Testing the Capacity of the Shareholders' Meeting to Protect Minority Shareholder Rights under the Chinese Company Law

*Allan Verman Y. Ong**

I. INTRODUCTION 683
II. RECENT DEVELOPMENTS IN CHINESE COMPANY LAW...............688
A. Corporate Personality
B. Directors' Duties
C. Some Reflections
III. THE DESIGN OF THE SHAREHOLDERS' MEETING 691

---

* '04 J.D. with honors, Ateneo de Manila University School of Law. The author is currently an associate in Sycip Salazar Hernandez & Gatmaitan Law Office. Atty. Ong was a member of the *Journal's* Editorial Staff of Volume 46, Editor of Volume 47, Executive Editor of Volume 48, and Lead Editor for the first issue of Volume 48. His previous works published in the *Journal* include *Foreign Investment Law: Studying the Administrative Treatment of Legislative Restrictions*, 51 ATENEO L.J. 314; *Infusing Principles of Corporate Governance in Corporate Law: A Proposed Hierarchy of Director Accountabilities to Various Stockholders*, 50 ATENEO L.J. 479 (2005); *Upholding the Right to Freedom and Fear: An Examination of the Jurisprudential Response of Criminal Procedure and the Law on Public Offices to the Threat of Kidnapping for Ransom*, 48 ATENEO L.J. 1260 (2004); *The Commercial Ends that Motivate Legal Profession: An Alternative Model to Understanding the Rules that Govern the Practice of Law*, 48 ATENEO L.J. 749 (2003); *The Implication of the Principles of Corporate Governance on the Doctrine of Piercing the Veil of Corporate Fiction: Rethinking MR Holdings v. Bajar*, 48 ATENEO L.J. 209 (2003); and, *Judicial Policy in the Law on Public Offices*, 47 ATENEO L.J. 71 (2002). He also co-*authored Examining the Standards for the Approval of Rehabiliation Plans in Corporate Rehabilitation Proceedings* with Kelvin Lester K. Lee, 50 ATENEO L.J. 878 (2006).

Laws in China are enacted in Mandarin, and no official translations are issued by the National Peoples' Congress to accompany the original enactments. Translations prepared by academicians, government agencies, and private commercial entities are available, but some translations may contain errors. For purposes of this essay, the translation prepared by LawInfoChina (*beidafalv yingwenwang*) was used. The author verified the translations with the original enactments in Mandarin but all errors that remain are the author's own.

Cite as 53 ATENEO L.J. 682 (2008).

A. Convening the Shareholders' Meeting
B. Voting Procedure
C. Other Special Rules
IV. CRITIQUE OF THE DESIGN OF SHAREHOLDERS' MEETINGS........694
A. Lack of a Quorum Requirement
B. Passive Role of the Company in Information Dissemination
V. POSSIBLE REASONS BEHIND THE MECHANICS OF THE SHAREHOLDERS' MEETINGS..701
VI. CONCLUSION 704

I. INTRODUCTION

When the Company Law[1] (*gongsi fa*) was first enacted in 1993 by the National People's Congress, it was intended to provide a legal framework for companies to set up business in the People's Republic of China (China),[2]

1. Company Law of the People's Republic of China [COMPANY LAW] (1993).
2. This discussion on Chinese Company Law in this article is limited to the Company Law in effect in mainland China. The Hong Kong Special Administrative Region (HKSAR), in accordance with the Basic Law of the HKSAR of the PRC, promulgated Apr. 4, 1990 and effective July 1, 1997, provides that the HKSAR is authorized by the National People's Congress of the PRC to exercise a high degree of autonomy and to enjoy executive, legislative and independent judicial power (Basic Law of the Hong Kong Administrative Region [HKSAR BASIC LAW], art. 2 (1990)) and that laws previously in effect in Hong Kong shall be maintained (*Id.* art. 8.). "The major source of Hong Kong's company law is common law, and the principles of equity are supplemented by a rather developed statutory framework. The most important piece of legislation in this area is the Companies Ordinance, which was enacted in 1865." (Lutz-Christian Wolff, *The Disappearance of the Ultra Vires Doctrine in Greater China: Harmonized Legislative Action or (simply) an Accident of History?* 23 NW. J. INT'L & BUS. 633 (2003)). The Macao Special Administrative Region (MSAR), in accordance with the Basic Law of the MSAR of the PRC, promulgated Mar. 31, 1993 and effective Dec. 20, 1999, provides that the MSAR is authorized by the National People's Congress of the PRC to exercise a high degree of autonomy and to enjoy executive, legislative and independent judicial power (Basic Law of the Macao Special Administrative Region [MSAR BASIC LAW], art. 2 (1993)) and that laws previously in effect in Hong Kong shall be maintained *(Id.* art. 8). "In 1989, the [Macao] government entrusted a Portuguese expert with the preparation of the draft of a [Macao] Company code. The draft … was used by the [Macao] lawmakers as a basis for the company-law-related stipulations contained in the [Macao] Commercial Code, which became law on Nov. 1, 1999." (Wolff, *supra* note 2) Taiwan (the Republic of China) has its own system of laws independent from the Chinese legal system. "The ROC Company Law is the major source of the formation,

but it was primarily intended to facilitate the corporatization of State-owned enterprises (SOEs).[3] After several years of experiment of a State-planned economy, it appeared that the most efficient means to achieve prosperity was to introduce elements of a market economy into China. The newly enacted Company Law sought to change SOEs into institutions that would no longer have as its primary motive the objectives laid down by the State, and would no longer be managed by a State-appointed government officer. At the same time, it allowed for the creation of privately held companies where all the parties are private persons. Thus, the Company Law provided for the creation of two kinds of companies — limited liability companies (*youxianzeren gongsi* or LLC) which is a corporation formed by less than 50 shareholders[4] and with lower capitalization requirements,[5] and joint stock limited company (*gufenyouxian gongsi* or JSLC), which is a corporation formed by promotion or stock flotation[6] and with higher capitalization requirements.[7]

It should be noted, however, that this was not the first time that elements of the market economy would enter into China. It is interesting to note that the earliest piece of legislation in China that governed the corporate form of doing business was enacted in relation to foreign enterprises conducting business in China.[8] These laws were enacted in order to put into place a stable legal regime in relation to foreign investment, to attract enterprises with foreign investments.[9] But the Company Law also has a suppletory effect as to matters which are not specifically provided for by the laws dealing with enterprises with foreign investment.[10]

The Company Law that emerged has characteristics that are unique to China. As if mirroring the constitutional mandate that China is under the

---

organization, operation and dissolution of incorporated business entities in Taiwan." (*Id.*).

