

An interpretive analysis of the application rules for the forfeiture system for shareholders' failure to fulfill capital contribution obligations under the new *Company Law*

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Abstract. The newly revised *Company Law* of 2023 introduces the shareholder forfeiture mechanism (Article 52), aiming to address the problems of capital dilution and inadequate creditor protection arising from shareholders' failure to fulfill their capital contribution obligations under the subscribed-capital system. Through a self-governing procedural framework of "demand for contribution–forfeiture–disposition," the mechanism seeks to strengthen capital discipline and corporate governance. Based on the methodologies of legal doctrinal analysis and empirical research, this paper systematically examines the legislative rationale, normative structure, and practical controversies surrounding the forfeiture mechanism, revealing its three core functions within the company law framework: restoring the symmetry between shareholders' rights and obligations, reducing corporate governance costs, and safeguarding capital credibility as well as creditors' interests. The study finds that significant ambiguities remain in the current regime regarding the determination of substantive requirements and the coordination of procedural rules. Representative controversies include the legal boundaries of valid demand notices (such as the effectiveness of electronic service), the absence of explicit statutory provisions on the recusal obligations of interested directors, and procedural conflicts between equity disposition following forfeiture and the rules governing capital reduction. In response to these issues, this paper explores flexible mechanisms such as partial forfeiture of shareholder rights and advocates a governance transition in company law from "capital credit" to "behavioral credit," thereby providing institutional support for optimizing the business environment and promoting high-quality economic development.

Keywords: new *Company Law*, shareholder forfeiture mechanism, capital contribution obligations, capital credit, creditor protection

1. Introduction

1.1. Research background and significance

1.1.1. Legislative rationale for the introduction of the forfeiture mechanism

China's corporate capital system has undergone a significant transformation from a paid-in capital regime to a subscribed capital regime. Following the comprehensive adoption of the subscribed capital system in the 2013 revision of the *Company Law*, the liberalization of shareholders' contribution periods became a defining feature of corporate capital regulation. In practice, however, many shareholders have abused this flexibility by failing to fulfill, or only partially fulfilling, their capital contribution obligations over extended periods. Such conduct has given rise to systemic risks, including capital dilution and inadequate protection of creditors' interests. According to statistics released by the Supreme People's Court, the average annual growth rate of shareholder capital contribution disputes accepted by courts nationwide reached 21% between 2020 and 2023, with more than 60% of such cases involving shareholders' failure to make capital contributions on schedule. Against this backdrop, Article 52 of the 2023 revised *Company Law* introduced the shareholder forfeiture mechanism for the first time. Through a *self-governing* procedural framework consisting of "demand for contribution–forfeiture–equity disposition," the mechanism seeks to establish a safeguard for capital credit. This mechanism transcends the limitations of the traditional shareholder expulsion system by extending its scope from cases of complete non-contribution to situations involving failure to make full capital contributions within the prescribed period. Furthermore, it authorizes the board of directors to directly initiate forfeiture proceedings, thereby significantly enhancing corporate governance efficiency.

1.1.2. The urgency of practical problems

Under the subscribed capital system, the prolonged suspension of shareholders' capital contribution obligations not only undermines corporate capital credit but also generates multiple conflicts of interest. At the corporate level, unpaid subscribed capital weakens a company's solvency, thereby adversely affecting its normal business operations and financing activities. Judicial practice has largely relied on the supplementary liability mechanism established under Article 13 of the *Interpretation (III) of the Supreme People's Court on Several Issues Concerning the Application of the Company Law*, yet this approach is characterized by high litigation costs and limited enforcement effectiveness. At the level of market order, certain shareholders exploit shell companies and the flexibility of subscription periods to evade debts, thereby jeopardizing transaction security. For example, in Case No. (2023) Yu 01 Min Zhong 12110, a shareholder took advantage of loopholes in the subscribed capital regime to transfer assets, resulting in creditor losses exceeding RMB 10 million. By compelling defaulting shareholders either to exit the company or to fulfill their capital contribution obligations, the forfeiture mechanism can effectively curb such misconduct and help restore the foundation of market credit¹.

1.1.3. Theoretical value of the mechanism

First, the forfeiture mechanism reinforces the principle of capital maintenance. By depriving defaulting shareholders of their rights as a deterrent, it helps ensure the authenticity and integrity of corporate capital, thereby aligning with the legislative intent embodied in Article 3 of the *Company Law*, which provides that shareholders shall bear liability to the extent of their subscribed capital contributions. Second, the mechanism strikes a balance between corporate autonomy and judicial restraint. Traditional shareholder

¹ Zhengzhou Intermediate People's Court of Henan Province, Civil Judgment (2023) Yu 01 Min Zhong No. 12110.

expulsion procedures rely heavily on judicial intervention and are often cumbersome and inefficient. In contrast, the forfeiture mechanism permits the board of directors to take the lead in issuing demand notices and adopting forfeiture resolutions, reflecting the efficiency-oriented approach advocated by contractarian theories of the corporation [1]. At the same time, procedural safeguards serve to prevent abuses of corporate autonomy. Third, the mechanism introduces innovation in the protection of creditors' interests. Following forfeiture, the unpaid portion of the equity may be addressed through capital reduction or equity transfer, thereby replenishing corporate capital and avoiding a situation in which creditors can seek relief only through ex post recovery actions. In this regard, the mechanism complements the "acceleration of maturity" rule established under Article 35 of the *Enterprise Bankruptcy Law*.

