Protection of Corporate Creditors’ Interests under Subscription System

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Abstract: At the end of 2013, the reform of China’s corporate capital system established the full subscription system design. This reform, however, is far from ideal. It also introduces new issues, such as bogus companies, which have a new impact on the market economy. The reason for this is that it only eliminates the minimum registered capital and first capital contribution requirements, leaving other systems that are actually matched with the paid-in system unchanged, resulting in the old and new systems forcibly grafted together being unable to adapt to each other in practice. In the real world, such a corporate capital arrangement is certain to have issues. Given the company’s debt repayment problem, which is caused by the current full subscription system, it is advisable to establish and improve the company’s credit and information publicity system, appropriately expand the application scope of the disregard of corporate personality system, and constantly improve the company’s registered capital urging system, in order to ensure the enrichment of the company’s capital, better safeguard the interests of the company’s creditors, and avoid the company’s debt repayment problem.

Keywords: Subscription system; Corporate personality; Credit publicity

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1. The protection of corporate creditors’ interests brought by the new company law

With the deepening of reform and opening up, it is common to encourage investment and entrepreneurship. The original full paid-in system of company capital seems to be unable to meet the needs of market development. Therefore, in order to respond to the practical needs and guide the market, China has made efforts to reduce the threshold for enterprise establishment: In 2005, China’s Company law significantly reduced the minimum capital of the company, expanded the form of shareholders’ capital contribution, changed the original “legal + paid in capital system” into a more relaxed and easy “legal capital system + installment payment system,” and made efforts to reduce the difficulty of company establishment and promote company establishment. In 2013, China’s company law abolished the requirement of minimum registered capital and established a complete subscription system, further reducing the difficulty of establishing the company [1]. From the perspective of promoting the establishment of companies and promoting employment, such efforts are undoubtedly beneficial, but from the perspective of institutional cohesion and coordination, systematic consideration can be further improved.

From a systematic point of view, the new Company law has not modified the deeper and supporting systems. This leads to the disjointed phenomenon between the new and the old measures of China’s corporate capital system. In fact, the current capital rules of the company law still take the paid in system as the model, which cannot adapt to the capital structure in which the company only enjoys the contribution creditor’s rights after the subscription system. In the face of the subscription system, the paid in system rules will produce legislative gaps. One of the more prominent is the phenomenon that the company’s
shareholders make huge subscription and long-term capital contribution by taking advantage of the defects of the paid in system.

With the decrease of registered capital and the random subscription period, the company does not have enough assets to guarantee the creditor’s rights, and various supporting systems have not been improved in time, which makes it difficult to protect the interests of creditors. The promoters of companies under the subscription system can agree on the time limit of capital contribution, which often becomes a means for shareholders to maliciously evade the obligation of capital contribution. In reality, these people often agree on a distant time limit, and then carry out the behavior of “get something for nothing” on the cloak of legal line. The emergence of many such “bogus company” has seriously damaged the interests of creditors. In this case, in order to protect the rights and interests of creditors, there seems to be no other way than to apply for bankruptcy of the company to make the shareholders’ capital contribution obligations expire. However, it is difficult to apply for bankruptcy, and the procedures to be faced are very complex, which makes the creditors face great risks. And even if bankruptcy proceedings succeed, it is unlikely that the sponsors of these “bogus companies” will have the assets to fund and pay off their debts in practical terms. Therefore, under the current system, in order to maintain a fair and reasonable market economic order, maintain the stable operation of the market economy, appropriately expanding the scope of application of the company’s legal personality denial system, establishing and improving the credit information publicity system, breaking faith punishment system and capital call system are the due meaning of improving the company’s creditor interest protection mechanism.

2. The outlet of protecting creditors’ rights and interests under subscription system
2.1. Establish and improve the company’s credit information publicity system
People tend to think that the more registered capital a company has, the better its credit and the stronger its ability to bear responsibility. Under the subscribed capital system, the promoters of the company have great autonomy. Some enterprises have a lot of registered capital, but in fact they are subscribed capital. Actually, there are not so many assets at all, and some are the so-called “bogus companies.” In this case, if the company’s information publicity is not timely and untrue, the investors’ right to know will be damaged, so that they cannot accurately judge the company’s credit ability, making their rights and interests very unstable.