3. Shi Chenxia, *Protecting Investors in China Through Multiple Regulatory Mechanisms and Effective Enforcement*, 23 ARIZ. J. INT'L & COMP. L. 1 (2007).
4. COMPANY LAW, art. 24.
5. Article 26 of the Company Law provides that the minimum amount of registered capital of an LLC is 30,000 Chinese Renminbi ("RMB").
6. COMPANY LAW, art. 78.
7. Article 81 of the Company Law provides that the minimum amount of registered capital of an LLC is RMB 5,000,000.
8. These are (a) the Law of the PRC on Chinese-Foreign Equity Joint Ventures (*zhongwaihezi jingyingqiyefa*), promulgated July 1, 1979, as amended, (b) the Law of the PRC on Chinese-Foreign Contractual Joint Ventures (*zhongwaihezuo jing yingqiyefa*), promulgated Apr. 13, 1988, as amended, and (c) the Law of the PRC on Foreign-Capital Enterprises (*waiziqiyefa*), promulgated Apr. 12, 1986.
9. Wolff, *supra* note 2.
10. *Id.*

people's democratic dictatorship led by the working class,[11] the drafters chose to vest full control over the corporation on its most basic constituencies, the shareholders. Thus, the shareholders' meeting (*gudonghui*) in an LLC and the shareholders' assembly (*gudongdahui*) in a JSLC, is the "authority of the company" and exercises the company's powers[12] (both shareholders' meeting and shareholders' assembly are hereinafter referred to as "shareholders' meeting"). The Company Law provides:

> The shareholders' meeting shall exercise the following functions:
>
> 1. Determining the company's operational guidelines and investment plans;
> 2. Electing and changing the directors and supervisors assumed by non-representatives of the employees and deciding the matters relating to their salaries and compensations;
> 3. Deliberating and approving reports of the board of directors;
> 4. Deliberating and approving reports of the board of supervisors or the supervisor;
> 5. Deliberating and approving annual financial budget plans and final account plans of the company;
> 6. Deliberating and approving company profit distribution plans and loss recovery plans;
> 7. Making resolutions about the increase or reduction of the company's registered capital;
> 8. Making resolutions about the issuance of corporate bonds;
> 9. Adopting resolutions about the assignment, split-up, change of company form, dissolution, liquidation of the company;
> 10. Revising the bylaw of the company;
> 11. Other functions as specified in the by-law.[13]

In turn, the Company Law virtually limits the functions of the board of directors to implementing the matters that have already been decided by the shareholders.[14] To wit, the Company Law provides:

---

11. PEOPLE'S REPUBLIC OF CHINA CONST. art. 1.

12. COMPANY LAW, arts. 38 & 100.

13. *Id.* art. 38. This provision applies to LLCs, but the same rule applies to JSLCs. To wit, Article 100 of the Company Law provides, "The provisions regarding the powers of the shareholders' assembly of a limited liability company as prescribed in the first paragraph of Article 38 of this Law shall apply to the shareholders' assembly of a joint stock limited company."

14. *Id.* arts. 47 & 109.

> The board of directors shall be responsible for the shareholders' meeting and exercise the following functions:
>
> 1. Convening shareholders' meetings and presenting reports thereto;
> 2. Implementing the resolutions made at the shareholders' meetings;
> 3. Determining the company's business and investment plans;
> 4. Working out the company's annual financial budget plans and final account plans;
> 5. Working out the company's profit distribution plans and loss recovery plans;
> 6. Working out the company's plans on the increase or reduction of registered capital, as well as on the issuance of corporate bonds;
> 7. Working out the company's plans on merger, split, change of the company form, or dissolution, etc.;
> 8. Making decisions on the establishment of the company's internal management departments;
> 9. Making decisions on hiring or dismissing the company's manager and his salary and compensation, and, according to the nomination of the manager, deciding on the hiring or dismissal of vice manager(s) and the persons in charge of finance as well as their salaries and compensations;
> 10. Working out the company's basic management system; and,
> 11. Other functions as specified in the by-laws.[15]

This is in stark contrast to the company law regimes in other jurisdictions. For instance, under the standard governance system in the United States of America, the board of directors has the central role and bears ultimate responsibility for the conduct of the corporation's business.[16] Under Section 8.01 (b) of the Model Business Corporation Act: "All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed by or under the direction of, its board of directors...."[17] Under the Japanese Corporation Law, unless the articles of incorporation provide the contrary, the directors execute the business of the company.[18]

---

15. *Id.* art. 47. This provision applies to LLCs, and also to JSLCs, as Article 109 of the Company Law provides, in part, that "The provisions in Article 47 of this Law on the functions of the board of directors of a limited liability company shall apply to the board of directors of a joint stock limited company."

16. LEWIS D. SOLOM, CORPORATIONS LAW AND POLICY, MATERIALS AND PROBLEMS 373 (3d ed. 1999).

17. Committee on Corporate Laws of the Section of Business Law, Model Business Corporation Act, *available at* http://www.abanet.org/buslaw/library/onlinepublications/mbca2002.pdf (last accessed Nov. 16, 2008).

18. The Commercial Code of Japan, Law No. 48, art. 348 (1899).

Under the Philippine Corporation Code, the corporate powers of all corporations, all business conducted and all property of such corporations controlled and held by the board of directors.[19]

There are several theories behind the primal role given to the board of directors and the arguments have become commonplace in corporate law and governance — it is more efficient for shareholders who may be otherwise dispersed to entrust management of the corporate affairs to the board of directors, and shareholders may be persons who have capital to do business but do not have the expertise that the directors have in order to manage these funds.[20] Imposing a "forced" delegation of decision-making power on the shareholders is precisely an advantage that the corporate form of doing business enjoys — centralized management.[21] The fact that Chinese Company Law places the greatest decision-making powers on shareholders rather than the board of directors means that its Legislature, the National Peoples' Congress (*quanguorenmin daibiaodahui*), was willing to forego the advantages of having centralized management of the corporation, in order to fulfill other goals.

