

# EXAMINING THE PROSPECTS OF CORPORATE CAPITAL SYSTEM: ANALYSIS OF ARTICLE 47 OF THE AMENDED PRC COMPANY LAW

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## EXAMINING THE PROSPECTS OF CORPORATE CAPITAL SYSTEM: ANALYSIS OF ARTICLE 47 OF THE AMENDED PRC COMPANY LAW

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### *Abstract*

*The corporate capital system under the PRC Company Law has undergone numerous revisions since its inception and was recently updated in the Amendment adopted in December 2023. This Article provides an overview of the system's legislative modifications and relevant complementary provisions, including capital paid-up requirements, shareholder default prevention mechanisms, and share transfer regulations. By drawing comparisons between the revised provisions and their predecessors, this Article analyzes the tension behind the corporate capital system, namely between the protection of shareholders' and creditors' rights, and aims to unravel the legislators' effort to balance them in the recent Amendment.*

*Keywords: Capital Contribution System; Corporate Capital System; Shareholders' Right Protection.*

### I. INTRODUCTION

On December 29, 2023, the seventh meeting of the Standing Committee of the 14th National People's Congress voted to adopt the Amended PRC Company Law, which will come into effect on July 1, 2024. One of the most eye-catching changes, as mentioned by the head of the Legislative Affairs Commission, is the improvement of the corporate capital system.<sup>1</sup> Specifically, Article 47 was revised to require the shareholders of limited liability companies to fully pay up their subscribed capital amount within five years, in contrast to the current company law, which does not place a limit on the maximum period. Among the mixed comments this revision has received, it is often forgotten in the debate that this system has already undergone several significant changes since its introduction to the PRC Company Law, and any assessment of the newly amended one should be based on historical analysis.

To accomplish this purpose, this paper is divided into three chapters. The first chapter traces the history of the corporate capital system under the PRC Company Law since its introduction in 1993 to the Amended PRC Company Law, with attention paid to the impetus of each change. Secondly, this paper analyzes its complementary provisions and discusses the policy objective

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<sup>1</sup> Quanguo Renda Changweihui Fagongwei Xiangguan Fuzeren Jiedu Guowuyuan Zuzhi Xiuding Caoan(全国人大常委会法工委相关负责人解读国务院组织法修订草案)[The relevant person in charge of the Legal Affairs Commission of the Standing Committee of the National People's Congress interpreted the draft amendment to the State Council Organization Law], Xinhuashe, Website (Mar. 6, 2024), <http://www.news.cn/20240306/46d4a1a43a3c437496bd15bb05396d14/c.html>.

behind Article 47 of the Amended PRC Company Law. It considers how these goals were planned to be met through specific provisions. Lastly, an outlook on the impact of the newly amended capital subscription system is discussed, which concludes the analysis.

## II. DEVELOPMENT OF THE CORPORATE CAPITAL SYSTEM UNDER PRC COMPANY LAW

In the more than thirty years since the PRC Company Law came into effect in 1993, the regulation of China's corporate capital system has gone through a total of four periods ranging from stringent to lax and then to strict, namely the paid-up capital system period from 1993 to 2005, the relaxed paid-up capital system from 2005 to 2013, the capital subscription system from 2013 to 2023, and finally returning to the relaxed paid-up capital system in 2023. As each revision reflects, to some extent, the real needs of our society and economy and, in turn, influences both by acting on the corporate governance structure, this chapter aims to trace the development of the corporate capital system to analyze social and economic impetus.<sup>2</sup>

### A. 1993-2005: *The Paid-up Capital System*

1993 witnessed the release of the first Company Law of China since the Reform and Opening-up. At that time, most of the major companies in China were state-owned enterprises ("SOEs"), making the Company Law largely tailored to regulate them. Moreover, the theoretical underpinning of the Company Law was significantly shaped by the so-called "Three Principles of Capital."<sup>3</sup>

The name may confuse the reader when first encountering it, as these principles are not found in any national legislation, but are based on a doctrinal summary of specific provisions in several countries,<sup>4</sup> containing the principle of capital specification (资本确定原则), the principle of capital maintenance (资本维持原则), and the principle of capital fixedness (资本不变原则). The principle of capital specification governs the initial determination of corporate capital, and requires the capital to be stipulated in the Articles of Association ("AOA") upon corporate establishment, fully subscribed by the shareholders, and paid in on time.<sup>5</sup> The principle of capital maintenance limits the freedom

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<sup>2</sup> Zhu Ziyun, Shen Zhaohui(朱慈蕴, 沈朝晖), Leibiegu Yu Zhongguo Gongsifa De Yanjin(类别股与中国公司法的演进)[Class Shares and the Evolution of Chinese Company Law], ZHONGGUO SHEHUI KEXUE(中国社会科学)[Social Sciences in China], 09(2013).