1.2. Research status and existing controversies

Substantial disagreement exists among scholars regarding the legal nature of the forfeiture mechanism. Represented by Professor Wang, proponents of the "contract termination theory" argue that forfeiture essentially constitutes the company's exercise of a statutory right of termination, grounded in the contractual nature of shareholders' capital contribution obligations under Article 563 of the *Civil Code*. According to this view, the rule that a forfeiture notice becomes effective upon dispatch represents a departure from the traditional principle that legal notices become effective upon receipt [2]. In contrast, Professor Zhao advocates the "punitive measure theory," emphasizing the mandatory nature of the forfeiture mechanism as a distinctive institution of company law. From this perspective, its function extends beyond remedying breaches of capital contribution obligations to safeguarding the public interest in maintaining capital order [3]. A third, intermediate position contends that the forfeiture mechanism possesses both autonomous and mandatory characteristics. While the initiation of forfeiture proceedings depends upon corporate self-governance, the legal consequences of forfeiture are prescribed directly by law [4]. Although the new *Company Law* explicitly distinguishes shareholder forfeiture (Article 52) from shareholder expulsion (Article 32), considerable debate remains concerning the relationship between the two mechanisms. Some scholars argue that forfeiture addresses breaches of capital contribution obligations, which concern the capital-oriented nature of the company (zihéxing), whereas shareholder expulsion is designed to resolve personal and relational conflicts among shareholders, such as serious harm to the company's interests. On this view, the two systems perform complementary functions [5]. Opponents, however, contend that in practice failures to make capital contributions are often accompanied by a breakdown in shareholder relations, resulting in potential overlap between the two mechanisms and uncertainty regarding their respective scopes of application.

2. Value orientation: legislative purpose and functional positioning of the forfeiture mechanism

2.1. The value orientation of the shareholder forfeiture mechanism

As a core innovation in the capital regime established by the new *Company Law*, the shareholder forfeiture mechanism is rooted in the dynamic balance between efficiency and fairness that characterizes the modernization of company law. It also reflects the coordinated relationship between corporate autonomy and state intervention. From the perspective of efficiency, the forfeiture mechanism aims to reduce corporate governance costs through procedural simplification and enhanced corporate autonomy, thereby addressing the practical challenges of capital dilution under the subscribed capital system. Article 52 of the new *Company Law* expressly authorizes the board of directors to initiate forfeiture proceedings. Compared with the

traditional shareholder expulsion mechanism, which depends upon a supermajority resolution of the shareholders' meeting—for example, Article 32 requires approval by shareholders representing more than two-thirds of the voting rights—this design significantly shortens the period required for rights enforcement and avoids institutional paralysis caused by difficulties in convening shareholders' meetings or obstruction by controlling shareholders. Another manifestation of the efficiency-oriented nature of the forfeiture mechanism lies in the certainty of its legal consequences. The rule that a forfeiture notice becomes effective upon dispatch, as provided in Article 52(3), departs from the traditional "receipt rule" governing contract termination under civil law. This approach enables a company to promptly remove the rights burden associated with defaulting shareholders and prevents them from continuing to consume corporate resources. The jurisprudential foundation of this rule stems from company law's prioritization of commercial efficiency. As Easterbrook (1996) observed, a central function of business organization law is to reduce transaction costs through standardized legal rules; the forfeiture mechanism represents a concrete manifestation of this principle. At the same time, the forfeiture mechanism embodies considerations of fairness. While safeguarding the legitimate interests of creditors and compliant shareholders, it imposes legal consequences on shareholders who fail to fulfill their capital contribution obligations. In doing so, it restores the substantive balance between rights and responsibilities within the corporate structure and reinforces the normative expectation that shareholders must honor their contribution commitments.

2.2. The dual dimensions of functional positioning

The functional positioning of the forfeiture mechanism may be examined from two interrelated perspectives: the optimization of internal corporate governance and the maintenance of external market order. Together, these dimensions constitute the dual pillars of the capital-credit protection system under company law.

Within the sphere of corporate governance, the primary function of the forfeiture mechanism is to curb shareholder opportunism and restore symmetry between shareholder rights and obligations. Under the subscribed capital system, although shareholders enjoy the benefit of deferred contribution periods, the exercise of their shareholder rights should remain contingent upon the fulfillment of their capital contribution obligations. In practice, however, many shareholders exploit the flexibility afforded by corporate autonomy, retaining voting rights, profit distribution rights, and other core shareholder privileges despite long-term defaults in capital contributions. This creates a distorted structure characterized by "expanding rights and shrinking obligations." The forfeiture mechanism addresses this problem through innovative forms of partial deprivation of shareholder rights. For example, it may restrict the voting power or entitlement to profit distributions of shareholders who have failed to make the required contributions, thereby imposing proportionate sanctions for breach of duty. Article 64 of the German Limited Liability Companies Act provides that where a shareholder fails to pay subscribed capital on time, the company may declare the forfeiture of rights attached to the relevant shares while preserving the shareholder's remaining rights². This model of "graduated sanctions" has influenced and been adapted by Chinese legislators. Such a design avoids the rigidity of the traditional expulsion mechanism, which operates on an all-or-nothing basis, while preserving incentives for shareholders to remedy their defaults by completing their contributions. In this respect, the mechanism aligns with Posner's theory of efficient breach, under which legal rules should encourage parties to select remedies that minimize overall social costs through rational cost-benefit analysis [6].