Vesting the ultimate decision-making power on the shareholders' meeting, however, is problematic. Unlike directors who are required to observe duties of diligence and fidelity,[22] shareholders do not have such duties and are free to pursue their own agenda. Usually, a common agenda binds both the majority and the minority shareholders in a company — profit. But the history of corporate governance is replete with accounts of the oppression of minority shareholders, and studies have shown that this same problem exists in China.[23] And from the provisions of the Company Law, it appears that there is wide latitude granted to majority shareholders to exploit the interest of minority shareholders, particularly in the company's decision-making process. This Article is therefore an examination of the shareholder

---

19. The Corporation Code of the Philippines [CORPORATION CODE], Batas Pambansa Blg. 68, § 23 (1980).

20. ROBERT C. CLARK, CORPORATE LAW 94 (1986).

21. *Id.* at 21.

22. COMPANY LAW, art. 148.

23. Chenxia, *supra* note 3; Donald C. Clarke, *The Independent Director in Chinese Corporate Governance*, 31 DEL. J. CORP. L. 125 (2006); Qiao Liu, Corporate Governance in China: Current Practices, Economic Effects and Institutional Determinants, *available at* http://cesifo.oxfordjournals.org/cgi/content/full/52/2/415?maxtoshow=&HITS=10&hits=10&RESULTFORMAT=&fulltext=%22Qiao+Liu%22&searchid=1&FIRSTINDEX=0&resourcetype=HWCIT (last acceseed Dec. 19, 2008); Steven Yan-Leung Cheung, et al., The Helping Hand, the Lazy Hand, or the Grabbing Hand? Central vs. Local Government Shareholders in Publicly Listed Firms in China, *available at* http://ssrn.com/abstract=673283 (last accessed Nov. 16, 2008).

meeting as the most powerful body in a Chinese company in terms of decision-making, and its implications in good corporate governance, particularly the possible oppression of minority shareholders.

The first Part of this Article provides a framework of Company Law, highlighting recent changes enacted as recent as 2005. The second Part summarizes the rules of the shareholder meeting for both the LLC and the JSLC. The third Part of this Article discusses the flaws in the design of the rules for shareholder meetings. The fourth Part discusses the possible reasons for the current design of the shareholders' meetings, and a discussion on how it may be possible to reform the rules. The last Part concludes.

II. RECENT DEVELOPMENTS IN CHINESE COMPANY LAW

The 2005 amendments to the Company Law, which took effect on January 1, 2006, sets down several important mechanisms which provide more protection to minority shareholders. These mechanisms — independent director requirements, proposed cumulative voting, shareholder suits, and piercing of the corporate veil of fiction — are common in business organization laws the world over, mark a shifting of the paradigm in Chinese corporate law. Indeed, the Company Law creates a legal regime that is familiar to lawyers the world over. This Part will survey some select aspects of Company Law, which are the corporate personality of companies formed under the law and duties of the board of directors.

A. Corporate Personality

Under the law, a company is an enterprise legal person (equivalent to the Philippine concept of "an artificial being created by operation of law"[24]), which has property independent from its shareholders, and bears liabilities for its debts with all its property.[25] Shareholders of LLCs are liable for the company's obligations to the extent of the capital contributions it has paid. On the other hand, shareholders of JSLCS are liable for company debts to the extent of the shares it has subscribed to.[26]

A company is required to define its business scope in its articles of association and shall be registered according to law. The company may change its business scope by modifying its articles of association, but it shall go through the formalities for modifying the registration.[27] Note that in spite

24. CORPORATION CODE, § 2.

25. COMPANY LAW, art. 3.

26. *Id.*

27. *Id.* art. 12.

of these seemingly restrictive provisions, China has abandoned the concept of *ultra vires* acts.[28]

The China Securities Regulation Commission issues company business licenses to entities that are able to comply with the legal requirements for incorporation. The date of issuance of the company business license is considered the date of establishment of the company. The company business license states such information as the name, domicile, registered capital, actually paid capital, business scope, and the legal representative of the company. If any of the items as stated in the business license are changed, the company should modify the registration and the company registration authority shall replace its old business license by a new one.[29]

The 2005 amendments lay down what is the equivalent of the doctrine of piercing the veil of corporate fiction under Chinese corporate law. Thus, where any of the shareholders of a company evades the payment of its debts by abusing the independent status of the company as a legal person or the shareholders' limited liabilities and such act seriously injures the interests of any creditor, such shareholder will be made to bear joint and several liability (*liandaizeren*) for the debts of the company.[30]

B. Directors' Duties

Directors, supervisors and senior managers are required to comply with laws, administrative regulations, and articles of association and they bear obligations of fidelity and diligence to the company.[31] They may not take any bribe or other illegal gains by taking the advantage of his powers, or encroach on the property of the company.[32] As part of their duties of fidelity, directors and senior managers may not misappropriate the company's fund, or perform any acts without being authorized by shareholders, such as depositing the company's fund into an account in his own name or in any other individual's name or loaning the company's fund to others or providing any guaranty to any other person by using the company's property.[33] Furthermore, the directors who have any relationship with the enterprise involved in a matter to be decided at the meeting of the board of directors may not vote on this resolution, nor may he vote on behalf of any other

28. *See* Wolff, *supra* note 2.

29. COMPANY LAW, art. 7.

30. *Id.* art. 20.

31. In China, as well as in other jurisdictions where the *ultra vires* doctrine has been abandoned, directors do not owe shareholders the "duty of obedience" as exemplified in § 45 of the Corporation Code.

