article 10)

The Legal Rep is deemed to be the authorized representative of the company with full power to act on behalf of the company. The name of the Legal Rep is recorded and reflected in the business license of the company. Most important legal documents and most government-required forms and documents (e.g., application documents for corporate registrations/filings, amendment to AoA, certificate of capital contribution) require the wet-ink signature of the Legal Rep, sometimes along with the company's company chop.

The New Company Law stipulates that the company itself assumes the legal consequences of the civil activities carried out by the Legal Rep, and limitations of the Legal Rep's authorization under the company's AoA or imposed by the shareholder(s) shall not be used against any bona fide third party.

Where the Legal Rep causes harm to others while performing his/her duties, the company shall assume the civil liabilities incurred therefrom. After assuming the civil liability, the company is entitled to seek indemnity by the Legal Rep who is at fault. (Article 11)

Director

A company shall have a Board of Directors consisting of no less than three Directors or alternatively one sole Director. The New Company Law abolishes the upper limit on the number of members who can sit on a company's Board of Directors.

Directors of Chinese companies have certain fiduciary duties to the company, including the duty of loyalty and the duty of diligence, which can somewhat be analogized to the US legal concept of duty of care. The New Company Law increases the Directors' risk exposure and potential liabilities as it sets out a number of matters that fall within their responsibilities and duties including, among others, examining shareholders' capital contributions and demanding shareholders to make up unpaid capital contribution (Article 51) as well as liquidation of the company (Article 232). In particular, a Director will be liable for adoption of board resolutions that violate the law, the AoA of the company, or shareholder resolutions, unless such person's objection is clearly recorded in the relevant meeting minutes. (Article 125)

While the shareholder(s) may dismiss the Director by making a resolution, if the Director is dismissed early without being given a fair reason, such Director is entitled to seek compensation from the company. (Article 71) What's more, the New Company Law for the first time introduces D&O liability insurance to reduce the risks of acting as a Director. (Article 193)

D&Os Roles That Are Not Mandatorily Required

Supervisor

The Supervisor is not directly responsible for the management or operation of the company, but instead oversees other D&Os of the company. In light of the nature of its role, none of the Directors or other senior officers of the company may concurrently serve as the Supervisor.

The New Company Law allows LLCs to establish an audit committee instead of having the Board of Supervisors or sole Supervisor. (Article 69) For small-size LLCs or LLCs with few shareholders, such companies may opt not to have a Supervisor upon the unanimous consent of all shareholders. (Article 83)

The law gives the Supervisor the authority to, among other things, inspect the company's financials, supervise other D&Os in discharging their responsibilities, attend Board meetings and raise questions or recommendations regarding matters to be considered before the Board, engage an accountant to conduct an audit of abnormal situations at the company's expense, and make impeachment recommendations against Directors and senior officers if they violate laws, the AoA, or shareholder resolutions. (Article 78 for LLCs and Article 131 for JSLCs)

As integral to the Supervisor's powers and responsibilities, the Supervisor has similar fiduciary duties to the company as Directors. As a matter of practice, the position of Supervisor in a company wholly owned by a single investor is generally of form over substance, since the shareholder can technically dismiss the Directors and other senior officers of the company directly without going through the Supervisor.

Manager

Foreign investors are sometimes confused by the concept of "Manager" under the law compared with "managers" that the company may have in different functional divisions.

The Board of Directors (or the sole Director) may appoint the Manager to be in charge of the daily operations of the company and to exercise any other powers and perform any duties expressly set forth in the company's AoA or otherwise authorized or delegated by the Board of Directors. The law also allows the Manager to attend the meetings of the Board of Directors as non-voting attendee. (Article 74)

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The Manager has similar fiduciary duties to the company as Directors.

Enhanced Liabilities of D&Os under New Company Law

The New Company Law emphasizes the duty of loyalty and duty of diligence of D&Os by setting out a number of circumstances wherein they would be personally liable to the shareholders or the company, for instance gross negligence or intentional misconduct in performing their duties and causing damage to third parties; engaging in related-party transactions and causing damage to the company; and exploiting an opportunity related to the corporation's business (similar to the corporate opportunity doctrine under US law).