From the perspective of external market order, the forfeiture mechanism serves as a tool for the ex

² German Company Law 2003, Article 64.

ante prevention of credit risks and the systematic protection of creditors' interests. The existence of unpaid subscribed capital essentially constitutes a false signal of creditworthiness transmitted by the company to creditors. Through mandatory disclosure and capital restructuring mechanisms, the forfeiture system interrupts this chain of risk transmission. Pursuant to Article 10 of the *Interim Regulations on Enterprise Information Disclosure*, resolutions concerning shareholder forfeiture must be publicly disclosed through the commercial registration system. This enables creditors to accurately assess the company's paid-in capital status and reduces the risk of misjudgments arising from information asymmetry. Moreover, the unpaid

equity interests subject to forfeiture may subsequently be addressed through targeted capital reduction or equity transfer arrangements, allowing actual capital to be injected into the company and thereby strengthening its solvency. This mechanism complements the creditor revocation right established under Article 538 of the *Civil Code*. While the forfeiture mechanism proactively eliminates capital defects through corporate self-governance, the creditor revocation system provides ex post judicial correction of improper asset transfers. Together, they form a dual-layered framework of prevention and remedy for creditor protection. It should be noted, however, that the protective effect of the forfeiture mechanism is not absolute. If a company exempts a shareholder from capital contribution obligations without completing the legally required capital reduction registration procedures, creditors may still invoke Article 13 of the *Interpretation (III) of the Supreme People's Court on Several Issues Concerning the Application of the Company Law* to seek supplementary compensation from the original shareholder. This principle has been affirmed in judicial practice, including Case No. (2021) Zui Gao Fa Zhi Min Zhong 884³. The complexity of this interaction between forfeiture rules and creditor remedies demonstrates that the effectiveness of the forfeiture mechanism depends not only on the company law framework itself but also on the coordinated development of related commercial registration, enforcement, and creditor protection systems. Such institutional integration is essential to fully realizing the governance objectives of the new *Company Law*.

2.3. Comparison with similar legal mechanisms

Although the shareholder forfeiture mechanism, shareholder expulsion, and capital reduction procedures all serve as instruments of corporate capital regulation, they differ significantly in their legislative purposes, operational logic, and legal consequences. These distinctions reflect company law's increasingly refined response to diverse governance needs.

2.3.1. Distinguishing the forfeiture mechanism from shareholder expulsion

The shareholder expulsion mechanism is primarily grounded in Article 32 of the *Company Law*. Its core function is to address crises in the personal relationship among shareholders and is generally applicable where a shareholder has seriously harmed the company's interests or breached fiduciary duties, such as through the misappropriation of corporate assets or violations of non-competition obligations. Procedurally, shareholder expulsion requires a special resolution of the shareholders' meeting, approved by shareholders representing more than two-thirds of the voting rights. The voting rights of the shareholder subject to expulsion are excluded from the voting process to ensure the fairness and impartiality of the resolution. In contrast, the forfeiture mechanism focuses on defects in the performance of capital contribution obligations. The authority to initiate forfeiture proceedings is vested in the board of directors, and a forfeiture resolution may be adopted by a simple majority vote pursuant to Article 52(2) of the new *Company Law*. Furthermore, the legal consequences of forfeiture are limited to the equity interests corresponding to the unpaid portion of the

³ Supreme People's Court, Judgment (2021) Zui Gao Fa Zhi Min Zhong No. 884.

subscribed capital. The shareholder's status as a member of the company is not necessarily extinguished. Judicial practice has emphasized the distinction between these two mechanisms. In Case No. (2018) Su 04 Min Zhong 1874, the court expressly differentiated their respective spheres of application, holding that a shareholder who had withdrawn the entirety of the contributed capital could be expelled from the company, whereas a shareholder who had only partially failed to make the required contribution should be subject to the forfeiture mechanism. This dual regulatory framework, distinguishing between matters of personal association (renhexing) and capital association (zihexing), not only prevents functional overlap between the two systems but also provides a layered approach to resolving complex corporate disputes⁴.

2.3.2. Coordination and tension between the forfeiture mechanism and capital reduction procedures

The capital reduction procedure, governed by Article 224 of the *Company Law*, is a neutral mechanism for adjusting a company's capital structure in response to operational and business needs. A valid capital reduction requires a special resolution of the shareholders' meeting and compliance with creditor-protection requirements, including notification to creditors and the provision of debt repayment or adequate security. By contrast, the forfeiture mechanism possesses a distinctly punitive character. Its essential purpose is to impose a non-voluntary adjustment of capital interests in response to a shareholder's breach of capital contribution obligations. Although the disposition of forfeited equity frequently involves a subsequent reduction of registered capital, the two mechanisms differ fundamentally in their procedural structures. Capital reduction resulting from forfeiture is typically a form of targeted capital reduction, affecting only the unpaid portion of a specific shareholder's equity interest. Traditional capital reduction, however, generally requires a proportional reduction of capital contributions among all shareholders. This distinction gives rise to potential conflicts between the two sets of rules. For example, Article 224 requires a capital reduction resolution to be approved by shareholders representing more than two-thirds of the voting rights, whereas a targeted capital reduction following forfeiture may be obstructed by minority shareholders, thereby frustrating the implementation of the forfeiture mechanism. Such procedural difficulties were illustrated in Case No. (2018) Hu 01 Min Zhong 11780⁵. In this regard, the "simplified capital reduction" mechanism provided under Article 222 of the German company law regime offers a valuable comparative reference. Under this approach, where shareholder forfeiture has occurred, the company may directly cancel the unpaid equity interests through a resolution of the board of directors without obtaining approval from the shareholders' meeting. This arrangement eliminates unnecessary procedural duplication and enhances governance efficiency. Future amendments to Chinese company law may therefore consider introducing a comparable exception, permitting streamlined capital reduction procedures in cases involving shareholder forfeiture. Such reform would improve the practical operability of the forfeiture mechanism and further advance the legislative objective of maintaining corporate capital discipline.