<sup>3</sup> Zhao Wanyi(赵万一), Ziben San Yuanze De Gongneng Gengxin Yu Jiazhi Dingwei(资本三原则的功能更新与价值定位)[Functional Renewal and Value Proposition of the Three Principles of Capital], FAXUE PINGLUN(法学评论)[Law Review], 01(2017).

<sup>4</sup> Zhu Ziyun (朱慈蕴), Zhongguo Gongsifa Ziben Zhidu Tixihua Zaizao Zhi Sikao (中国公司资本制度体系化再造之思考) [Thoughts on the Systematic Reconstruction of China's Corporate Capital System], FALV KEXUE (XIBEI ZHENGFA DAXUE XUEBAO) (法律科学(西北政法大学学报)) [Legal Science (Journal of Northwest University of Political Science and Law)], 39(03)(2021).

<sup>5</sup> Li Jianwei (李建伟), Gongsifa Ziben De Hexin Gainian Shuzheng (公司资本的核心概念疏证) [An Analysis of the Core Concept of Corporate Capital], BEIFANG FAXUE (北方法学) [Northern Legal Science], 10(01)(2016).

of corporate management by demanding the company to maintain during its existence property equal to the total amount of its registered capital.<sup>6</sup> The principle of capital fixedness provides that corporate capital can only be adjusted through certain procedures specified by national legislation rather than being entirely at the discretion of the company.<sup>7</sup> The Three Principles of Capital was warmly received by the 1993 Company Law for its emphasis on public welfare, market stability, and protection of creditors' rights.<sup>8</sup>

Against this backdrop, the 1993 Company Law stipulates the most rigid corporate capital system thus far. Firstly, Article 23 sets out the minimum amounts of registered capital for companies, the lowest of which is RMB 100,000. Secondly, the paid-up capital system was established in Article 25, requiring shareholders to fully invest the capital contribution they have subscribed for in the AOA. Thirdly, the authenticity of contributed capital must be verified before registration. As provided in Articles 26 and 27, only after the confirmation by a legally prescribed capital verification agency can the shareholders or the agent jointly apply for the registration of the company.

### B. 2005-2013: The Relaxed Paid-up Capital System

The paid-up capital system, together with the theoretical foundation, was seriously challenged in the first few years of the 21st century, leading to its relaxation in the 2005 Company Law. In the meantime, the reconstruction of SOEs proceeded towards its finalization, and the Chinese economy became more than ever intertwined with the global market after becoming a member of the World Trade Organization.<sup>9</sup> The stringent regulation of the 1993 Company Law was widely considered an institutional disadvantage for the flourishing of private companies, hereby hampering China's economic development.<sup>10</sup>

To address the abovementioned shortcomings, the 2005 Company Law adopted a less stringent approach by relaxing the specific regulations in the paid-up capital system. Specifically, the minimum amount of registered capital was lowered to RMB 30,000, as provided in Article 26. Also, shareholders were obliged to invest in at least 20% of the registered capital at the time of corporate establishment, while the remaining part should be paid up within 2 years. However, this revision does not shake the dominance of the Three Principles of Capital as the theoretical underpinning, as can be easily discerned from the fact that

<sup>6</sup> Zhang Baohua (张保华), Ziben Weichi Yuanze Jiexian——Yi “Weichi” De Wudu Yu Chengqing Wei Shijiao (资本维持原则解析——以“维持”的误读与澄清为视角) [Analysis of the Principle of Capital Maintenance: A Perspective on Misinterpretations and Clarifications of “Maintenance”], FAZHI YANJIU (法治研究) [Rule of Law Studies], (04)(2012):63-73.

<sup>7</sup> Zhao Wanyi, *supra* note 3, 84.

<sup>8</sup> Zhao Wanyi, *supra* note 3, 85.

<sup>9</sup> Zhu Ciyun, *supra* note, 62.