The D&Os would be jointly liable with a shareholder for such shareholder's violation of the law that has jeopardized the company's interests when conducting certain activities such as withdrawing paid-in capital, illegally reducing registered capital of the company, or illegally distributing profits.

The controlling shareholder and the actual controller directing the D&Os to conduct activities that jeopardize the interests of the company and the shareholder would also be jointly liable with the D&Os.

Notably, the D&Os can be subject to administrative and, in serious cases, criminal liabilities under the New Company Law and other laws of China. The D&Os do not bear administrative or criminal liability for the violations or criminal offenses committed by the company simply by virtue of their office. Under the relevant Chinese law, only those persons who are deemed as "directly responsible persons in charge" or "other directly responsible persons" would be liable for the violations or criminal offenses committed by the company.

"Directly responsible persons in charge" and "other directly responsible persons" are not explicitly defined by Chinese law. As a matter of practice, a "directly responsible person in charge" generally refers to a person who plays a role in deciding on, approving, authorizing, conniving, or directing the act of crime implemented by the company. Such person can be the Legal Rep, the Director, the Manager, or some other person if he/she actually exercises managerial duties and responsibilities in the company and takes charge of the specific act of the company that constitutes a violation or a crime.

Best Practices for Foreign Investors Operating in China

Customize the D&O Slate Based on Practical Considerations

Foreign investors may leverage the flexibility provided by the New Company Law to customize the D&O slate for FIEs by taking into account practical considerations, to the extent not in violation of the statutory requirements.

For instance, for enterprises like joint ventures, having a Board of Directors may offer better checks and balances among Directors. However, for small-size companies or a company with few shareholders (such as a wholly foreign-owned enterprise, or WFOE), a sole Director may simplify and expedite the corporate decision procedure and alleviate the burden of having to collect signatures from multiple Directors whenever a board resolution of the company is required during the operation stage.

Formulate Effective Organizational Documents and Internal Policy

Foreign investors should stipulate in the FIE's AoA the specific powers and duties of each D&O role. FIEs shall also formulate and implement a robust internal approval policy specifying the authorized approvers for various company affairs as well as a set of working procedures laying out the approval procedures of various company affairs.

Foreign investors and FIEs should keep proper records of valid organizational documents, internal policies, resolutions, and meeting minutes of the shareholders' meeting and board meetings.

Keep Corporate Registrations/Filings Up to Date

Foreign investors should monitor the change in the D&Os appointed to the FIEs and timely update corporate registrations/filings upon any resignation or replacement of such roles to avoid potential liabilities arising from delayed corporate registrations/filings.

Regular Trainings for D&Os

Foreign investors should provide regular training to the D&Os in FIEs to help familiarize them with their duties and responsibilities, as well as potential liabilities, so as to keep robust corporate governance and protect the D&Os from potential risks and liabilities arising from their performance of duties.

For example, it is important for Directors, particularly those appointed to joint ventures, to record their objection to the resolutions that they are against in the meeting minutes and have such records in place.

Securing D&O Insurance

The New Company Law highlights the importance of leveraging D&O insurance to limit the D&Os' losses and risks from civil, administrative, or criminal liabilities resulting from exercising their powers and duties. It has been increasingly important for companies to secure D&O liability insurance to provide sufficient coverage for a company's senior executives against claims that may arise against them.

ENHANCED PROTECTION FOR SHAREHOLDER RIGHTS

In principle, the New Company Law provides shareholders with more flexibility to agree in the company's AoA on corporate governance and other items depending on the company's own situations.

We summarize below highlights of the changes under the New Company Law that may affect the rights of shareholders, in particular the minority shareholders in joint ventures, as well as our recommendations to foreign investors.

