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Creative Approaches for Investors and Joint Venture Partners to Leverage New PRC Company Law to Take Control of Onshore Chinese Companies

Many Chinese companies are in financial distress, leaving joint venture partners and private credit lenders to risk facing the worst-case scenario of attempting to take over onshore projects, companies and assets. However, a new Chinese company law coming into effect in July 2024 could smooth the path to recovery – including by making it easier to replace the legal representative and therefore take control of onshore companies.

Unfavorable economic conditions in China are putting many onshore companies in distress. This has both strained relations between joint venture partners and put private credit lenders at risk. In worst-case scenarios, both parties face the difficult prospect of attempting a recovery by taking over onshore projects, companies and assets.

A new Chinese company law that comes into effect in July 2024 offers investors and private lenders new powers in high-stakes corporate control fights over onshore companies and assets. Investors now have an easier path to replace legal representatives that, when combined with a multijurisdictional strategy, can more quickly and effectively achieve recovery.

In China, a legal representative is essential in exercising de facto control of an onshore operating company. Companies must have a legal representative who can represent the company in major business activities, such as signing contracts, opening accounts and transacting business.

Under the old legal regime, many local regulators required the incumbent legal representative (controlled by the debtor) to sign off on any transfer of authority to a new legal representative, inadvertently giving debtors an effective veto over any takeover attempts by creditors. Instead, investors were forced to litigate, sometimes for years, during which time the debtor's management would have unfettered control of the company and its assets.

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What Is Changing?

The new law makes clear that when a controlling shareholder attempts to take control of a PRC company, the cooperation and signature of the incumbent legal representative is not required. This means that onshore companies' legal representatives can be changed unilaterally by a creditor, receiver or liquidator acting as or for the controlling shareholder, notwithstanding the objection of the incumbent representative. In addition, the law makes eligible any director or the general manager to become a legal representative, creating a bigger pool of potentially more cooperative candidates.

This unlocks many potential opportunities for offshore investors to takeover onshore PRC companies, particularly if they take advantage of leverage points in both onshore and offshore jurisdictions as part of a coordinated global strategy.

For example, placing a PRC company's offshore holding structure into receivership can meaningfully unlock access to its onshore assets for creditors. Now, without the effective veto of the incumbent, liquidators will have an easier time replacing legal representatives, and realizing onshore assets for private lenders.

Still, obstacles remain. Regional variations in practice will mean that implementation of takeovers will require a highly choreographed approach. In addition, for creditors to obtain absolute control of an onshore company, they would still need to fight for physical control of the company's official seal.

Nevertheless, the new law means private lenders, joint venture partners and other international investors have more potent tools as part of a cross-border campaign to takeover onshore Chinese project companies, giving them access to recoverable claims and assets faster and more effectively than previously possible.

About Kobre & Kim

Kobre & Kim is a global law firm that focuses on cross-border disputes and investigations, often involving fraud and misconduct. The firm:

- Focuses on helping clients realize value from their claims, developing investigative, enforcement and asset tracing/recovery plans in the pre-dispute stage, to maximize future monetization.
- Often enforce high-value debt claims around the world with our integrated onshore-offshore team including BVI, Cayman, Hong Kong, PRC, UK and US lawyers (including King's Counsel).
- Maintains our independence as advocates ready to litigate against virtually any institution by avoiding repeat client relationships, and the conflicts of interest that come with them.

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