<sup>10</sup> Shi Tiantao (施天涛), Gongsì Ziben Zhìdù Gǎigé: Jiědù Yú Biǎnxì (公司资本制度改革: 解读与辨析) [Reform of the Corporate Capital System: Interpretation and Analysis], QINGHUA FAXUE (清华法学) [Tsinghua Law Review], 8(05)(2014); Zhao Xudong (赵旭东), Gongsì Fǎ Xiūding De Jībēn Mùbiāo Yú Jiàzhíxiàng (公司法修订的基本目标与价值取向) [The Basic Objectives and Value Orientation of the Amendment of Company Law], FAXUE LUNTAN (法学论坛) [Legal Forum], (06)(2004).

the threshold of corporate capital was not abolished, the paid-up period was still limited, and the requirement of capital verification was not changed.

The relaxed paid-up capital system proposed by the 2005 Company Law points out a conundrum in corporate capital regulations, i.e., how to balance the protection of creditors' rights and shareholders' rights. In sharp contrast to its predecessor, the paid-up capital system allows partial capital contribution upon corporate establishment, enhancing flexibility on corporate governance while simultaneously creating the risk of fictitious registered capital. The risk will be ultimately transmitted to creditors, who have only limited knowledge of the daily operation of the company and can claim rights against the company only at a specific point in time when the capital risk may have crystallized.<sup>11</sup> The 2005 Company Law attempted to resolve this challenge by regulating penalties, setting the stage for subsequent revisions. For example, Article 199 provides fines and other penalties for fictitious capital registers. However, with essential terminologies such as "capital withdrawal" remaining undefined, various detailed provisions are required to set up the whole framework.

### C. 2013-2023: The Capital Subscription System

The 2005 Company Law was a huge leap forward from its predecessor, but it was still characterized as rigor compared with relevant legislation in developed countries such as the United Kingdom and the United States.<sup>12</sup> Moreover, as the development of legislation in civil law systems has been more fully examined, the sanctification of the Three Principles of Capital is also seriously questioned.<sup>13</sup> As a result, the 2013 Company Law brought forth the capital subscription system to replace the paid-up capital system.

In the capital subscription system, the minimum amount of registered capital was finally abandoned, minimizing the cost of the corporate establishment. More importantly, shareholders were entirely free to stipulate the period of capital investment, without any regulatory restraint. The amount of invested capital was also no longer required to be listed in the business license. In addition, the compulsory capital verification system was abolished, rendering its necessity subject only to the company itself. The capital subscription system was further complemented by revisions regarding share repurchase in 2018. By expanding the scope and circumstances under which a company can repurchase equity, it strikes at the traditional corporate capitalization system and enhances the flexibility of corporate governance.<sup>14</sup>

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<sup>11</sup> Zhu Ciyun, *supra* note, 58.

<sup>12</sup> Shi Tiantao (施天涛), *Gongsi Fa Lun* (公司法论) [Company Law Theory], 176(2018).

<sup>13</sup> Liu Yingshuang (刘迎霜), *Gongsi Ziben San Yuanze Neizai Maodun Zhi Tanjiu* (公司资本三原则内在矛盾的探究) [Exploration of the Internal Contradictions of the Three Principles of Corporate Capital], *SHEHUI KEXUE* (社会科学) [Social Sciences], 03(2008); Zhao Wanyi, *supra* note 3, 82.

<sup>14</sup> Wang Guojun, Zheng Yuxin, Zhu Qingjing, et al. (王国俊, 郑宇昕, 朱晴婧, 等), *Guoneiwai Gufen Huigou Yanjiu: Wenxian Huigu Yu Yanjiu Zhanwang* (国内外股份回购研究:文献回顾与研究展望) [Research on Stock Repurchase at Home and Abroad: Literature Review and Research Prospects], *XUEHAI* (学海) [Academic Seas], 05(2019).

The 2013 Company Law also refines the penalty mechanism, some of which were further developed by accompanying judicial interpretations. To cite one example, “capital withdrawal” was narrowed down to four categories, namely making false financial accounting statements to inflate profits for distribution; transferring out the capital contribution by fictitious debt relationship; transferring out the capital contribution by utilizing related transactions; and other acts of withdrawing capital contributions without legal procedures.<sup>15</sup> Also, the acceleration of outstanding capital contributions in a non-bankrupt context was finally introduced in a Meeting Minutes publicized in 2019.<sup>16</sup>

