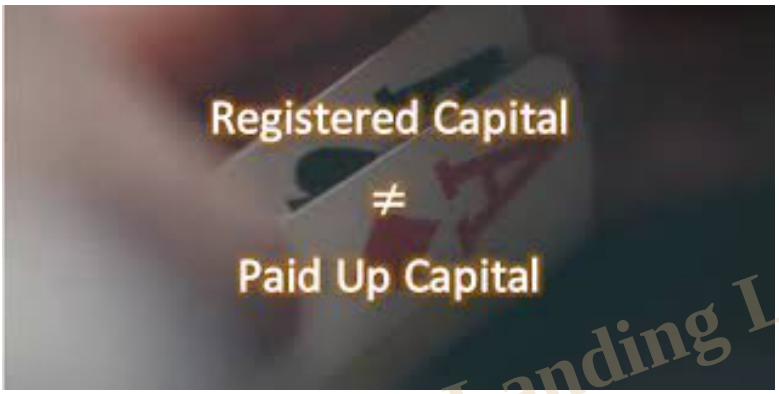
Update on Shareholder Liability for Corporate Debts of Companies under Chinese Laws

Description

We told you before on this blog that creditors can go after a China company's shareholders if these shareholders have not paid up their subscribed capital in the company's registered capital. Click here: Can Creditors Go After Corporate Shareholders Who Have Not Paid up Subscribed Capital in China?



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However, as with other things in China, Chinese laws evolve all the time. On this particular point of corporate creditors going after corporate shareholders, there has been some change in judicial practice. We update you on this development.

I. The Legal Issue in Question

We are talking about whether and when a China court should request a shareholder of a China company who has not paid up the capital he subscribed in the company's registered capital.

A typical scenario for reference: A, B and C cooperated to set up a new company D in 2020, each holding 1/3 of the corporate equities. To make this company look good, they decided on a high amount of registered capital for this company, say RMB 10 million. However, each of them actually paid only a little portion of the registered capital, not more than RMB 1 million in total. On the other hand, in the company's articles of association (AOA, or corporate charter), the due date for paying up all subscribed registered capital is far in the future, 30 years later.

In 2021, the company incurred a debt of RMB 5 million, which made the company insolvent. But the company didn't file for bankruptcy.

The RMB 5 million creditor was desperate in recovering the debt from the company.

II. Minutes of 9th Conference of National Civil Courts

As in the past post super-linked above back in 2017, we said that it was reasonable and just for the

corporate creditor to directly sue the company together with its shareholders A, B and C, and request the shareholders to immediately pay their subscribed capital in the company that has not come due and thus not been paid yet. In judicial practice, it is called “acceleration of capital contribution obligation”.

Many cases are so judged by China courts.

Then there arose arguments to the effect that a shareholder has a time interest in not paying their subscribed capital when it is not due as stipulated in the company’s charter or AOA, and further that creditors can resort to bankruptcy law to protect themselves and punish the company and its shareholders and it will be unjust to other creditors who have not sued the shareholders to accelerate their capital contribution. By the way, according to China bankruptcy law, in the case of bankruptcy proceeding being instituted, the court has the power to order shareholders to accelerate their obligation of capital contribution regardless the time schedule in the company’s articles of association.

So on the 9th conference of China Civil Courts, in the published meeting minutes dated November of 2019, the judges came to reach a consensus that:

(1) Shareholder’s time interests in paying up their subscribed capital at a later time as scheduled in the company’s articles of association; thus, it is not appropriate to ask these shareholders to contribute undue capital to discharge corporate debts;

(2) in the meantime, there are two exceptions to that general rule:

(i) where the company is subject to court enforcement proceeding, there are no other assets available for meeting judgment debts upon exhausting all possible enforcement measures by court, thus legal ground for bankruptcy comes into being, and the company doesn’t apply for bankruptcy; or

(ii) where the company extends the due date for capital contribution after a corporate debt has been incurred.

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According to the new rules, capital contribution acceleration is only triggered in the stage of enforcing a court judgment, meaning it is no longer possible for a creditor to sue a company’s shareholders to accelerate his capital contribution in the same court proceeding in which the creditor sues the company in regard of a debt.

III. Latest Trend

China legislator is overhauling China Company Law. In the draft published in December of 2021, there is an express provision regarding acceleration of shareholder’s obligation to pay up their subscribed capital in a company.

> Article 48 Where a company is unable to discharge its due debts and is apparently insolvent, the company or its creditors shall have the right to request the company shareholders who subscribe for the registered capital of the company to pay up such capital that has not come due yet.
> *Article 48 of China Company Law Draft published in December of 2021*

This draft provision seems to diverge from the provision in the meeting minutes quoted above, leaving more room to apply the rule of accelerating shareholder capital contribution.

The issue has yet to settle pending the enactment of the revised China company law.

Last note, please be advised that rules set out in the Meeting Minutes quoted above are not real law in a strict sense, and in judicial practice, courts may deviate from those rules if they think otherwise based on the merits of cases before them.

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