Expanded Information/Inspection Right

The old company law provided that shareholders of LLCs could inspect and copy the company's AoA, minutes of shareholder meetings, board resolutions, resolutions of the Board of Supervisors, and financial reports. Shareholders are entitled to inspect (but not copy) companies' accounting books.

The New Company Law provides additional protections to minority shareholders who may have little to no control over day-to-day management of the company and may face challenges investigating their suspicions about mismanagement. In particular, the law expands the scope of inspection right to include access to shareholder registers and accounting vouchers. It also makes clear that shareholders may engage third-party professions such as accounting firms or law firms to conduct the inspections on their behalf, which is essential for shareholders to effectively exercise their rights in practice. Furthermore, the New Company Law extends the shareholders' information/inspection right further to the same materials of the company's wholly owned subsidiaries. (Article 57)

JSLC shareholders of joint-stock companies have similar inspection rights, except that the shareholders must have continuously held 3% (or a lower threshold as provided under the company's AoA) of the company's shares for more than 180 days to be entitled to such right. (Article 110) The eligibility requirement specifically for JSLC shareholders is meant to maintain the balance between protection of minority shareholders and unnecessary intervention to a company's daily operations, given JSLCs typically have a larger number of shareholders compared with LLCs.

Enhanced Redemption Right for Dissenting Shareholders

The old company law allowed minority dissenting shareholders of LLCs to demand that the company repurchase their equity interests at a reasonable price upon the occurrence of any of the following events: (1) the company has been profitable in each of the past five consecutive years and was able to distribute profits to its shareholders, but failed to do so during such period; (2) the company engages in a merger, division, or transfer of its assets; or (3) the shareholders meeting adopts resolutions allowing the company to continue to exist even when the operating period of the company has expired or the company should have been dissolved according to the AoA. The law kept silent on the redemption rights of JSLCs.

Under the New Company Law, shareholders of all limited liabilities companies (for JSLCs, excluding listed companies that are subject to relevant securities laws) now have the equivalent redemption right. (Article 161) To ensure effective implementation of the redemption right, the New Company Law requires that the company complete the redemption (by a share transfer or cancellation) within six months of a shareholder's request. (Article 89 for LLCs and Article 161 for JSLCs)

In particular, to enhance the protection for minority shareholders of LLCs, the New Company Law adds a new scenario for a dissenting shareholder to exercise such right, i.e., when the controlling shareholder(s) has abused its power to seriously damage the interests of the company and its minority shareholders. (Article 89) The minority shareholders in a joint venture now have a more straightforward remedy (i.e.,

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to exit) when the major shareholders take unfair advantage of the minority shareholders by abusing their powers, where seeking monetary remedy can be costly and unpredictable.

More Flexibility in Decision-Making

The New Company Law simplifies the list of default statutory decision-making powers of the shareholders meeting (or the sole shareholder) as well as the Board of Directors (or the sole Director) and eliminated the list of powers of the Manager in its entirety.

We understand it is not meant to eliminate the powers and authorities that were on the list, but rather is to be left up to the shareholders to determine the decision-making mechanism that is most suitable for the company and customize the company's AoA. For instance, the shareholders meeting (or the sole shareholder) as the sovereign decision-making body of the company has the autonomy to delegate those matters within its power to the Board of Directors or a lower level as it deems suitable so long as those rights are not exclusively reserved to the shareholders, for instance the power to decide on issuance of new shares, liquidation and dissolution of the company, and other matters that are integral to the shareholders' interests and responsibilities.

Refined Voting and Proposal Right

In addition to the statutory voting threshold of two-thirds for adopting resolutions on significant matters such as amending the company's AoA, an increase or decrease of the registered capital, or merger, splitting, dissolution or a fundamental change to the form of the company, the New Company Law stipulates that adoption of resolutions on other (i.e., nonsignificant) matters requires a simple majority of the voting rights. (Article 66 for LLCs and 116 for JSLCs) This bridged a gap as the omission in the old law technically allowed a lower thresholding possible in practice. It also suggests that each vote will be counted and every shareholder has the right to vote and be outvoted.