32. COMPANY LAW, art. 148.

33. *Id.* art. 149.

person. Rules are adopted if a resolution needs to be arrived at in such cases.[34]

Stricter rules are provided in cases of listed companies, which are required to have independent directors.[35] During their term of office, directors in listed companies are not allowed to transfer yearly more than 25% of the total shares of that he owns in the company. Also, after he is removed from his post, he may not transfer the shares of the company he or she holds.[36]

The 2005 amendment of the Company Law now lays down a duty of diligence on the directors, which was not present in the original 1993 enactment. The duty of diligence, which includes fiduciary duties towards the company, is more difficult to define in a strictly civil law system, since a company director faces so many different situations everyday that it is difficult for the law to provide an exhaustive code of behavior that a director can use as a guide. The Company Law therefore provides a listing, in Articles 149 and 150, of acts that are prohibited and imposes liability on the performance of these acts. The Company Law even sets a higher standard of liability for the director, since the director appears to be liable even for ordinary negligence in the pursuit of his duties, in contrast to the members of the liquidation group, who are liable for damages only when their actions constitute gross negligence.[37] It may be noted that under the Philippine Corporation Code, directors are liable only when their acts constitute gross negligence.[38]

Under the Company Law, the if any director or senior manager damages the shareholders' interests by violating any law, administrative regulation, or the articles of association, the shareholders may lodge a lawsuit in the people's court,[39] and the director, supervisor or senior manager may be made liable for compensation.[40]

Minority shareholders are empowered to initiate this suit — those shareholders holding, individually or aggregately holding one percent or more of the total shares of the company for 180 consecutive days or more may request in writing the board of supervisors or the supervisors to initiate the suit. If such persons refuse or fail to lodge the suit after receipt of the

34. *Id.* art. 125.

35. *Id.* art. 123.

36. *Id.* art. 142.

37. *Id.* art. 190.

38. CORPORATION CODE, § 31.

39. COMPANY LAW, art. 153.

40. *Id.* art. 150.

written request, or in case of an emergency, the shareholder may directly lodge a lawsuit in the people's court.[41]

If the legitimate rights and interests of a company are impaired and any losses are caused to the company, the shareholders may also initiate a lawsuit in the people's court.[42]

These provisions, which are new introductions under the 2005 amendments, seek to capture the equivalent of derivative suits in foreign company law systems. At times, even when a director performs acts which damage the corporation, the other directors may have entrenched interests in maintaining the current set-up of the corporation and may be reluctant to file a case against one of its members. Thus, this new provision which allows the shareholder himself to bring the suit allows the shareholder to be able to truly police director actions. The fact that shareholders now have an effective means to check the actions of the directors, by bringing a suit against the director on behalf of the company, may also have the effect of directors more circumspect in acting, preventing possible abuse.

C. Some Reflections

Up to this point, most of the provisions of the Company Law that have been discussed are similar, or even identical, to most corporate law systems in the world. It is on this background of a familiar corporate law system on which unique Chinese elements (*zhongguo tese*) have been embedded. A deeper investigation of the Company Law will therefore be interesting as a study of the interaction of elements of the market economy in a socialist system.[43]

III. THE DESIGN OF THE SHAREHOLDERS' MEETING

Having established a point of comparison between the Company Law and other corporate law regimes, with the observation that many aspects are actually similar or even identical with other corporate law regimes, a study of the unique elements of Chinese corporate law can now be undertaken, particularly on the governance of the company through the shareholders' meeting, as the main decision making body of the corporation.

This Part provides a brief summary of the provisions of the Company Law on the shareholders' meeting. A separate discussion is provided for LLCs and JSLCs, but for the areas where identical provisions apply for LLCs and JSLCs, the discussion will be joined.

---

41. *Id.* art. 152.

42. *Id.* art. 152.

43. The Chinese Constitution describes the form of the Chinese government as a socialist system with Chinese characteristics, or *youzhongguotesede renminzhuyi*.

A. Convening the Shareholders' Meeting

Shareholders' meetings are classified into regular meetings and interim meetings. For LLCs, the regular meetings should be timely held in accordance with the articles of association.[44] Interim meetings may be proposed by (a) shareholders representing 1/10 of the voting rights or more, (b) directors representing 1/3 of the voting rights or more, or (c) board of supervisors.[45]

For LLCs, the shareholders' meeting is convened and presided over by the shareholder who made the largest percentage of capital contributions.[46] Where an LLC has set up a board of directors, the shareholders' meetings is convened by the board of directors. In the event of the failure or inability of the board to do so, the supervisors and even the shareholders representing 10% or more of the voting rights may convene a meeting.[47] Meetings are presided over by the shareholders with the largest percentage of capital contribution.[48] Where an LLC has set up a board of directors, the shareholders' meetings is presided by the chairman of the board. In his failure or inability to do so, the deputy chairman of the board or a director jointly recommended by half or more of the directors may preside over the meeting.[49] If the LLC has no board of directors, the shareholders' meetings will be convened and presided over by the executive director.[50]

Each shareholder should be notified of the meeting 15 days before a shareholders' meeting is held, unless it is otherwise specified by the articles of association or it is otherwise stipulated by all the shareholders.[51]

A JSLC also has an annual session of its shareholders' meeting and an interim shareholders' meeting.[52] In the JSLC, the board of directors, the board of supervisors, and the shareholders may call for an interim shareholders' meeting.[53] However, certain events will automatically trigger the call for an interim meeting, without need for a call, and these are when (a) the number of directors falls below two-thirds of the number of directors as required by the Company Law or the articles of association; (b) the un-

44. COMPANY LAW, art. 40.

45. *Id.* art. 40.

46. *Id.* art. 39.

47. *Id.* art. 41.

48. *Id.* art. 39.

49. *Id.* art. 41.

50. COMPANY LAW, art. 41.

51. *Id.* art. 42.

52. *Id.* art. 101.