Some people believe that the company’s initiative to disclose the company’s relevant information is a more convenient and fast way for creditors to obtain the company’s information, but it is also prone to false information. The public authority should supervise the company’s information disclosure, and the necessary information should be disclosed by the public authority [2]. There is no problem with this proposition. It is also the responsibility of government agencies to supervise the activities of market subjects, but the problem is that it is not feasible and difficult to implement. The premise for the public authority to publicize the company’s information is that the authenticity of these information has been confirmed. However, if the public authority wants to grasp the company’s relevant information, it must either actively investigate, or passively accept the company’s report. The former is difficult to implement because of the large number of companies, and the government generally investigates companies suspected of violating regulations. If a company is not suspected of violating regulations and has not been reported, it may be suspected that the public has the right to interfere with the freedom of the company, at least this risk exists. The latter is less difficult to implement, but the information source still comes from the company itself, which falls into a bad cycle.

In practice, the industry and information technology management department will investigate the information of the reported company after receiving the report, but the problem is that the creditors infringed by the company’s false information may not choose to report, and the random inspection of the
industry and information technology department is a drop in the ocean in front of the huge number of companies, so in fact, the effect of these measures is not good.

It is undoubtedly the creditors who are most concerned about the company’s information. Therefore, we can appropriately expand the creditors’ right to know and support them to access the company’s relevant information, so as to safeguard their legitimate rights and interests. At the same time, from the standpoint of ensuring the authenticity of the company’s information, we should also support the government to increase the punishment of companies providing false information, publicize trust-breaking companies, and establish company credit files for public access. Only in this way can we make it possible for creditors to grasp the real situation of the company under the subscription system.

2.2. Appropriately expand the application scope of disregard of corporate personality system

The system of disregard of corporate personality system is a remeasurement of the interests of the company, shareholders and creditors. By strictly investigating the legal responsibility of limited liability, it gives special legal relief to corporate creditors who are difficult to obtain legal protection within the framework of the traditional corporate system because of the abuse of the independent personality of corporate legal person. Its function is to prevent shareholders from abusing limited liability to infringe on the interests of corporate creditors [3].

In 2005, China’s company law clearly affirmed the system of disregard of corporate personality in the form of written law, but only made principled provisions on it and did not list the specific circumstances, which led to the existence of disregard of corporate personality system only in individual cases, without perfect legislation and unified judgment. But according to the academic theory, when the company’s capital is obviously insufficient, generally speaking, at this time, we can think that the shareholders of the company do not have the sincerity to operate the company, but just want to use the company’s independent legal person status and limited liability to transfer the operation risk to the creditors. Therefore, in fact, it is also a manifestation of abusing the company’s independent legal person personality and should “pierce the veil of the company” to find the shareholders behind the company’s personality and order them to bear the liability for debt repayment to creditors.

Evidently, it is undeniable that there are some doubts in the implementation of the system. For example, what is the discretionary benchmark of “abuse of the company’s independent legal person status and limited liability system” as an uncertain legal concept? For another example, according to the rules of civil procedure, even if the company’s shareholders have the behavior that causes the application of the system, how can we prove that the denial of the company’s legal personality is legitimate, rather than an infringement of private power? Perhaps it is these problems that challenge the professional level of judges, so there are few trial cases that directly apply this system in practice.

In the case, the judge should exercise discretion, but at the same time give open testimony, and judge whether the company in the case belongs to the situation of “obvious lack of capital” and “lack of management sincerity of shareholders” in combination with social common sense, local economy, trading habits and other factors. In addition to the efforts of the judge, we should also pay attention to that the burden of proof should not be mechanically allocated to the plaintiff, but should consider reversing the burden of proof. Because it is very difficult for the plaintiff creditors to obtain the internal information of the company, the defendant shareholders are undoubtedly in a strong position in this regard. Therefore, we need to tilt the system to the creditors. Only in this way, the creditors may use judicial means to protect their legitimate interests.

2.3. Establish a director’s call system

In the face of the abuse of the company’s independent personality and the lack of effective supervision of
the company’s registered capital, we need to establish a reasonable and effective supervision and restriction mechanism to prevent shareholders from getting out of control and infringing on the interests of the company and creditors. Some people advocate strengthening the capital collection responsibility of directors and senior managers of the company and transforming the responsibility of the company to individuals. This view is reasonable. This is because under the new company law, the capital contribution obligation of the company’s shareholders has changed from the original legal provisions to the provisions of the articles of association, and the company’s board of directors is responsible for the implementation of the articles of association. Therefore, it is feasible for the company’s directors to bear the responsibility of capital collection in law and the embodiment of their diligence obligation.