#### *D. 2023 Company Law: The Relaxed Paid-up Capital System*

The capital subscription system proved efficient and conducive for commercial practices, but it had flaws. It is conceivable that canceling the period of capital investment enabled and even encouraged companies to set the deadline on a distant date to reduce the financial pressure on their shareholders.<sup>17</sup> Coupled with the fact that more than half of Chinese companies are dissolved or bankrupted within five years of their establishment,<sup>18</sup> shareholders were able to shift the risk of the company’s operational failure to its creditors through this practice, who did not share the benefit of the capital investment period.<sup>19</sup> To avoid this circumstance, the creditor would conduct more substantial due diligence on the target company before the investment, instead of relying on the registered capital amount.<sup>20</sup> Together, the mistrust of the corporate registered capital will lead to an increase in transaction costs and a deterioration of the market environment.<sup>21</sup>

<sup>15</sup> Zuigao Renmin Fayuan Guanyu Shiyong 《Zhonghua Renmin Gongheguo Gongsì Fa》 Ruogan Wenti De Guiding (San) (最高人民法院关于适用《中华人民共和国公司法》若干问题的规定(三)) [Provisions of the Supreme People’s Court on Several Issues Concerning the Application of the “Company Law of the People’s Republic of China” (III)] (promulgated by Sup. People’s Ct. Dec. 6, 2010, last amended Dec. 2020, effective Jan. 1, 2021).

<sup>16</sup> Quanguo Fayuan Minshangshi Shenpan Gongzuo Huiyi Jiyao (全国法院民商事审判工作会议纪要) [Minutes of the National Conference on Civil and Commercial Trial Work of Courts].

<sup>17</sup> Zhu Ziyun (朱慈蕴), Gudong Chuizi Yiyi De Xingzhi Yu Gongsì Ziben Zhidu Wanshan (股东出资义务的性质与公司资本制度完善) [The Nature of Shareholders’ Capital Contribution Obligations and the Improvement of the Corporate Capital System], QINGHUA FAXUE (清华法学) [Tsinghua Law Review], 16(02)(2022).

<sup>18</sup> Gongshang Zongju Jinqi Fabu Quanguo Neizi Qiye Shengcun Shijian Fenxi Baogao (工商总局近日发布全国内资企业生存时间分析报告) [The State Administration for Industry and Commerce Recently Released the National Analysis Report on the Survival Time of Domestic Enterprises], Zhongyang Renmin Zhengfu Wang (中央人民政府网) [Central People’s Government of the People’s Republic of China Website], July 30, 2013, [https://www.gov.cn/gzdt/2013-07/30/content\\_2458145.htm](https://www.gov.cn/gzdt/2013-07/30/content_2458145.htm).

<sup>19</sup> Liu Yingshuang (刘迎霜), Ziben Renjiaozhi: Gudong Chuizi Ziyou Yu Gongsì Ziben Zizhi (资本认缴制：股东出资自由与公司资本自治) [Capital Subscription System: Shareholders’ Freedom of Contribution and Corporate Capital Autonomy], ZHENGZHI YU FALV (政治与法律) [Politics and Law], (08)(2023).

<sup>20</sup> Zhu Ziyun (朱慈蕴), Youxian Zeren Gongsì Quanmian Renjiaozhi Gai Hequhecong?——Jianping 《Gongsì Fa (Xiuding Caoan Sishengao)》 Di 47 Tiao (有限责任公司全面认缴制该何去何从?——兼评《公司法(修订草案三审稿)》第47条) [Where Should the Comprehensive Subscription System of Limited Liability Companies Go?—Commentary on Article 47 of the “Company Law (Third Draft Amendment)”], XIANDAI FAXUE (现代法学) [Modern Law Science], 45(06)(2023).

<sup>21</sup> Zhu Ciyun, *supra* note 20.

The 2023 Company Law addressed this problem by distinguishing limited liability companies (“LLCs”) from joint-stock companies in Article 47. Shareholders of LLCs are required to pay their subscribed capital in full within five years of the corporate establishment. Concerning the joint-stock companies, its shareholders must pay the shares subscribed in full at the time of corporate establishment. Moreover, as described in the next chapter, many supporting regulations have been put in place to smooth the transition from the capital subscription system to the relaxed paid-up capital system.

### III. COMPLEMENTARY REGULATIONS TO ARTICLE 47 OF THE AMENDED PRC COMPANY LAW

The revision of the corporate capital system was far from a change that can be summarized in a single article. On the contrary, considering its intricacy and unquestioned key position in corporate regulation, it must have numerous complementary provisions to achieve the desired effect. Therefore, this chapter digests the detailed provisions associated with the reconstruction of the relaxed paid-up capital system in the 2023 Company Law as well as the newly publicized consultation draft of the Provisions of the State Council on Implementing the Registered Capital Registration Administration System under the Company Law of the People’s Republic of China (“the Consultation Draft”), aiming to analyze the significance of Article 47 in a more comprehensive context.