3. Systematic integration: a coordinated interpretation of the forfeiture mechanism within the framework of corporate capital regulation

3.1. The normative structure of the forfeiture provisions under the new Company Law

Article 52 of the new *Company Law*, which serves as the normative cornerstone of the shareholder forfeiture

⁴ Changzhou Intermediate People's Court of Jiangsu Province, Civil Judgment (2018) Su 04 Min Zhong No. 1874.

⁵ Shanghai First Intermediate People's Court, Civil Judgment (2018) Hu 01 Min Zhong No. 11780.

mechanism, establishes a three-stage procedural framework consisting of "demand for contribution–forfeiture–disposition." However, the full realization of its legal effects requires a systematic interpretation within the broader framework of corporate capital regulation.

First, Article 52(1) limits the application of the forfeiture mechanism to circumstances in which "a shareholder fails to make capital contributions in full and on schedule." The term "capital contribution" should be interpreted in conjunction with Article 43, which enumerates the permissible forms of capital contribution, and Article 48, which governs the valuation of non-monetary contributions. For example, where a shareholder contributes non-monetary assets but their appraised value is substantially inflated—such as an overvaluation of patented technology—the question arises whether such conduct constitutes a failure to make full capital contributions. This issue should be resolved pursuant to Article 48, under which the portion attributable to inaccurate valuation is deemed unpaid capital. Furthermore, where a shareholder's inability to perform results from force majeure events or the company's own fault, such as refusing to accept a valid contribution, the forfeiture mechanism should not apply. In such cases, the shareholder may invoke the force majeure provisions of Article 590 of the *Civil Code* or rely on the contractual liability framework established under Article 577 as a defense.

Second, although Article 52 refers generally to the "company" as the initiating entity for the demand procedure, Article 67's residual authorization of board powers—covering "other powers prescribed by the company's articles of association"—supports the conclusion that the board of directors, as the company's principal management and decision-making body, naturally assumes primary responsibility for administering forfeiture proceedings. Nevertheless, potential conflicts arise where the articles of association expressly reserve the authority to adopt forfeiture resolutions to the shareholders' meeting. For example, an article of association may provide that "shareholder forfeiture requires approval by a majority vote of the shareholders' meeting." Such arrangements raise questions regarding the relationship between Article 52 and Article 44, which recognizes the governing role of the articles of association. Judicial practice has not reached a uniform position on this issue. In Case No. (2010) Hu Er Zhong Min Si (Shang) Zhong Zi No. 436, the court held that restrictions imposed by the articles of association on the board's authority were invalid because they conflicted with the mandatory procedural framework established by Article 52. The court emphasized that legislative designation of the board of directors as the principal body responsible for forfeiture proceedings reflects a mandatory institutional arrangement grounded in considerations of governance efficiency⁶. Such divergent judicial approaches reveal the ambiguity of the current legislation regarding procedural authority and underscore the need for further clarification through judicial interpretation.

Finally, the disposition of forfeited equity interests must be coordinated with other rules governing changes in corporate capital. Pursuant to Article 52(4), a company may dispose of forfeited equity through capital reduction or transfer. However, the provision remains silent on issues such as the allocation of proceeds and the assumption of risks during the disposition process. For instance, if forfeited equity is sold through a public auction, it remains unclear whether any premium exceeding the original subscribed amount should be treated as capital surplus. Under Article 168, premiums generated through equity transfers are generally included in the company's capital reserve. Yet uncertainty arises where the forfeited equity corresponds to unpaid subscribed capital, since the legal nature of the proceeds differs from that of ordinary equity transfers. In light of the legislative principle embodied in Article 3 — that shareholders bear liability only to the extent of their

⁶ Shanghai Second Intermediate People's Court, Commercial Judgment (2010) Hu Er Zhong Min Si (Shang) Zhong Zi No. 436.

subscribed capital contributions—the more persuasive interpretation is that the proceeds from the disposition of forfeited equity should first be used to cover the unpaid capital contribution obligation. Only any remaining surplus should be allocated to the capital reserve. These interpretive uncertainties demonstrate that the normative structure of Article 52 requires systematic supplementation through purposive and contextual interpretation to prevent ambiguity from undermining the effectiveness of the forfeiture mechanism.

3.2. Coordination with other areas of law

The effectiveness of the forfeiture mechanism depends not only on coherence within company law itself but also on its integration with external legal regimes, including the *Civil Code*, the *Enterprise Bankruptcy Law*, and the Civil Procedure Law. This coordination reflects a dialectical relationship between functional complementarity and normative competition.

