LLINKS Law Offices
通力律师事务所

Shanghai
21F, South Tower
Shanghai Stock Exchange Bldg.
528 Pudong Road South
Shanghai 200120 P.R.China
Tel: (86 21) 6881 8100
Fax: (86 21) 6881 6880

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100034 P.R.China
Tel: (86 10) 6655 5050
Fax: (86 10) 6655 5060

上海
上海市浦东南路528号
上海证券大厦南塔21楼
邮政编码: 200120
电话: (86 21) 6881 8100
传真: (86 21) 6881 6880

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100034
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060

www.llinkslaw.com
master@llinkslaw.com

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An Introduction to the "Measures on the Registration of Pledge of Shares in Limited Liability Companies (Trial)" of the Shanghai Municipal Administration of Industry and Commerce

By Michael Mei

Two months after the implementation of the *Property Law of the People's Republic of China* (**the *Property Law***) on 1 October 2007, the Shanghai Municipal Administration of Industry and Commerce issued the "*Measures on the Registration of Pledge of Shares in Limited Liability Companies (Trial)*" (**the *Measures***) on 11 December 2007 with effect from 1 January 2008.[1] The registration procedures and relevant provisions in the *Measures* are intended to implement Article 226 of the *Property Law* in respect of share pledge. The *Measures*, which have established a set of practical rules governing the registration procedures for pledge of shares in limited liability companies, do not only provide a valuable reference for other regions, but also offer further protection for corporate financing and the guarantee industry in terms of their business development by more effectively implementing the provisions in the *Property Law*.

Scope of the *Measures*

Article 226 of the *Property Law* provides that "a pledge over fund units, or shares which have been registered with securities registration and settlement institutions shall be deemed to be created upon the completion of the pledge registration with the securities registration and settlement institutions. A pledge over other shares shall be deemed to be created upon the completion of the pledge registration with the competent authorities of industry and commerce."[2]

Based on the requirements above in the *Property Law*, the *Measures* provide further stipulation that, in Article 2 of the *Measures*, "the *Measures* shall be applicable to shareholders who intend to pledge shares in limited liability companies registered in Shanghai at the same time pledgor and pledgee intending to apply to the authorities of industry and commerce for the pledge registration of such shares." On the other hand, the *Measures* stipulate that the pledge registration of shares in foreign-invested enterprises does not fall within the scope of the *Measures*.

如果您需要本出版物的中文本，请与下列人员联系：

韩东红: (86 21) 6881 8100 - 6609
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Lily Han: (86 21) 6881 8100 - 6609
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

The *Measures* are only applicable to the pledge registration of shares in domestic limited liability companies registered in Shanghai. Compared with the scope of "other shares" specified in Article 226 of the *Property Law*, the scope of the *Measures* has been narrowed such that companies limited by shares are completely excluded.[3]

Registries and Duties of Inspection

According to Article 3 of the *Measures*, the "Shanghai Municipal Administration of Industry and Commerce and its branches are responsible for the pledge registration of shares of limited liability companies which have been registered with them."

The registries shall inspect the format of all application materials. Applicants shall be legally liable for the authenticity of such materials. In an interpretation of the *Measures*, the Shanghai Municipal Administration of Industry and Commerce explains that "the purposes of the registration are to create pledged rights against third parties and to improve the public recognition of the pledges through more effective public announcements. Whether the materials submitted by applicants are legally valid or not is beyond the scope of the registry's duty of inspection." The interpretation is compatible with the *Property Law*.

Registration

Article 4 of the *Measures* specifies the entries required in the registration of share pledge, including names of the pledgor and pledgee, value of pledged shares and term of the pledge.

The registries shall allow the interested parties to agree upon the term of the pledge. If the term of the pledge is expressed as indefinite according to the pledge contract, the registries shall state in the registration form "indefinite". It is a welcoming arrangement as the free will of the interested parties is respected.

The *Measures* also stipulate that the registration of share pledge shall be completed by either the pledgor and pledgee jointly or an agent jointly appointed by the pledgor and pledgee at the competent registry.

Application Documents

According to Article 6 of the *Measures*, an applicant for the registration of share pledge shall file the following documents with the competent registry:

- An application form for the registration of share pledge (the form can be downloaded from the website of the Shanghai Municipal Administration of Industry and Commerce);
- Evidential documents of the joint appointment of representative or agent;
- Contract for the share pledge;
- Identification documents of the pledgor and pledgee regarding their capacity as entities or natural persons;
- Documents indicating the pledge in question and shareholdings of the pledgor as recorded in the register of members of the limited liability company; and
- Evidential documents indicating that the articles of association of the limited liability company do not contain any clauses prohibiting transfer of shares.