53. *Id.* arts. 101 (4), (5), & (3).

recovered losses of the company reach one-third of the total paid-in capital; and (c) other circumstances as specified in the articles of association.[54]

The parties responsible for convening and presiding over the shareholders' meetings in JSLCs follow the same rules as in the LLC, except that there is no option for the largest shareholder in a JSLC to convene or preside over the meeting.[55]

For JSLCs, notice to the meeting should be given to each shareholder 20 days in advance, which shall state the time and place of the meeting, and the matters to be deliberated at the meeting. An interim meeting requires only 15 days advanced notice. For unregistered stocks, the time and place of the meeting and the matters to be deliberated at the meeting should be announced 30 days in advance.[56]

B. Voting Procedure

In the shareholders' meeting in LLCs, voting rights are exercised based on the percentage of the capital contributions of the shareholders.[57] No other provision provides for the threshold of votes that is required to be obtained in order for resolutions to pass, apart from the requirement that in order to approve the revision of the articles of association, the increase or decrease of registered capital, merger, split-up, dissolution or change of company form, the approval should come from shareholders representing 2/3 or more of the voting rights.[58]

In JSLCs, it is different. When any resolution is to be made by the shareholders' meeting, it should be adopted by shareholders representing more than half of the voting rights of the shareholders present.[59] Similar to LLCs, a higher threshold is required in deciding to modify the articles of association, or to increase or reduce the registered capital, or a resolution about the merger, split-up, dissolution or change of the company form. But the vote requirement is different — it is 2/3 or more of the voting rights of the shareholders in presence.[60]

Note also that JSLCs may adopt a cumulative voting system for the election of directors or supervisors.[61] Furthermore, a special rule for listed

54. *Id.* arts. 101 (1), (2) & (6).

55. *Id.* art. 102.

56. COMPANY LAW, art. 103.

57. *Id.* art. 41.

58. *Id.* art. 44.

59. *Id.* art. 104.

60. *Id.*

61. *Id.* art. 106.

companies is that when it purchases or sells any important asset, or provides a guaranty of which the amount exceeds 30% of its total assets, a resolution shall be made by the shareholders' meeting which requires the vote of shareholders representing 2/3 of the voting rights of the shareholders in presence.[62]

C. Other Special Rules

In shareholders' meetings of JSLCs, shareholders may not make any decision on any matter not listed in the notice of the meeting that is sent out to shareholders.[63]

Shareholders of a JSLC who individually or aggregately hold at least three percent of the shares of the company may put forward a written interim proposal to the board of directors of additional matters to be discussed in a shareholders' meeting.[64]

All shareholders have the right to participate in the shareholders' meeting. If the procedures for calling a shareholders' meeting is in violation of any law, administrative regulation or the articles of association, the shareholders may ask the court to revoke the meeting.[65] Furthermore, a resolution of the shareholders' meeting, shareholders' assembly or board of directors of the company that is in violation of any law or administrative regulation shall be null and void, and shareholders have the right to go before the court to seek a declaration that the resolution is void from the beginning.

IV. CRITIQUE OF THE DESIGN OF SHAREHOLDERS' MEETINGS

A quick look at the provisions of the Company Law on shareholders' meetings gives the impression that the shareholders' meeting runs on the same mechanics as are commonly found in other jurisdictions. However, a careful reading of the provisions reveals that there are some fundamental problems with the set-up of the shareholders' meeting. This Part explores some of these problems.

A. Lack of a Quorum Requirement

There is no requirement under the provisions of the Company Law for a quorum to be present during shareholders' meetings. By "quorum," we mean a rule requiring that a minimum number of members of a deliberative body should be present in order to conduct the business of that group.

62. COMPANY LAW, art. 122.

63. *Id.* art. 103.

64. *Id.* art. 102.

65. *Id.* art. 22.

Ordinarily, this is a majority of the persons expected to be present. For example, under the Philippine Corporation Code, a quorum ordinarily consists of the stockholders representing a majority of the outstanding capital stock or a majority of the members in the case of non-stock corporations.[66]

The lack of a requirement of a quorum has different implications for the shareholders' meetings in LLCs and JSLCs. A separate discussion is therefore necessary for each.

1. Implications for the Lack of Quorum Requirement in JSLCs

The statutory provisions for JSLCs are clear. Article 104 of the Company Law, in part, states: "When any resolution is to be made by the shareholders' assembly, it shall be adopted by shareholders representing more than half of the voting rights of the shareholders in presence."[67] Since a resolution may be passed when it is adopted by the shareholders representing more than half of the voting rights present in the meeting (not the total voting rights), and since there is no minimum attendance requirement, then any resolution can theoretically be adopted shareholders who represent less than majority of the total voting rights of the corporation.

This Provision of the Company Law appears to pursue a good end. A JSLC may have widely dispersed shareholders and it may be difficult to gather all the shareholders to pass resolutions that might be urgently needed by the company. Consider further that the Company Law requires that shareholders decide on more issues and are actually the governing body of the corporation, rather than the board of directors. Thus, it can be expected that shareholders of Chinese companies will be expected to meet more often than their counterparts acting under a different corporate law regime. If the vote of shareholders representing majority of the voting rights is required to be present in order to pass resolutions, then the operations of the company can be paralyzed by the refusal of shareholders to attend meetings.

However, there are some defects in this system which are apparent. Through the control they exercise on the chairman of the board who convenes the meeting, the majority shareholders can sway the chairman to schedule the meeting on the date most convenient for the majority, or conversely, the date most inconvenient to convene the minority. If the majority shareholders truly wish to exercise bad faith against the minority shareholders, they can schedule the shareholders' meetings on holidays or non-working days when it will be impossible, or at least extremely inconvenient, for a large group of minority shareholders to attend the meetings to raise objections.

66. CORPORATION CODE, § 52.

67. COMPANY LAW, art. 104.

The thresholds required to approve important corporate matters should also provide some discomfort for minority shareholders. Article 104 of the Company Law provides: "[R]esolutions of a shareholders' assembly concerning the amendment of the company's articles of association, the increase or reduction of registered capital, the merger, division, dissolution or restructuring of the company shall require at least 2/3 of the voting rights held by the shareholders in attendance for adoption."[68] This means that since there is no quorum requirement, there is no lower limit to the attendance of shareholders in order to make the shareholders' meeting valid. Further, if 2/3 of the voting rights present will vote for the merger, then the company can actually be merged with another company based on the vote that represents a virtual minority of the voting rights in the corporation. These Provisions of the Company Law make it simple matter for the controlling shareholders, who do not even have to occupy majority position in the shareholdings of the company, to abuse rights of minority shareholders.