For JSLCs, the New Company Law lowers the submission threshold for shareholder proposals from 3% to 1%. In particular, the law emphasizes that the company shall not raise such submission threshold for shareholder proposals. (Article 115)

The refined voting and proposal right of shareholders allows minority shareholders to confront management and have their voices heard, while the majority shareholders may dominate the decision-making of the company in daily operation.

Streamlined Procedures for Equity Transfer

The New Company Law simplifies the procedures for LLC shareholders to transfer their equity interests to a person other than the existing shareholders of the company by removing the requirement for consent of a majority of shareholders of the company.

Unless otherwise provided under the AoA, the transferring shareholder now only needs to notify other shareholders of the key terms of the proposed equity transfer, including the quantity of the equity interests to be transferred, price, payment method, and terms, which other existing shareholders may choose to exercise the right of first refusal by responding to the transferring shareholder within 30 days. (Article 84)

Recommendations for Foreign Investors

Foreign investors, especially if they are minority shareholders in joint ventures, are recommended to conduct a comprehensive review of the company's AoA and update the provisions accordingly to leverage the protection or flexibility provided under the New Company Law.

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Furthermore, the New Company Law does not exclude contractual protections for shareholders. In particular, there are still many details concerning the investors regardless of the general principles established in the New Company Law. For instance, for a dissenting shareholder to exercise the redemption right, the New Company Law does not specify what activities of the controlling shareholder can be deemed as having "abused its power" or "seriously damaged the interests of the company and its minority shareholders," and what is "a reasonable price" for the redemption.

While such issues are to be interpreted by the court in specific cases, to avoid uncertainty of the outcome in case a dispute arises it is important for investors to consider these issues beforehand and stipulate desired resolutions of such issues in the AoA or shareholders' agreement, such as the agreed appraisal firm or mechanism to determine the "reasonable price," as well as matters that are pertinent to minority shareholders' interests.

ADAPTING TO STRENGTHENED CAPITAL CONTRIBUTION REQUIREMENTS

The New Company Law introduces significant changes to the existing capital contribution rules, concerning all limited liability companies in mainland China and their investors.

This section provides a snapshot of some of the key changes and new requirements that may impact FIEs' operation in China.

Five-Year Time Limit for Capital Contribution

The New Company Law stipulates a five-year time limit for shareholders to pay their subscribed capital that is applicable to all LLCs.

For LLCs established on or after July 1, 2024, the New Company Law requires that shareholders fully pay their subscribed capital, including subsequent capital increases to the company, within five years.

Following the issuance of the New Company Law, the State Council of China issued a regulation for implementation of the new capital contribution requirements as stipulated in the New Company Law, also effective on July 1, 2024, which specially addressed the ambiguity of application of the new rules to existing companies that were established before June 30, 2024.

According to such regulation, for an LLC that was established before July 1, 2024 and whose remaining capital contribution period exceeds five years from July 1, 2027, the company shall, prior to June 30, 2027, adjust such capital contribution period to within five years and amend the AoA accordingly. In brief, for existing companies that were established before June 30, 2024, the deadline for shareholders' capital contributions is June 30, 2032.

The State Council's regulation also clarified the application of new capital contribution rules on JSLCs that the founding shareholders shall fully pay their subscribed shares before June 30, 2027.

More Flexibility for Method of Capital Contribution

As a response to the practical dynamics of capital contribution, the New Company Law expands the scope for assets that can be used by shareholders for their capital contribution. According to Article 48 (for LLCs) and Article 98 (for JSLCs), in addition to cash shareholders can also contribute capital using noncash assets, including in-kind, intellectual property rights, land use rights, equity and debt claims, to the extent such noncash assets can be professionally appraised and are legally transferable.

Furthermore, the Measures (defined below) introduce two new types of in-kind contribution, including data and virtual assets, to the extent the ownership of such assets can be recognized under the laws. This is to be explored in practice. For instance, both the regulator and investors need to figure out how to make capital contributions with data while maintaining compliance with the data privacy and personal data protection regulation.