3.2.1. Coordination with the contract law provisions of the Civil Code

The characterization of shareholders' capital contribution obligations constitutes the central issue in cross-disciplinary legal coordination. If, pursuant to Article 509 of the *Civil Code*, capital contribution obligations are regarded as contractual debts arising between shareholders and the company, the forfeiture mechanism may be understood as a form of statutory termination right. However, a direct conflict emerges between Article 52's rule that a forfeiture notice becomes effective upon dispatch and Article 565 of the *Civil Code*, which adopts the traditional principle that contract termination becomes effective only upon receipt of notice by the other party. To resolve this conflict, Article 12 of the Judicial Interpretation (V) of the *Company Law* (Draft for Comments) issued by the Supreme People's Court expressly provides that the forfeiture procedure under company law constitutes a special commercial rule that takes precedence over the general principles of contract law. This interpretive approach accords with the theory of the autonomy of commercial organizational law, which maintains that company law, as a body of organizational law, should prioritize the efficiency requirements of collective business entities rather than adhere rigidly to the logic of traditional contract law [7].

3.2.2. Coordination with the Enterprise Bankruptcy Law

In the context of corporate insolvency, the forfeiture mechanism may overlap with the "acceleration of maturity" rule established under Article 35 of the *Enterprise Bankruptcy Law*. Pursuant to Article 35, once a bankruptcy petition has been accepted by the court, the bankruptcy administrator may require shareholders to immediately fulfill their subscribed capital contribution obligations without first undertaking the forfeiture demand procedure. However, complications arise where the company initiated forfeiture proceedings before the commencement of bankruptcy proceedings but had not completed the disposition of the forfeited equity. In such circumstances, it becomes necessary to determine whether the legal effect of forfeiture survives independently or is absorbed into the bankruptcy process. According to Ou Ping, Deputy Chief Judge of the Second Civil Division and Deputy Director of the Enforcement Bureau of the Kunshan People's Court in Jiangsu Province, where a forfeiture notice became effective before the court accepted the bankruptcy petition, the unpaid equity interest no longer constitutes property attributable to the shareholder for purposes of capital liability. Consequently, the bankruptcy administrator may only pursue the original shareholder for the unpaid contribution obligation. Conversely, if the forfeiture process had not been completed before the commencement of bankruptcy proceedings, the administrator may directly demand payment of the subscribed capital contribution. This reasoning reflects bankruptcy law's respect for legal relationships already established under company law. At the same time, it highlights the complexity of coordinating the two legal regimes. In particular, the standards governing the recognition of forfeiture effects within bankruptcy proceedings remain insufficiently clear and require further clarification through legislation or judicial interpretation [8].

4. Practical application: constituent elements and procedural rules of the forfeiture mechanism

4.1. Analysis of substantive requirements

The substantive requirements of the shareholder forfeiture mechanism must be determined in strict accordance with the normative logic of Article 52 of the *Company Law*. At its core, the mechanism requires a comprehensive assessment of both the objective conduct of "failing to make capital contributions in full and on schedule" and the circumstances underlying such non-performance.

First, certainty regarding the capital contribution period constitutes the fundamental prerequisite for initiating forfeiture proceedings. Pursuant to Article 28 of the new *Company Law*, where the articles of association do not expressly specify the contribution period, it must be interpreted according to the principle of a "reasonable period." The determination of reasonableness should be made dynamically in light of the company's operational needs, prevailing industry practices concerning capital investment, and the relationship of trust among shareholders. For example, where a company undertakes a major project in anticipation of expansion, a shareholder's contractual benefit arising from a deferred contribution period may justifiably be restricted in response to the need to preserve capital credit. Such intervention reflects a necessary limitation on private autonomy in pursuit of commercial efficiency.

Second, the determination of whether a shareholder has "failed to contribute in full" should be guided by the principle of proportionality so as to balance the authenticity of corporate capital against the protection of shareholders' legitimate interests. Although the law does not establish a minimum threshold for unpaid contributions, forfeiture proceedings may lack legitimacy where the unpaid portion is insignificant—for example, less than 5 percent of the total subscribed capital—and does not materially affect the company's solvency or operational stability. In such circumstances, alternative remedies, such as restrictions on dividend rights or voting rights, may be more appropriate and proportionate than forfeiture. With respect to non-monetary contributions, the valuation rules under Article 48 must be strictly observed. If the actual value of non-monetary property falls below the valuation specified in the articles of association due to market fluctuations or technological developments, and the shareholder is free from intentional misconduct or gross negligence, such circumstances should not automatically be regarded as a failure to fully perform the contribution obligation. In this context, the "significantly lower than" standard established under Article 9 of the *Judicial Interpretation (III) of the Company Law* should be interpreted restrictively to prevent ordinary commercial risks from being improperly transformed into shareholder liability.

Although subjective fault is not a statutory requirement, judicial practice should continue to distinguish between objective impediments to performance and deliberate evasion of capital contribution obligations. While the new law adopts an objective liability approach, forfeiture should not apply where shareholders can demonstrate that non-performance resulted from force majeure events, such as natural disasters or regulatory restrictions, or from the company's own fault, including refusal to accept contributions or provision of incorrect account information. For example, where a company fails to fulfill its duty of cooperation and thereby prevents a shareholder from completing the contribution process, any forfeiture proceeding initiated by the company should be deemed invalid as contrary to the principle of good faith. To establish such defenses, shareholders should bear the burden of producing sufficient evidence, including written communications and third-party documentation, thereby preserving the efficiency-oriented character of the forfeiture mechanism.