2. Implications for the Lack of Quorum Requirement in LLCs

For LLCs the provisions of the Company Law are not very clear. Article 43 states: "The shareholders shall exercise their voting rights at the shareholders' meetings on the basis of their respective percentage of the capital contributions unless it is otherwise prescribed by the articles of association."[69] Article 44 on the other hand states: "A resolution made at a shareholders' meeting on revising the articles of association, increasing or reducing the registered capital, merger, split-up, dissolution or change of the company form shall be adopted by the shareholders representing 2/3 or more of the voting rights."[70]

The statutes are unclear on how to gather enough votes for an ordinary resolution to pass. While it is clear that for special matters such as for mergers and split-ups, the vote of stockholders representing 2/3 of the voting stock is required, for ordinary matters, the Company Law allows shareholders to decide based on the basis of their capital contribution but without providing for a quorum requirement. This can be interpreted in two ways. First, since the Company Law provides that the vote of the shareholders representing majority of voting rights is needed, even if there is no minimum attendance requirement for an LLC shareholders' meeting to be valid, a meeting attended by stockholders who do not represent a majority of the voting stock will not be able to decide on any matter, since voting rights are exercised based on the percentage of capital contribution. Under this school of thought, a majority vote of the shareholders, *i.e.* more than 50% of the voting stock, is necessary for all resolutions to pass, except for those matters

68. *Id.*
69. *Id.* art. 43.
70. *Id.* art. 44.

requiring the vote of stockholders representing 2/3 of the voting stock. Professor Deng Feng of Peking University subscribes to this interpretation.[71]

A second possible interpretation is that since the Company law sets no quorum requirement, then in the shareholders' meeting, as long as the shareholders decide on the basis of their capital contribution, the requirements of the Company Law are met. So in the example given, the meeting attended by the shareholders representing only 40% of the voting stock will still be able to decide on ordinary matters if a majority of those 40% will vote for the passage of a resolution. Professor Peng Bing of Peking University subscribes to this latter interpretation.[72]

This lack of definitive language in the Company Law leads to confusion in the LLC provisions on the decision-making process in shareholders' meetings. If the rule were interpreted to mean that a majority of the voting rights is required to pass resolutions then the rule is logically and commercially sound. Shareholders may need to meet in order to discuss certain emergency matters that arise, *even if the shareholders representing the majority of the voting stock are not present*. This group that forms less than majority will not be able to issue resolutions because a majority of the voting stock is not present. Since shareholders hold a stake on the corporation arising from the investment they have made, they deserve to be able to control corporate affairs. However, if the rule were interpreted to mean that the vote of shareholders who represent a majority of the subscribed capital could decide on ordinary matters, then the rule appears to be illogical. While such interpretation can serve to make the decision-making process in a company efficient, any efficiency that arises from such a system sacrifices true representation in the company's affairs.

The LLC is a conglomeration of small group of persons who want to engage in the business only with each other. In fact, the Company Law provides for strict rules on the transferability of stock rights in LLCs.[73] The second interpretation of the decision-making process for LLCs will allow a self-serving majority to be able to easily exploit minority interests. The ambiguity of the language of the Company Law does not provide guidance on this vague area and as of the writing of this Article, the Supreme People's Court has yet to issue any interpretation on this provision of the Company Law.

71. E-mail from Deng Feng, Professor, Peking University, to Allan Verman Yap Ong (Dec. 21, 2007) (on file with author).

72. E-mail from Peng Bing, Professor, Peking University, to Allan Verman Yap Ong (Dec. 16, 2007) (on file with author).

73. COMPANY LAW, arts. 72 – 73.

3. Possible Underlying Explanation Behind the Lack of Quorum Requirement

The failure to provide for a quorum requirement can either be viewed as a failure on the part of the Chinese legislators to provide a streamlined design for shareholders' meetings that is to the detriment of minority shareholders, or an intentional move on their part to push for the efficiency in the corporate decision-making process. From the provisions of the Company Law, it appears that there is reason to believe that the underlying motive for not requiring a quorum is this emphasis on efficiency.

To wit, the Company Law requires the notification of shareholders in case meetings are to be held.[74] The Company Law appears to presume that shareholders will receive proper notification, and their non-attendance in the meeting should be construed as a waiver of their right to express their views on matters to be discussed in meetings. If it turns out that they were not notified and resolutions were passed, the Company Law provides for the right of the aggrieved shareholder to file a suit to revoke the resolution.[75] Furthermore, since the Company Law allows for shareholders to provide a quorum requirement when drafting the articles of association.[76] The procedures therefore assume that if the shareholders do not negotiate a quorum requirement into the law, then the default provisions of the Company Law will apply.

The foregoing rationale is an offer to explaining the nature of the rather harsh provisions of the Company Law on the procedures for shareholders' meetings show that the concern of the drafters of the Chinese Company Law is for the efficiency of the running of the corporation. But it appears that this desire for efficiency has created large avenues within which minority shareholders can be abused.

The Provision that allows for resolutions in shareholders' meetings in JSLCs to pass with just the vote of the shareholders present therefore presents enormous implications to the minority shareholders rights. Based on the naked principles of law, and without any other protection to the minority shareholders in the form of shareholders agreements providing for their protection, the minority shareholders in a JSLC occupy a very weak position in the company.

For minority shareholders in LLCs, their status is unclear. The Company Law provision stating that decision-making should be based on their

74. *Id.* arts. 42 & 103.

75. *Id.* art. 22.

76. *Id.* art. 44. "Unless it is otherwise provided for by this Law, the discussion methods and voting procedures of the shareholders' meeting shall be provided for in the articles of association."

respective capital contributions can be interpreted two ways, as described above.