Enhanced Public Disclosure Requirements

On December 30, 2024, the SAMR (the corporate registration authority in China) issued the Implementing Measures for the Administration of Company Registration (the Measures), which entered into effect on February 10, 2025 and provided specific public disclosure requirements for shareholders capital contribution.

In addition to the existing corporate registration that is required for the change of a company's registered capital, the Measures further require that, in case of any change to the subscribed or paid-in capital, the

method or timeline of capital contribution, or the shares subscribed by the founding shareholders (for JSLCs), the company shall publish such information to the public through the National Enterprise Credit Information Publishing System within 20 working days after such change occurs. The company shall ensure that all such publicized information is authenticate, accurate, and complete.

The Measures reiterate the five-year time limit and further state that the SAMR may ask the company to timely adjust the capital contribution period and/or amount of registered capital if they are deemed abnormal and inconsistent with the authenticity and reasonableness principles based on the SAMR's judgment, taking in account multiple considerations such as the business scope, operation status, and the shareholder's capacity of capital contribution, major business, and asset scale.

Acceleration of Shareholders' Capital Contribution

Before the New Company Law took effect, per the Minutes of the National Court Work Conference for Civil and Commercial Trials issued by the Supreme People's Court of China in 2019, shareholders are not required to accelerate their capital contribution even if corporate creditors claim so, with the exception of two circumstances: first, the court has exhausted company assets for enforcement and the company has met the requirements for bankruptcy but has not initiated the bankruptcy proceeding; or, second, the shareholders resolved to extend the timeline for capital contribution despite the occurrence of corporate debts.

To better protect corporate creditors who may have relied on the registered capital of the company in practice, Article 54 provides that if an LLC cannot meet its financial obligations to creditors as debts become due, the company or the creditors may demand an acceleration of the capital contribution by such shareholders that have not yet paid their subscribed capital.

Liabilities of Violating the New Capital Contribution Rules

The New Company Law lays out a series of measures to urge shareholders to make capital contributions in accordance with the law and the company's AoA. A failure to do so may cause the shareholders and other stakeholders of the company (such as other shareholders or the Directors of the company) to be subject to civil and even administrative liabilities.

Failure to Timely Make a Capital Contribution

Under the New Company Law, LLC shareholders that fail to pay capital contribution shall indemnify the company of the incurred losses in addition to making up the shortfall. (Article 49) For shareholders that fail to make capital contribution in accordance with the AoA, and upon demand by the company still fail to meet their obligations during the grace period provided by the company, they may lose the rights to the subscribed but unpaid equity interests of the company. Such equity interests can then be canceled by the company via a capital reduction, transferred to a third party, or allocated to other shareholders of the company on a pro rata basis. (Article 52)

In particular, the New Company Law provides that an innocent shareholder will be on the hook if other shareholders fail to meet their obligation: if upon the incorporation of the LLC a shareholder fails to make actual capital contribution or the value of the in-kind capital contribution is obviously lower than the subscribe capital, other founding shareholders shall be jointly liable for the defective capital contribution. (Article 50)

Furthermore, the Board of Directors is responsible for examining the shareholders' capital contribution and sending demand letters to those shareholders who fail to meet their capital contribution obligation in accordance with the company's AoA. The Directors that fail to perform the above obligations, and thus cause losses to the company, shall indemnify the company. (Article 51)

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Withdrawal of Paid Capital Contribution

The old law did not specifically address the liabilities of other stakeholders other than the shareholder at fault. However, in judicial practice, the court would hold the other shareholders, directors and senior management, or actual controller of the company who assisted such capital withdraw jointly liable upon the demand of the company, other shareholders, or the corporate creditors, in accordance with the Provisions of on Several Issues Relating to Application of the Company Law of the PRC (III) (Amended in 2020) issued by Supreme People's Court.