#### A. *Capital Paid-up Requirements*

In both the 2023 Company Law and the Consultation Draft, specific requirements about capital paid-up were regulated including the authorized capital system and the transition arrangements.

Firstly, one of the most noteworthy changes in the 2023 Company Law is introducing an authorized capital system for joint-stock companies. As stipulated in Article 152, the articles of association or the shareholders’ meeting may authorize the board of directors to decide to issue not more than 50% of the shares that have been issued within three years. Nevertheless, if the capital contributions are to be made using non-monetary property, they shall be subject to a resolution made by the shareholders’ meeting. As shown in its convoluted revision history, this bifurcation represents the compromise between values.<sup>22</sup> On the one hand, the first prone highlights the autonomy of the board of directors in deciding the issuance of shares but attempts to restrain its competence by limiting the percentage of shares allowed to be issued and the issuance period. On the other hand, the second prone stresses the importance of shareholder dominance in non-monetary property contributions. The rationale behind this is to prevent the board from improperly valuing non-monetary assets to the

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<sup>22</sup> Gongsì Fa (Xiuding Caoan)(《公司法(修订草案)》) [Company Law (Draft Amendment)], reviewed at the 32nd meeting of the Standing Committee of the 13th National People’s Congress in December 2021 and the 38th meeting in December 2022.

detriment of shareholders.<sup>23</sup> Nevertheless, it failed to answer the question of why shareholders are in a better position to value these assets, thus running the risk of contradicting the value base of the authorized capital system itself.<sup>24</sup>

Secondly, as provided in Article 266 of the 2023 Company Law, the State Council should set out specific instructions for existing companies to adapt to the legislation, which was contained in the Consultation Draft. Article 3 of the Consultation Draft divided LLCs into three categories and listed different capital investment requirements. For LLCs whose paid-up periods end within 5 years from July 1st, 2027, no adjustments are necessary. However, for those with paid-up periods ending after 5 years from July 1st, 2027, the company must adjust the period to within 5 years during a transition period of 3 years, allowing for a maximum period of 8 years. If the company fails to make this adjustment within the transition period, the government department responsible for company registration can require them to do so within 90 days and is entitled to mark out this irregularity on the National Enterprise Credit Information Publicity System (“the NECIPS”) to warn its potential investors. Article 3 also required joint-stock companies established using promotion and the subscribed capital is not fully contributed to pay up the remaining part within 3 years starting from July 1st, 2024, but penalties for default were not listed.

Thirdly, the legislation gave attention to the companies of which the capital contribution is “obviously abnormal”, allowing company registration authorities to require an adjustment “in a timely manner.” Further regulations were included in the Consultation Draft. Article 7 delineated the criteria to consider when estimating whether a company falls within this category, including the shareholders’ ability to contribute capital, the main business project, the scale of assets, the authenticity of registered capital, etc. If an obvious abnormality exists, relevant market regulation authorities may permit the company to adjust the capital contribution amount or period within six months to conform with the requirements listed above. For companies established after the 2023 Company Law takes effect, Article 9 forbids their registration if its registered capital is obviously too high, contrary to objective common sense and the characteristics of the industry, or the shareholders cannot pay up the capital, etc.

Also, the Consultation Draft established a disclosure system for information related to capital subscription and contribution in numerous provisions. For instance, Article 3 requires the adjusted capital contribution period to be recorded in its articles of association and updated on the NECIPS. Likewise, information related to shareholders’ capital contribution, including the method and date of capital contribution and transfer of shares, must be disclosed. To ensure compliance, the Consultation Draft empowers the company registration authority to

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<sup>23</sup> Ma Gengxin, An Zhenlei (马更新, 安振雷), Chongsu Ziben Xingcheng: Shouquan Ziben Zhi De Bentuhua Jianju (重塑资本形成：授权资本制的本土化建构) [Reshaping Capital Formation: Localization Construction of Authorized Capital System], JINGMAO FALV PINGLUN (经贸法律评论) [Journal of Economic and Trade Law Review], (03)(2023).