Some people further designed this system as a director’s call system [4] on the basis of the above views, advocating the legalization of the director’s call obligation, which is believed to help protect the interests of creditors. In fact, similar systems have appeared in the United States, Japan and other countries. Then, as far as the United States and Japan are concerned, their legislative emphases in this respect are actually different, but both have reference value for us to establish similar systems.

In the process of implementation, this system has been proved to standardize the capital contribution behavior of the company’s promoters and shareholders. Due to the lack of restrictions on the exercise of shareholders’ rights under the subscription system, within the existing institutional framework, shareholders may infringe on the interests of creditors through lengthy subscription periods under the guise of legality. Therefore, the director’s investigation obligation at the time of establishment can at least ensure that shareholders have the ability to perform and will not make the company lose both people and money. In order to ensure that the directors fulfill this obligation, the law stipulates that the directors of the company have the responsibility to fill the insufficiency of capital contribution of the company’s promoters and shareholders. Under the compulsion of this provision, the directors may, to the best of their ability, investigate the contributions of the sponsors and shareholders at the time of establishment. In the case of insufficient capital contribution by the sponsors and shareholders, the directors shall call for payment and report to the shareholders’ meeting, or fail to fulfill the investigation responsibilities at the time of establishment, so that the directors will fulfill their obligations to make up for the insufficient capital contribution by the sponsors and shareholders. This system protects the property rights and interests of the company and the interests of creditors through the investigation obligations of shareholders at the time of establishment.

Evidently, the law positively sets the investigation obligation of directors at the time of establishment, which seems to be a little strict, but from the perspective of safeguarding the interests of the company and the interests of the company’s creditors, this design has its progressive significance and provides a way to safeguard the interests of corporate creditors for China. However, we should not copy its provisions, and because China is still in the early stage of the reform of the company’s capital system, this change increases the obligations of the company’s directors, which may make it conservative and inactive, and may not be completely suitable for our country.

In view of this matter, when establishing the director’s call system in China, we can focus on the duty exemption of directors and implement the business judgment rules. Based on the finiteness theory, people’s cognitive ability is limited, and of course, directors and others management only have limited rationality. The business judgment rule refers to the presumption that the business judgment of the directors of the company is made based on reliable information and in good faith and honesty that the behavior is beneficial to the company [5]. According to this rule, we seem to have found an exemption clause for directors subject to investigation responsibility at the time of establishment. When the directors have made due efforts to investigate the situation of the promoters and shareholders of the company, they are in the business judgment rules and should not be required to bear the filling responsibility. Although the director has an
interest in the investigation, this interest is more likely to prompt the director to investigate than no interest at all. If the investigation fails to find out the defects of the sponsors and shareholders, the interests of the directors will be damaged. Therefore, the directors will do their best to investigate even from the perspective of protecting their own interests. Of course, to judge whether the director complies with the transaction judgment rules, we also need to rely on objective facts, which belongs to the scope of proof provided by the director. If he cannot prove it, he will naturally bear the due responsibility.

Based on the above-mentioned analysis, we believe that establishing a director’s call system is a viable solution to the problem of protecting corporate creditors’ interests under China’s company subscription system. We can avoid the negative impact of the company’s directors’ excessive obligation by legally imposing the investigation obligation on the company’s directors at the time of formation, stipulating the adverse consequences of their failure to perform their duties, and drawing lessons from the professional conduct rules.

3. Conclusion
Under the fully subscribed system, corporate creditors’ interests are jeopardized, and politicians demonstrate sufficient commitment to corporate autonomy. Such earnestness, on the other hand, does not produce ideal results, but rather chaos. How to defend the rights and interests of corporate creditors has become a challenge we must tackle under the existing system in order to sustain the good development of the market economy. The ultimate goal is to go beyond the protection of the company’s creditors, point to higher-level company autonomy, and also point to a healthy and orderly economic environment, whether it is to establish and improve the company’s credit and information publicity system, expand the scope of application of the company’s legal personality denial system, or construct the director’s call system. China, which has yet to build a fully functioning market economy, has a longer way to go in this aspect. From the perspective of comparative law, we need to develop rules based on our own strengths and learn from the capabilities of others to compensate for our own limitations. The beneficial connection between the old and new systems in the new company law can still be improved, so we must redo the relevant systems under the paid-in system, fill the legislative emptiness, eliminate unnecessary disputes, and truly establish a system suitable for the company’s capital subscription system, in order to achieve a balance between the rights and obligations subjects in the company law.

Disclosure statement
The author declares no conflict of interest.

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