4.2. Reconstruction of procedural rules

The procedural framework of the forfeiture mechanism requires systematic reconstruction to address the ambiguities inherent in the current legislative scheme and to ensure both procedural transparency and practical operability. First, the standardization of the demand procedure constitutes the starting point of procedural fairness. Although the new *Company Law* requires that a demand be made "in writing," it does not specify the formal requirements of such notice. From the perspective of commercial practice, written notice should encompass both traditional paper-based documents and electronic communications, such as emails and notifications transmitted through corporate information systems, provided that the shareholder can be timely informed and the content remains complete and accessible. A valid demand notice should clearly state the legal consequences of forfeiture, the commencement and expiration dates of the grace period, and the available avenues of relief. Failure to include such essential information should be regarded as a material procedural defect.

The determination of the grace period should balance the competing objectives of efficiency and shareholder protection. While the legislation stipulates that the grace period shall not be less than sixty days, it does not prescribe an upper limit, thereby creating the risk that companies may intentionally delay the disposition process. Drawing upon the experience of Japanese company law, the maximum grace period could be set at 180 days, while allowing companies facing exceptional circumstances, such as imminent insolvency, to apply for a shortened period. Such an approach would enhance procedural flexibility without undermining the protective function of the grace period. Second, the reconstruction of internal decision-making procedures requires a clearer delineation of authority between the board of directors and the shareholders' meeting. As the body responsible for initiating forfeiture proceedings, the legitimacy of board resolutions depends upon both the independence of directors and the fairness of the decision-making process. Where a director has an interest connected to the shareholder whose contribution is defective, a mandatory recusal mechanism should be introduced to prevent procedural manipulation and conflicts of interest. Similar approaches may be found in comparative corporate law. For example, Article 209 of the Japanese Companies Act of 2006 reflects the broader principle that decision-making processes involving conflicts of interest should be subject to enhanced procedural safeguards⁷. Likewise, German company law provides that interested directors may not participate in deliberations or voting on matters in which they possess a personal interest. This rule offers a useful model for strengthening procedural fairness within the Chinese forfeiture framework⁸.

4.3. The boundaries of judicial review

Judicial review of forfeiture proceedings should maintain a clear balance between respect for corporate autonomy and the prevention of abuses of power. This balance primarily depends on the proper definition of the scope of review and the allocation of evidentiary burdens.

First, judicial review should focus principally on procedural legality and should avoid excessive interference with business judgments. Courts should generally confine their inquiry to whether the company fulfilled its statutory obligation to issue a demand notice, whether the grace period satisfied legal requirements, and whether the resolution was adopted through proper procedures. They should ordinarily refrain from conducting extensive substantive review of commercial decisions concerning capital contributions. For example, where a company can produce written evidence of a valid demand notice and the

⁷ Companies Act of Japan 2006, Article 209.

⁸ German Company Law 1993, Article 35.

shareholder failed to raise objections within the prescribed period, a court may directly affirm the legality of the procedure. Such an approach reflects the principle of judicial restraint and respects the autonomy of corporate governance.

Nevertheless, where a shareholder raises substantive objections concerning the underlying contribution obligation—such as alleging that the contribution has already been made but was improperly rejected by the company—the court must undertake an appropriate factual inquiry. In such cases, professional institutions, including accounting firms or valuation agencies, may be appointed to examine the contribution status in order to ensure neutrality and objectivity in the fact-finding process. The allocation of the burden of proof should follow a sequential framework. The company bears the initial burden of establishing a *prima facie* case, including proof of the contribution deadline specified in the articles of association and records demonstrating non-receipt of funds. Once this burden has been satisfied, the shareholder must provide counter-evidence establishing circumstances that prevented performance. For instance, where a shareholder claims that the company refused to accept a contribution, the shareholder should be required to produce written correspondence, transaction records, or testimony from third-party witnesses. Failure to provide such evidence should result in the shareholder bearing the adverse consequences of non-persuasion. Through this restrained yet effective model of judicial review, courts can safeguard procedural fairness while preserving the efficiency and autonomy that constitute the fundamental objectives of the shareholder forfeiture mechanism.

5. Practical controversies and paths for improvement

5.1. Analysis of a representative case

In the judicial practice concerning the shareholder forfeiture mechanism, the dispute over the validity of a corporate resolution in *Heilongjiang Nongken Wandashan Trading Co., Ltd. v. Wang Binli et al.* (hereinafter the "Wandashan Case") vividly illustrates the core issues surrounding procedural legality, regulation of conflicts of interest, and the coordination of related legal rules. It has become a landmark case reflecting the practical operation of the forfeiture mechanism before and after the enactment of the new *Company Law*.