<sup>24</sup> Feng Guo (冯果), Lun Shouquan Ziben Zhi Xia Renjiao Zhi de Qu yu Liu (论授权资本制下认缴制的去与留) [On the Retention and Abolishment of Paid-in Capital Subscription System under Authorized Capital System], ZHENGFA LUNFANG (政法论坛) [Political Science and Law Forum], 40(06) 2022.



oversight through inspections by randomly selected inspectors of randomly selected entities and the public release of inspection results. Information sharing between departments and hierarchical and categorical regulations are also envisaged.

Lastly, the Amendment incorporated regulations on the acceleration of outstanding capital contributions, which was previously covered only by the Minutes of the National Court Work Conference for Civil and Commercial Trials issued by the Supreme People's Court in 2019. In contrast to its predecessor, the 2023 Company Law provides that the company may require shareholders to make early contributions in addition to its creditors. As the company bases its rights on the contribution agreement with its shareholders but the creditor's rights originated from the subrogation of the company's rights, the creditors may claim early contribution only to the extent of the lesser of the unpaid capital of the shareholder and its unliquidated claims against the company. In contrast, the company may claim full payment of the unpaid capital of the shareholder.<sup>25</sup> Also, Article 54 of the 2023 Company Law explicitly recognized that in the absence of bankruptcy, shareholder contributions can accelerate if the company is unable to repay its debts as they fall due. The "inability to repay" test distinguishes the accelerated contribution regime under the Company Law from the eponymous regime under the Bankruptcy Law, which aims precisely at expanding the bankruptcy estate, whereas the former aims at sustaining the company's operations.<sup>26</sup> Although the definition of the "inability to repay" criterion is still subject to a variety of arguments, such as the company ceasing to make payments, shareholders being added as executors, etc., and the law does not provide a precise definition, a more appropriate way of understanding is to treat "the company's assets are in fact incapable of repaying its debts" as a criterion for satisfying the test to avoid abuse.<sup>27</sup>

<sup>25</sup> Shen Zhaohui (沈朝晖), Chongsu Fading Ziben Zhi——Cong Wanzheng Renjiao Dao Xianqi Renjiao de Dongtai Xitong Tiaoshi (重塑法定资本制——从完全认缴到限期认缴的动态系统调适) [Reshaping the Statutory Capital System: Dynamic Adjustment from Full Subscription to Limited Term Subscription], ZHONGGUO FALV PINGLUN (中国法律评论) [China Legal Review], (02)2024; Liu Junhai (刘俊海), Lun Gongsì Zhaiquan Ren Dui Xiayi Chuzi Gudong de Daiwei Quan——Jian Ping "Gongsì Fa (Xiuding Cao'an Ershen Gao)" (论公司债权人对瑕疵出资股东的代位权——兼评《公司法（修订草案二审稿）》) [On the Subrogation Rights of Corporate Creditors against Defective Contributing Shareholders—With Comments on the Second Draft of the Company Law Amendment], ZHONGGUO YINGYONG FAXUE (中国应用法学) [China Applied Jurisprudence], 2023(01).

<sup>26</sup> Shen Zhaohui, *supra* note 25.

<sup>27</sup> Lin Yiying (林一英), Gongsì Zhuce Ziben Renjiao Dengji Zhi de Wanshan [公司注册资本认缴登记制的完善] [Improvement of the Paid-in Registration System of Company Registered Capital], GUOJIA JIANCHAGUAN XUEYUAN XUEBAO (国家检察官学院学报) [Journal of National Prosecutors College], 2023, 31(06); Ding Yong (丁勇), Gu Dong Chu Zi Qi Xian Dui Kang de Jiao Zheng yu Gui Zhi [股东出资期限对抗的矫正与规制] [Correction and Regulation of Shareholders' Confrontation on Contribution Period], BEIJING DAXUE XUEBAO (ZHEXUE SHEHUI KEXUE BAN) (北京大学学报(哲学社会科学版)) [Journal of Peking University (Philosophy and Social Sciences)], 2023, 60(06); Liang Shangshang (梁上上), Gongsì Zhengyi: Yi Gongsì Gudong de Quanze Peizhi Wei Shijiao Zhan kai (公司正义：以公司股东的权责配置为视角展开) [Corporate Justice: A Perspective on the Allocation of Rights and Responsibilities of Shareholders], 2022, 188—189; Shen Zhaohui, *supra* note 25.