In addition, in the case of change or revocation of any entries in the pledge registration, the pledgor and the pledgee shall complete the corresponding procedures for the alteration of the registration or cancellation of the registration, and file the required documents with the competent registry under Articles 7 and 10 of the *Measures*.

Other Matters

The *Measures* also contain provisions governing the relevant issues in relation to the registration procedures for share pledge and public inspection, covering all the basic conditions of the registration of share pledge.

Practical Issues

During the two-month period of implementation of the *Measures*, we have conducted a series of telephone surveys with the State Administration of Industry and Commerce, the Shanghai Municipal Administration of Industry and Commerce and some of its district bureaus in respect of the registration of pledge of shares. Set out below are some key practical issues:

Although "the pledge is deemed created upon the completion of the registration with the administration of industry and commerce" is a provision in the *Property Law*, the State Administration of Industry and Commerce has not yet issued any detailed measures to implement this provision. Our contacts said that local administrations of industry and commerce should be consulted in respect of the implementation of the provision.

The Shanghai Municipal Administration of Industry and Commerce, as the issuing body of the *Measures*, stated that the registration procedures could be completed according to the *Measures* at district and county bureaus of industry and commerce and that some registrations have been successfully completed.

As the *Measures* have been implemented for only a short period, the city's district and county bureaus of industry and commerce impose strict requirements and process the registrations with great discretion. For instance, the Pudong New Area Bureau requires submission of explanatory notes on the share pledge, and requires the officers in charge of the registration to obtain the supervisors' approvals before processing the registration. The Songjiang District Bureau recommends shareholders intending to complete the registration to produce the required documents in person. The bureau will decide their applications within five working days should the documents submitted meet the relevant requirements. The Minhang District Bureau explains after an internal discussion that if the pledgee is a bank, the registration is likely to be processed. If, however, the pledgee is an enterprise, its application for the registration will not be accepted under most circumstances. The officer we contacted advised that further consultation be followed in the near future.

This shows that there is no uniform practice in proceeding this kind of registration between city, district and county bureaus. The Shanghai Municipal Administration of Industry and Commerce explained that district and county bureaus should operate according to the *Measures*, and seek instructions from municipal administration in problematic cases. Therefore, each bureau has a certain degree of discretionary power in this regard.[4]

In spite of uncertainties in the implementation of the *Measures*, the *Measures* no doubt provide an elaborate and practical basis for registrations of pledge over shares in domestic limited liability companies.

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Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Charles Qin Tel: (86 21) 6881 8100 - 6612 (86 10) 6655 5020 Charles.Qin@llinkslaw.com
Michael Mei Tel: (86 21) 6881 8100 - 6639 Michael.Mei@llinkslaw.com

1 It is reported that the Wuhan Administration for Industry and Commerce and Wuzhong Administration for Industry and Commerce (Suzhou) have also promulgated the "*Interim Provisions of Wuhan On the Registration of Pledge of Shares in Limited Liability Companies (Trial)*" and "*Interim Provisions on the Registration of Pledge of Shares in Limited Liability Companies*" to govern this kind of registration of pledge of share. The former was effective from 20 February 2008. However, details of these rules have not been fully revealed.

2 According to the interpretation of the *Property Law* issued by the Legal Affairs Committee of the National People's Congress Standing Committee, "shares registered with securities registration and settlement institutions" in Article 226 include shares of listed companies, shares of companies that offer shares publicly and shares of companies that do not offer shares publicly but have more than 200 shareholders; "other shares" refer to those not registered with the securities registration and settlement institutions, including those of limited liability companies and shareholding companies that do not offer shares publicly and have less than 200 shareholders.

3 After telephone consultation with the Shanghai Administration of Industry and Commerce and some of its branch bureaus, it has been reflected that pledge of shares of foreign-invested enterprises should be governed by "*Certain Provisions on the Alteration of Equity Rights of Foreign-Invested Company Investors*", issued by the former Ministry of Foreign Trade and Economic Cooperation, the State Administration for Industry and Commerce in 1997, and the "*Opinions Concerning the Implementation of the Applicable Laws on the Administration of Approval and Registration of Foreign-Invested Companies*", issued by the State Administration for Industry and Commerce, Ministry of Commerce, General Administration of Customs and the State Administration of Foreign Exchange in 2006.

4 The handling of such registration is still in the initial stage in various district and county bureaus. The above summary is made on the basis of the information currently available. The registration practice may be modified with changes in the rules imposed by the State Administration for Industry and Commerce and the Shanghai Administration of Industry and Commerce as well as changes in the requirements imposed by various district and county bureaus.