Wandashan Beijing Company had three shareholders: Heilongjiang Wandashan Company, Wang Binli, and Lemu Agricultural Company. According to the company's articles of association, the registered capital was RMB 8.5 million. Heilongjiang Wandashan Company subscribed RMB 4.5 million in cash and had paid in RMB 900,000; Wang Binli subscribed RMB 2 million in cash and fully paid the amount; and Lemu Agricultural Company subscribed RMB 2 million in cash and had paid in RMB 400,000. Subsequently, Wandashan Beijing Company issued a demand notice to Heilongjiang Wandashan Company, requiring it to fulfill its capital contribution obligations in accordance with the articles of association. After Heilongjiang Wandashan Company refused to make the required contribution, Wandashan Beijing Company convened an extraordinary shareholders' meeting, which Heilongjiang Wandashan Company did not attend. The shareholders' meeting adopted a resolution under which Wang Binli would contribute the unpaid subscribed capital originally attributable to Heilongjiang Wandashan Company and Lemu Agricultural Company. The shareholding structure was accordingly adjusted to 84.71% for Wang Binli, 10.59% for Heilongjiang Wandashan Company, and 4.70% for Lemu Agricultural Company. As a result, of the company's registered capital of RMB 8.5 million, Wang Binli would subscribe RMB 7.2 million, Heilongjiang Wandashan Company RMB 900,000, and Lemu Agricultural Company RMB 400,000. Heilongjiang Wandashan Company subsequently brought an action seeking a declaration that the resolution was invalid. The court ultimately upheld the validity of the resolution.

This case demonstrates that even before the formal introduction of the shareholder forfeiture mechanism in the new *Company Law*, judicial practice had already begun addressing situations involving non-performing shareholders by relying on principles such as the correspondence between rights and obligations, corporate autonomy, good faith, and economic efficiency. The court held that the adjustment of shareholding ratios did not infringe upon the lawful rights and interests of Heilongjiang Wandashan Company. Since the shareholder had failed to remedy its contribution default after receiving a demand notice, the shareholders' resolution removing the shareholder rights corresponding to the unpaid capital contribution did not violate any law or administrative regulation and therefore did not constitute a circumstance rendering the resolution invalid. The judgment provided valuable practical experience for the subsequent codification of the shareholder forfeiture mechanism and further confirmed both its rationality and necessity.

The Wandashan Case reveals three fundamental jurisprudential dilemmas associated with the forfeiture mechanism. First, it highlights the tension between procedural justice and efficiency. Although flexibility in the form of demand notices promotes commercial efficiency, it may also weaken the procedural rights of shareholders. Second, it exposes the absence of a comprehensive legislative framework governing conflicts of interest. Current law does not expressly require directors with interests connected to the defaulting shareholder to recuse themselves, creating the possibility that controlling shareholders may manipulate the board's decision-making process. In this regard, Article 8.62 of the American Model Business Corporation Act, which establishes an independence review mechanism for director conflicts of interest, offers a useful reference. Under that framework, an independent committee reviews the fairness of transactions or decisions involving interested directors. A similar mechanism could enhance the procedural integrity of forfeiture decisions in China⁹. Third, the case reveals systemic deficiencies in the coordination of legal rules. The disposition of forfeited equity often requires capital reduction procedures, yet the *Company Law* generally requires proportional capital reduction among shareholders, a requirement that conflicts with the inherently targeted nature of forfeiture. The Japanese Companies Act provides a useful model through its special capital reduction mechanism, which allows unpaid equity interests to be cancelled by board resolution under certain circumstances.

Although the court in the Wandashan Case partially filled legislative gaps through judicial discretion, the case clearly demonstrates the need for systematic legal reform. Future judicial interpretations should clarify the acceptable forms of demand notices, establish recusal obligations for interested decision-makers, and introduce streamlined capital reduction procedures to ensure both doctrinal coherence and effective implementation of the forfeiture mechanism.

5.2. Major areas of controversy and proposed solutions

The practical controversies surrounding the forfeiture mechanism may be grouped into three principal categories: the boundaries of procedural legality, the scope of application, and conflicts with related corporate law mechanisms.

The first issue concerns the appropriate scope of judicial intervention. If courts limit themselves to purely formal review—examining only the form of the demand notice or the calculation of the grace period—they may inadvertently permit companies to abuse procedural mechanisms. Conversely, excessive judicial scrutiny of substantive issues, such as the factual existence of contribution defects, risks undermining corporate autonomy. A more balanced approach would adopt a two-stage review model. At the first stage, courts should

⁹ American Bar Association, Model Business Corporation Act, § 8.62.

rigorously examine procedural legality. The effectiveness of forfeiture should be recognized only where the company has fulfilled its statutory demand obligations and the board's decision-making process is free from procedural defects. At the second stage, substantive review should occur only where the shareholder raises a credible defense based on an impediment to performance. In such circumstances, courts may conduct a limited factual inquiry into the contribution dispute while refraining from substituting judicial judgment for legitimate business decisions.

The second area of controversy concerns whether the forfeiture mechanism should extend to capital withdrawal and defects in non-monetary contributions. Although Article 52 limits forfeiture to situations involving a failure to make capital contributions in full and on time, the withdrawal of paid-in capital effectively constitutes a reverse erosion of the company's capital base. The harm caused by capital withdrawal is often no less severe than that resulting from non-contribution. Accordingly, a purposive interpretation of Article 52 could justify extending the forfeiture mechanism to cases of capital withdrawal, provided that the shareholder has not already rectified the misconduct. With respect to defects in non-monetary contributions, a distinction should be drawn between subjective bad faith and objective valuation discrepancies. Where a shareholder intentionally inflates the value of contributed assets, forfeiture may be appropriate. By contrast, where valuation discrepancies arise from market fluctuations or limitations inherent in appraisal methodologies, the issue should ordinarily be resolved through supplemental contributions or replacement of the contributed assets rather than forfeiture.