### B. Mechanisms for Dealing with Shareholder Defaults

As mentioned above, the recent amendment marks the shift from prioritizing shareholder rights protection over creditor's rights towards a balanced model.<sup>28</sup> Shareholders' liability in default scenarios is further clarified and expanded in the 2023 Company law to ensure such protection.

Defaults occur when shareholders fail to comply fully, either in form or in substance, with their obligation to make capital contributions. Generally speaking, fictitious capital contributions, failure to pay contributions in full by the end of the period, illicit withdrawal of corporate capital, and illegal capital reduction all constitute shareholder defaults.<sup>29</sup>

The current Company Law demands the shareholder to make up for the difference between the registered and the contributed capital when default occurs, and the other shareholders at the time of company incorporation shall bear joint liability. The 2023 Company Law expands this requirement by providing that the defaulting shareholder shall also compensate the company against any losses incurred by the default. At the same time, however, the joint liability of other shareholders remains the same. This omission is an intentional restriction of liability, deviating from the first consultation draft which provided similar expansion for other shareholders.<sup>30</sup> Moreover, while the first consultation draft envisioned calculating the "loss incurred" by applying the bank interest rate, this provision was deleted in the finalized version.<sup>31</sup>

Besides the expansion of shareholder liability, the 2023 Company Law further restricted the rights of defaulting shareholders to deter acts detrimental to the adequacy of corporate capital.<sup>32</sup> Article 52 creates the shareholder right forfeiture system, enabling the company to issue a written notice of call for capital contribution and designate a compulsory grace period upon any shareholder's failure to make capital contributions on the date following the articles of association. If the shareholder still has not fulfilled the contribution obligation upon the expiration of the grace period, the board of directors may, in the form of a resolution, send a notice of forfeiture to that shareholder. As of the issuance of the notice, the shareholder shall forfeit the equities for which the capital contribution has not been paid. To provide judicial remedies for the affected shareholder, Section 3 of Article 52 allows the shareholder to file a lawsuit with the people's court within 30 days of the receipt of the notice of forfeiture if having any objection.

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<sup>28</sup> Lin Weiyu (林威宇), Renjiao Zhidu Xia Zhaiquan Ren Liyi zhi Baohu——Yi "Gongsi Fa" Xiuding wei Shijiao [认缴制度下债权人利益之保护——以《公司法》修订为视角] [Protection of Creditors' Interests under the Subscription System: Perspective on the Revision of the Company Law], CHANGZHOU GONGXUEYUAN XUEBAO (SHEKE BAN) (常州工学院学报(社科版)) [Journal of Changzhou Institute of Technology (Social Sciences Edition)], 2022, 40(02).

<sup>29</sup> 瑕疵出资股权转让时受让人的责任承担及救济

<sup>30</sup> *supra* note 22.

<sup>31</sup> *Id.*

<sup>32</sup> Yang Yongqing, Pan Yongfeng (杨永清, 潘勇锋), Gongsi Fa Xiuding Ruogan Wenti Tanta [公司法修订若干问题探讨] [Discussion on Several Issues in the Amendment of the Company Law], FALV SHIYONG (法律适用) [Application of Law], 2023, (01).

Establishing the shareholder right forfeiture system has expanded the limitations on defaulting shareholders' rights stipulated in the judicial interpretation of the current Company Law. Firstly, compared to the shareholder right restriction mechanism, which merely restricts the property rights of the defaulting shareholders without limiting their voting rights, the forfeiture of the shareholder's right deprived the defaulting shareholder of the unpaid portion of equity.<sup>33</sup> Secondly, the forfeiture of shareholder's rights is different from the existing disqualification of shareholders in a variety of respects. Disqualification is applicable only when the shareholder completely fails to fulfill the capital contribution obligations or withdraws all contributions, but the forfeiture mechanism applies to those who only partially fulfill the obligations by depriving them of the uncontributed portion of equity.<sup>34</sup> Moreover, the disqualification of shareholders is decided by the general meeting, while the board of directors is entitled to announce the right forfeiture. To conclude, the right forfeiture system provides more flexibility to corporate governance as an alternative to disqualification, but the latter can still serve as a warning to shareholders because of its severe outcome.