A quorum requirement that will require the presence of shareholders representing majority of the voting stock may possibly serve as a check to possible abuse from the majority shareholder of its right. This should be done so that even if majority shareholders[77] will convene a meeting on a date inconvenient for other shareholders, then no resolutions may still be passed without a quorum being present. The lack of a quorum requirement therefore allows this window of possible abuse by the majority shareholders of the unique design of the decision-making process in JSLC shareholders' meetings. The benefits of not having a quorum, which is primarily efficiency in the decision-making process, do not outweigh the cost to the minority shareholders. This is so especially in the most important decisions of the corporation's life, that is, the amendment of articles of association, mergers and split-ups.

B. Passive Role of the Company in Information Dissemination

Based on the Company Law, the board of directors has a passive role in the dissemination of information, and it is the shareholders who must take an active role if they want to access corporate information. Shareholders of LLCs have the right to consult and take copies of the company's articles of association, minutes of shareholders' meetings, board resolutions, resolutions of the supervisory board and financial accounting reports.[78] Shareholders may consult the company's accounting books by submitting a written request to the company stating his or her reasons.

If the company has a reasonable basis to believe that the shareholder wishes to consult the accounting books for other than legitimate reasons that may cause harm to the company's lawful interests, it may refuse to provide them for the shareholder's consultation and shall give the shareholder a written response explaining its reason within 15 days of the date of submission of the written request by the shareholder. If the company refuses to provide the accounting books for his or her consultation, the shareholder may petition a people's court to require the company to provide him or her the accounting books for consultation.[79]

Shareholders of JSLCs have the right to access a broader range of documents. They have the right to consult the company's articles of

77. Clarke, *supra* note 23. Clarke notes that a study states that by the end of 2002, state shares, or shares that are held by the government in listed companies, represented as much as 47.2% of outstanding shares of listed companies. *Id.* at 134.

78. COMPANY LAW, art. 34.

79. *Id.* art. 34.

association, register of shareholders, corporate bond counterfoils, minutes of shareholders' assembly, resolutions of meetings of the board of directors and the supervisory board, and financial accounting reports. In addition, they have the right to make suggestions or pose questions on the company's operation.[80]

This passive role that is played by the board of directors is consistent with the standard that is applied in corporate law legislation the world over. This is because the management of the company's affairs is centralized with the board of directors, and shareholders are viewed as passive investors in the company. But this is not true under Chinese Company Law. In China, the shareholders hold most of the decision-making power in the corporation. In fact, under Chinese Company Law, the board of directors has a duty that is virtually limited to enforcing the resolutions that are passed by the shareholders.[81]

When a corporation operates, it will mostly be the directors and the managers who will be able to know first-hand the most pressing problems of the corporation. Shareholders may be widely dispersed around the country and may not be able to immediately ascertain if any pressing problem has arisen in the corporation that needs their resolution. Shareholders will need to fully rely on the directors and managers to convene a meeting and set the agenda in order for them to know that their decision is needed.

This great degree of reliance on the directors to disseminate information to the shareholders can give rise to two scenarios. Under a first possible scenario, since directors and managers have no duty to actively disclose information, then they are in a position to conceal information from shareholders and decide on matters even though not within the scope of their duties. Under another possible scenario, the majority shareholders who control the directors and managers will receive a constant flow of information and will be able to use this to exploit the interest of the minority shareholders, such as through the exclusion of the minority shareholders from deciding on matters that might later have an impact on them.

In China, the more probable scenario that will occur appears to be the second scenario, that is, the oppression of the minority shareholders. The company's directors do not have an active role in releasing information to the shareholders. The shareholders therefore need to actively assert their right to access information of the corporation in order to determine if there is a need to exert any managerial role in the corporation. If minority shareholders wish to avoid oppression, they will need to constantly monitor the affairs of the corporation. Without the constant monitoring minority

80. *Id.* art. 98.

81. *Id.* arts. 47 & 109.

shareholders will be unable anyway to exercise the rights designed for minority protection, such as the right of shareholders representing at least 10% of the voting rights to convene a meeting, in case of the failure or refusal of the board of directors or supervisors to do so.[82]

But in order to actively collect information, minority shareholders will need to be constantly vigilant, and this entails prohibitive costs. Unless the minority shareholders know that something is afoot, why should it take time out to obtain information on the company in order to exercise its right to compel the convening of a meeting?

V. POSSIBLE REASONS BEHIND THE MECHANICS OF THE SHAREHOLDERS' MEETINGS

The corporate world of China provides clues towards understanding the present setup of the corporate law, which, as already noted, is extremely oriented towards the majority shareholder. The most important clue is that the majority shareholder in most listed companies, the majority shareholder remains to be the state. Even as the thrust of the Company Law was for the privatization of the SOEs, the State remains as a stakeholder in the corporation that is formed under the corporatization process. A study states that by the end of 2002, State shares, or shares that are held by the government in listed companies, represented as much as 47.2% of outstanding shares of listed companies.[83] Through direct and indirect means of control, it is said that 85% of listed companies were ultimately under State control.[84] This policy of having the State remain as a major shareholder seems to have influenced the underlying philosophy of the Company Law, first in the domination of the shareholder in the corporation as the body that decides on the most important issues of the company and second in the domination of the majority shareholder over minority shareholders. Thus, it has been said that:

> The corporate governance model adopted in China can be described as a control-based model, in which the controlling shareholders — in most cases, the state — employ all feasible governance mechanisms to tightly control the listed firms. We find that that concentrated ownership structure, management-friendly boards, inadequate financial disclosure and

82. *Id.* arts. 41 & 101.

83. Clarke, *supra* note 23, at 134.

84. *Id.* (citing Guy S. Liu & Pei Sun, Identifying Ultimate Controlling Shareholders in Chinese Public Corporations: An Empirical Survey, *available at* http://www.chathamhouse.org.uk/files/3096_stateshareholding.pdf (last accessed Nov. 16, 2008)).

inactive take-over markets have been the standard governance practice commonly observed among the Chinese listed firms.[85]

It has been observed that the governance model of China provides the controlling shareholders with "plenty of leeway to engage in self-dealing and expropriate minority shareholders, and eventually undermine the public's confidence in the stock market."[86] Conversely, empirical studies have shown that in firms in China where governance practices deviate from the control-based model, and closely follow the market oriented governance model, "tend to have better accounting and stock market performance, they also tend to make more efficient corporate decisions that are in the interest of minority shareholders."[87]

It is difficult to argue for reform of the corporate governance mechanisms. It has been argued by scholars that the State wants the enterprises it owns to be run efficiently, but not solely for the purpose of wealth maximization.[88] In "running" the corporatized SOE, the State, even if it now governs not as a regulator but as a shareholder, still seeks the corporation to contribute in maintaining urban employment and directing the control of sensitive industries. The State is therefore playing two roles at the same time: as controlling shareholder and as regulator.[89]

Given this background, it now almost seems almost logical for the State to have designed the shareholders' meeting the way it is right now. The State wants to maintain its control over the enterprise and not to hand over control to directors. This is why the shareholders' meeting is the most important decision-making body in the corporation.