The final challenge concerns the relationship between forfeiture and other corporate law mechanisms, particularly capital reduction and shareholder expulsion. Simplifying procedures for targeted capital reduction represents a key solution to the practical difficulties associated with the disposition of forfeited equity. German corporate law provides a useful reference through Article 222 of the *Stock Corporation Act*, which permits simplified capital reduction procedures in specified circumstances. Drawing on this model, Chinese law could authorize companies to cancel unpaid equity interests directly through a board resolution, thereby eliminating the need for a separate special resolution of the shareholders' meeting. At the same time, measures must be adopted to prevent gaps in creditor protection. One possible approach would require companies to complete either capital reduction registration or the transfer of forfeited equity within a prescribed period, such as six months after forfeiture becomes effective. If the company fails to do so, the unpaid capital contribution should continue to be treated as property subject to shareholder liability. In such circumstances, creditors should retain the right to pursue the original shareholder pursuant to Article 13 of the *Judicial Interpretation (III) of the Company Law*.

6. Conclusion

6.1. Summary of the study

As a central innovation in the capital regime established by the new *Company Law*, the shareholder forfeiture mechanism seeks to address the crises of capital credibility and creditor protection arising from the dilution of shareholders' capital contribution obligations under the subscribed capital system. Through a self-governing framework of "demand for contribution–forfeiture–disposition," the mechanism provides a structured response to persistent defaults in capital contributions while enhancing the effectiveness of corporate governance. Drawing upon doctrinal legal analysis and empirical examination, this study has systematically explored the legislative rationale, normative structure, and practical controversies surrounding the forfeiture mechanism. The analysis reveals three principal functions that the mechanism performs within the framework of company law. First, by depriving defaulting shareholders of the equity rights corresponding to unpaid capital

contributions, the mechanism restores symmetry between shareholder rights and obligations and curbs opportunistic behavior. Second, by vesting primary procedural authority in the board of directors, the mechanism reduces governance costs and strengthens the efficiency of corporate self-governance. Third, through the integration of capital-credit protection and creditor-protection mechanisms, it contributes to the maintenance of transactional security and market confidence. The study further demonstrates that significant ambiguities remain in the current legal framework with respect to the determination of substantive requirements, the coordination of procedural rules, and the boundaries of judicial review. These ambiguities are reflected most prominently in disputes concerning the validity of demand notices, the absence of statutory recusal obligations for interested directors, and procedural deadlocks arising from the interaction between forfeiture and capital reduction procedures. At a deeper level, these challenges stem from enduring tensions between commercial efficiency and procedural fairness, as well as between corporate autonomy and judicial intervention. To ensure the effective realization of the forfeiture mechanism's legislative objectives, these tensions must be addressed through systematic interpretation and institutional refinement.

6.2. Future prospects

6.2.1. *Refinement of the legislative framework*

Article 52 of the current *Company Law* requires further clarification through judicial interpretation and supplementary legislation. First, the criteria for determining a "failure to perform capital contribution obligations" should be expressly defined. The scope of the forfeiture mechanism should be expanded to include capital withdrawal and intentional defects in non-monetary contributions, while excluding situations in which non-performance results from force majeure events or the company's own fault. Second, the procedural requirements governing demand notices should be further specified. Written notices should be required to state clearly the commencement and expiration dates of the grace period, the legal consequences of non-compliance, and the available avenues of relief. In addition, electronic service should be formally recognized as legally effective where adequate mechanisms for identity verification and receipt confirmation are in place. Third, a special exception for simplified capital reduction should be introduced. Under such a mechanism, the board of directors would be authorized to cancel unpaid equity interests directly following forfeiture, thereby avoiding unnecessary procedural conflicts with the ordinary capital reduction process.

6.2.2. *Development of supporting institutional mechanisms*

The effectiveness of the forfeiture mechanism ultimately depends upon the establishment of complementary institutional arrangements extending beyond company law itself. First, a shareholder contribution credit record system should be established. Records of shareholder forfeiture could be disclosed through the National Enterprise Credit Information Publicity System, thereby creating market-based reputational constraints and strengthening incentives for compliance. Second, consideration should be given to the introduction of shareholder liability insurance or related risk-allocation mechanisms. Such arrangements could mitigate the legal and commercial risks faced by boards of directors when implementing forfeiture procedures. Third, commercial registration rules should be further refined. Equity interests subject to forfeiture could be designated as "pending disposition" within the registration system, with clear rules governing their interim status and associated liabilities. Such measures would reduce legal uncertainty and prevent gaps in creditor protection during the disposition process.

The continued improvement of the shareholder forfeiture mechanism is not only a necessary step in the modernization of Chinese company law but also an important institutional safeguard for the transformation of China's capital market from a model of quantitative expansion to one emphasizing quality and sustainability. Only through the coordinated evolution of legislation, judicial practice, and supporting regulatory mechanisms

can an effective balance be achieved between efficiency and fairness, autonomy and order. Such an integrated framework will provide a solid institutional foundation for optimizing the business environment and promoting high-quality economic development.

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