The New Company Law adopts a more balanced approach. Article 53 provides that the responsible directors, supervisors, and senior management shall be jointly liable with the shareholder at fault toward the company, without mentioning the actual controller of the company. In light of the general principle that the new law will prevail, we expect that judicial interpretation will be reconciled with the New Company Law in this regard.

Administrative Liabilities for False Capital Contribution or Withdrawal of Capital

The New Company Law generally follows the old rules in terms of the administrative liabilities of the shareholder for a false capital contribution or withdrawal of capital. That said, the direct responsible persons in charge or other direct responsible persons now are also made liable for a shareholder's violation.

In particular:

- If a shareholder has made a false capital contribution or has failed to make (or failed to timely make) the capital contribution, such shareholder will be imposed a penalty from RMB 50,000 to RMB 200,000, or in serious cases a penalty of 5% to 15% of the amount of the false or unpaid capital contribution. The direct responsible persons in charge or other direct responsible persons will also be imposed a penalty of RMB 10,000 to RMB 100,000. (Article 252)
- If a shareholder has withdrawn the paid-in capital, such shareholder will be imposed a penalty of 5% to 15% of the withdrawn amount. The direct responsible persons in charge or other direct responsible persons will also be imposed a penalty of RMB 30,000 to RMB 300,000. (Article 253)

Liabilities of Transferor and Transferee for Unpaid/Underpaid Capital Contribution

The New Company Law also adjusts the mechanism of liability allocation between the transferor and transferee with respect to unpaid or underpaid capital in an equity transfer.

Article 88 provides that, regardless of the equity transfer, the transferor remains responsible for liabilities of unpaid or underpaid capital contribution. More specifically, while the transferee would be the primary obligator to pay the subscribed but unpaid capital, if the transferee fails to timely make the capital contribution the transferor shall then pitch in and undertake the supplementary liability.

In particular, the transferor and transferee shall be jointly liable if the capital contribution is not paid according to the schedule provided under the AoA or if the valuation of the in-kind contribution is obviously lower than the value of the subscribed capital. The transferee cannot be discharged unless one does not know and has no reason to know the above-mentioned situation.

This newly added provision has sparked heated controversy in practice since it was publicized. On one hand, the transferor would be concerned about being accountable for an infinite period, regardless of the closing of the equity transfer, as it will be liable if the transferee is unable or unwilling to make the capital

contribution, which could be beyond the transferor's control; on the other hand, the transferee would also be concerned about the potential risks arising from the historical in-kind capital contribution that was made by the transferor, unless it may prove that it was not and has no reason to be aware of such defective capital contribution.

Article 88 has a universal impact on shareholders of all limited liability companies in mainland China. Due to the controversial views on Article 88, the Supreme Court of China confirmed that the abovementioned Article 88(1) of the New Company Law will not be applied retroactively to equity transfers made before July 1, 2024.

Best Practices for Foreign Investors and FIEs

- Foreign investors and FIEs should conduct a comprehensive review of the company's AoA, in particular the articles on capital contribution, to make necessary adjustments in conformity with the new rules.
- Foreign investors should monitor the implementation of the New Company Law in terms of the changes to the existing corporate registration/filing system and their impact on relevant stockholders' rights and liabilities.
- Foreign investors are recommended to strategize their capital injection for investment in China and optimize their cash flow management by evaluating and leveraging available alternatives to traditional capital injection methods.
- For investors that are seeking a disinvestment in mainland China, to ensure a clean exit from the company through an equity transfer it is important for the transferor to make the capital contribution for the equity interests a covenant of the transferee along with robust indemnification clause, to the extent that the capital contribution has not yet been fully paid for the transferred equity.
- Expecting acquirers should make it a condition precedent to closing of the transferor that the transferor has fully paid the capital contribution of the transferred equity, if possible. The transferee or the buyer that acquires equity of a Chinese company should be more cautious of the legitimacy and compliance of historical in-kind capital contribution during the due diligence.

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