To further reduce the risk of shareholder default, the 2023 Company Law strengthened the directors' verification and reminder obligations. Previously, the verification of assets was conducted by third parties to ensure that the contributions were genuine, but this requirement has been abandoned since the 2013 Company Law.<sup>35</sup> The 2023 Company Law adopted the "internal control" model to replace the "third-party control" model, in other words, the board of directors should verify the capital contribution of the shareholders after the incorporation of the company and issue a notice to the defaulting shareholders to call for the payment of the capital contribution. In the event of shareholder default, directors shall be liable for the damages caused to the company by such act if they did not fulfill the foregoing obligations. The implication of this provision is not that the director is at all times liable for the default of the shareholder; rather, the director's obligation as set forth above falls within the scope of the fiduciary duty to show that he or she exercised reasonable care, which is evidenced by the issuance of a written reminder to the defaulting shareholder. Moreover, even if the board of directors failed to perform the obligation, an individual director can be exempt from the liability if he or she has expressed

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<sup>33</sup> Tan Xiao, Zhu Liufen (谈萧, 朱柳畲), Xin "Gongsi Fa" Zhong de Gudong Shiquan Zhidu Tanxi [新《公司法》中的股东失权制度探析] [Analysis of Shareholders' Disenfranchisement System in the New Company Law], ZHONGGUO SHICHANG JIANGUAN YANJIU (中国市场监管研究) [China Market Regulation Research], 2024 (01).

<sup>34</sup> Wang Dongguang (王东光), Gudong Shiquan Zhidu Yanjiu [股东失权制度研究] [Study on Shareholders' Disenfranchisement System], FAZHIZHANG YANJIU (法治研究) [Rule of Law Research], 2023(04).

<sup>35</sup> Guo Fuqing (郭富青), Zhongguo Gongsi Fa de Gongneng Zai Dingwei yu Jiazhi Daoxiang Jiaozheng [中国公司法的功能再定位与价值导向矫正] [Repositioning the Function and Value Orientation Correction of Chinese Company Law], BEIJING LIGONG DAXUE XUEBAO (SHEHUI KEXUE BAN) (北京理工大学学报(社会科学版)) [Journal of Beijing Institute of Technology (Social Sciences Edition)], 2022, 24(05).

disagreement with the vote, and it is recorded in the minutes of the board meeting.<sup>36</sup>

### C. Regulation Regarding the Transfer of Unpaid-up Shares

Under the capital subscription system, it is conceivable that shares are transferred before they are paid up. While the current Company Law did not mention the allocation of contribution responsibility under this scenario, the Judicial Interpretation (III) of the Company Law provided that the transferring shareholder and the transferee in the event that he or she had been aware of the unpaid-up circumstance, should bear joint and several liability. However, this provision does not differentiate between transfers before and after the shareholder default, thus creating conflicts in judgments. To address this issue, the 2023 Company Law provides more specific guidelines regarding the transfer of unpaid-up shares.

Firstly, if the outstanding capital contribution is not yet due at the transfer time, the transferee bears the responsibility for the contribution. If the transferee fails to make a total contribution in the required period, the transferor shall be liable for the outstanding capital contribution.

Secondly, if the transfer occurs when the capital contribution has already become overdue, the transferor bears the liability for the outstanding capital contribution. Moreover, the transferee bears the joint and severable liability unless it was unaware and could not have reasonably become aware of the deficient capital contribution status.

## IV. CONCLUSION

In conclusion, Article 47 of the 2023 Company Law, along with its accompanying regulations, represents a nuanced response to the challenges and opportunities presented by the evolution of China's corporate capital system. Rather than viewing it solely as an advancement or regression from previous laws, it should be understood in the context of the concept of the "benefit of period" originating from civil law. This concept recognizes the benefits enjoyed by parties during a specific timeframe, such as shareholders benefiting from the capital contribution period. While the capital subscription system offered flexibility, it also posed risks, particularly for creditors, by allowing companies to delay contributions. The revision to the system signifies a legislative effort to strike a balance between competing interests, addressing drawbacks while preserving benefits. By adjusting various aspects of the system, legislators aimed to optimize the balance between shareholder flexibility and creditor protection,

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<sup>36</sup> Li Zhenghui (李政辉), Lun Chuzi Xiayi Qingxing Xia Dongshi Dui Zhaiquan Ren Zeze [论出资瑕疵情形下董事对债权人责任] [On the Directors' Liability to Creditors in Cases of Defective Contributions], SHANGHAI ZHENGFA XUEYUAN XUEBAO (FAZHI LUNCONG) (上海政法学院学报(法治论丛)) [Journal of Shanghai University of Political Science and Law (Law Review)], 2024, 39(03); Shen Zhaohui, *supra* note 25.

reflecting careful consideration and adaptation to the evolving economic landscape.