As the majority shareholder, the State can control the board of directors with its appointees, and potentially, the flow of information to the minority shareholders. Thus, even as the minority shareholders have some means to compel the holding of a shareholders' meeting or can gather proxies to gain voting strength, the mechanisms of the shareholders' meeting prevent a meaningful exercise of these rights. Imposing a quorum requirement on shareholders' meetings can potentially address the deficiency of resolutions being adopted by less than the majority of the voting rights.

Similarly, changing the information disclosure mechanism of companies, such as by imposing a disclosure requirement on JSLCs that is currently imposed only on listed companies, may allow shareholders to more

85. Liu, *supra* note 23.

86. *Id.*

87. *Id.*

88. Donald Clarke, Corporate Governance in China: An Overview, *available at* http://ssrn.com/abstract=424885 (last accessed Nov. 16, 2008).

89. Liu, *supra* note 23.

meaningfully exercise their right to decide on the corporation's business affairs, and their right to compel the convening of a meeting. There however appears to be little incentive for the State to move in this direction. Reform in this direction will lessen the power of the State to control the affairs of the corporation, and given the complex ties and interests of the State and the corporations where it holds an interest, it does not seem that reform will come soon.

It may be noted further that other bodies of law apply in corporations where foreign parties hold large shareholdings, which are in wholly foreign-owned enterprises, Chinese-Foreign contractual joint ventures and Chinese-Foreign equity joint ventures. Equity joint ventures form a board of directors which is empowered:

> [P]ursuant to the provisions of the articles of association of the joint venture, to discuss and decide all major problems of the venture: expansion programmes, proposals for production and operating activities, the budget for revenues and expenditures, distribution of profits, plans concerning manpower and pay scales, the termination of business and the appointment or employment of the president, the vice-president(s), the chief engineer, the treasurer and the auditors, as well as their powers and terms of employment[.][90]

For a contractual joint venture, a board of directors or a joint managerial institution is formed which will, according to the contract or the articles of association for the contractual joint venture, decide on the major issues concerning the venture.[91] Lastly, while there is no direct grant for a board of director centered management for wholly-owned foreign enterprises, the relevant law provides that such enterprises shall conduct their operation and management in accordance with the approved articles of association and shall be free from any interference,[92] which means that such enterprise may provide for the decision making powers to be vested with the board of directors.

The relevance of these provisions is two-fold. First, by allowing for a board of directors to manage the corporation, minority shareholders will be able to elect representatives to the board of directors. This representative of the minority shareholders will be able to advocate the causes of the minority shareholders in the decision-making process of the board of directors.

90. Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, Order of the Chairman of the Standing Committee of the National People's Congress No. 7, art. 6 (1979).

91. Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, Order of the President No. 40, art. 12 (1988).

92. Law of the People's Republic of China on Foreign Capital Enterprises, Order of the President No. 41, art. 11 (1986).

Groups of minority shareholders may also muster votes needed to appoint more directors in the board. Second, the provisions are crafted broadly such as to recognize the validity of making private arrangements in the governance of corporate affairs. For instance, it would be possible for minority shareholders to negotiate high vote requirements for certain corporate acts where their interests might be prejudiced, the accumulation of proxies may be allowed, and other extra-corporate means of corporate control may be possible, such as control of sources of financing.

All these are not available to companies governed purely by the regime laid down under the Company Law. Without the protection that is granted under such a regime, the shareholders that stand to suffer the most from the current status of the law are Chinese individuals and companies who are minority shareholders in the companies governed by the Company Law. While minority shareholders in Chinese companies may be able to appoint directors to the board of directors, the diminished powers of the board of directors in companies established under the Company Law prevent the directors from actively championing the causes of minority shareholders or preventing their oppression.

VI. CONCLUSION

Minority shareholders have now been given greater minority protection rights, including the right to compel the company to by back their shares when the shareholder dissents with the majority's decision on mergers or split-ups.[93] But a healthy, and developed, capital market is not created by giving the minority shareholders, who are important sources of capital themselves, the right to leave when they are oppressed. Protecting minority shareholders from abuse will create incentives for more holders of capital to pour in funds into corporations. This will in turn encourage the growth of the Chinese capital market.

Part of the problem that minority shareholders have under the current Company Law is that while they are part of the most important decision-making body of the firm, the majority directors have incredibly large leeway to nullify their opportunity to meaningfully participate in this decision-making process. Based on the ideas presented in this Article, there is no need for huge changes to be incorporated in the Company Law in order to give shareholders more protection — small adjustments to the system can create a more secure representative system.

Thus, a quorum requirement will help to make decisions in LLC and JSLC shareholders' meetings to be truly representative of the shareholders. On the other hand, active disclosure requirements will allow the minority shareholders to be able to effectively participate in the "shareholder

93. COMPANY LAW, art. 143.

democracy." But incorporating these "small" adjustments may be difficult. Based on the structure of the Company Law as well as an examination of empirical evidence, it appears that the current structure of the Company Law is intended to protect entrenched interests within the system.

Ultimately, quite some work still needs to be achieved in the Chinese Company Law system. Although there has been a transition to a market economy, the relinquishment by the state of its shareholder interest in corporations may be necessary in order to fully create and implement a system where minority shareholders can fully and effectively participate in shareholders' meetings. This relinquishment allows the State to meaningfully perform its role as regulator, and avoid any possible conflicts of interest that may arise when the regulator and the body being regulated are merged in one entity.