under a board structure; and (5) transferable shares'.[82] As Hansmann and Kraakman (2004) point out, these attributes are to some extent universal in nature:[83]

> These characteristics are … included by the economic exigencies of the large modern business enterprises. Thus, corporate law everywhere must, of necessity, provide for them. To be sure, there other forms of business enterprise that lack one or more of these characteristics. But the remarkable fact – and the fact we wish to stress – is that, in market economies, almost all large-scale business firms adopt a legal form that possess[es] all five of the basic characteristics of the business corporation. Indeed, most small joint-owned firms adopt this corporate form as well, although sometimes with deviations from one or more of the five basic characteristics to fit the special needs of closely held firms … Self-evidently, a principal function of corporate law is to provide business enterprises with a legal form that possesses these five core attributes.

Hansmann and Kraakman (2004) further remark that '[b]usiness corporations have a fundamentally similar set of legal characteristics – and face a fundamentally similar set of legal problems – in all jurisdictions'.[84]

Indeed, the laws of corporations around the world, when they were first enacted, were very similar[85] largely because of the inherent nature of Western commerce and capitalism. The transplantation of corporate law from leading origin countries of the civil law and common law families, mainly England, France, Germany, and the United States, to countries in other regions has led to tremendous similarities in the basic legal framework of corporations across the globe. However, as the corporate world grew, divergence began to emerge among the origin countries, as they had to provide legal and institutional solutions to indigenous problems that occurred in different national settings that bore – sometimes slightly and other times extremely – different legal culture and philosophy from others. As a result, in terms of corporate law, the origin countries differ 'in how they responded to the challenges of the rapid growth of the enterprise and financial sectors and to the booms and busts

[82] Hansmann and Kraakman (2001), p. 440. Clark (1986, p. 2) identifies four characteristics of the corporation: '(1) limited liability for investors; (2) free transferability of investor interests; (3) legal personality (entity-attributable powers, life span, and purpose); and (4) centralized management'. See also Monks and Minow (2004), p. 11.

[83] pp. 1–2.

[84] p. 1.

[85] Pistor *et al.* (2003), p. 89 (noting '[w]hen the first corporate statutes were enacted, there were remarkably few differences among countries and legal families').

of financial markets that accompanies it'.[86] In spite of the differences, the corporate laws in the origin countries have been, in various degrees, successful. Time is to be credited for this: the development of capitalism and credit culture in Western Europe and North America has lasted for over two centuries, a time span wide enough for those countries to adjust and rationalize their regulatory and market institutions of corporations through learning from experiment and falsification, or trial and error.

In the successful origin countries, a central task of corporate governance is to control the 'controller', which is normally the management of the corporations. But countries differ in the tools used for corporate governance; and '[m]ost important are differences, particularly between the common law and civil law families, in the allocation of control rights'.[87] With few exceptions, the board of directors is the primary governance organ in the Western corporations. Over the years, two types of board structures have evolved, namely the unitary board and the two-tier board. The unitary system, adopted in Anglo-American countries allows for only one board, or the board of directors, which 'directs' and oversees the company, including proving strategic guidance for company, and appointing and monitoring the performance of the executives. In the Anglo-American systems, independence of the board of directors is supposed to be ensured by its composition, namely the board is composed of mainly independent directors. In the two-tier board structure, most notably adopted by Germany, the governing body of the corporation comprises two separate boards, including the management board (also called board of directors), and the supervisory board. The supervisory board chooses the directors of the management board and monitors their performance.

In the area of corporate law, developing and transition countries have their legal system transplanted from the one or two of the origin countries mentioned above. Pistor *et al.* (2003) survey the transplant effect of six representative countries that adopted foreign law[88] and concludes that

> [c]ountries that adopt foreign law are frequently unprepared for it or the changes it brings. It is therefore not surprising that the new law does not

[86] Pistor *et al.* (2003), p. 94.

[87] Pistor *et al.* (2003), p. 94.

[88] The countries in this survey have transplanted their corporate law from the following origins: Chile, Colombia, and Spain (from French law); Israel and Malaysia (from English common law); and Japan (from German law and U.S. law).

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Under this doctrine, a business enterprise cannot be established and operated in China without legal basis in Chinese law. However, Clarke notes that 'there simply does not exist any consistent rule of recognition guiding the decisions of various governmental agencies in China when they face the question of whether or not to acknowledge a claim that a particular business entity "exists" and that particular consequences should follow from the existence'.[3] Further, 'while such a consistent rule might be a good idea, there is nothing in the Chinese legal system that will operate to produce one'.[4]

It is definitely true that the world of business organizations is confusing. In fact, for a long time, although China promulgated numerous laws and regulations providing for the establishment of various business organizations, many other business entities, although their numbers are diminishing, exist without a 'solid legal basis'. Clarke points out that 'Chinese courts and government agencies do not consider a statute to be necessary for the recognition of an organization's existence'.[5] It is doubtful whether this statement is still true today. It is, however, clear that *nullem crimen sine lege*, although not formally established by the law possibly exists as a de facto legal practice.[6]

Most types of business organizations in China have already been given legal basis under national laws (made by the NPC or its Standing Committee) or administrative regulations (made by the State Council). As discussed in Chapter 1, laws and administrative regulations, in the sense that they both apply to the whole territories of the PRC, have the same legal force, provided that the regulations do not contradict national laws, which are the source of the regulations. There are no other rules on a par with the regulations. As a matter of fact, in terms of law-making, the State Council is no less important than the NPC and its Standing Committee. As such, we could consider a business organization to have a solid legal basis if it is provided for in either a national law or administrative regulation.

As noted in Chapter 1, major laws and regulations that concern the establishment of business organizations have been promulgated over the years; they have covered SOEs, collective enterprises, private enterprises, TVEs, companies, FIEs, partnerships, and sole proprietorships. However, a few types of business vehicles are not prescribed in national laws or regulations. Using Clarke's words, they are without a 'solid statutory

[3] Clarke (2005), p. 64.
[4] Clarke (2005), p. 64.
[5] Clarke (2005), p. 52.
[6] Jiang Ping (2006).

basis', which is defined as 'a basis in law that can, consistent with China's constitutional order, explain why certain legal consequences follow from an acknowledgement of the organization's existence'.[7] But, as explained above, this statement ignores the importance of the State Council's administrative regulations. Laws or administrative regulations should have the same force to give a 'solid legal basis' to business vehicles.

There are still a few types of business organizations that are created neither by national laws nor by administrative regulations. Instead, they have to find a legal basis from ministerial rules. One example concerns the shareholding cooperative enterprises (SCEs). As Clarke observes, the regulation of SCEs began at the municipal and provincial level. In time, three central ministries issued three sets of rules regulating SCEs in the urban and rural areas.[8] In the end, neither the NPC or its Standing Committee nor the State Council has made any rules concerning SCEs. As a former member of the NPC Standing Committee remarked, SCEs were not a form of business that can have a valuable long-term existence in China.[9] However, even though eye-catching business vehicles such as foreign-invested joint-stock limited companies (FI-JSLC) and foreign-invested securities companies (FISC) have no statutory basis, that fact does not affect their use as popular business vehicles for foreign investors and their recognition as legal entities.

2.1.3 Classifying Business Organizations in China

Business enterprises can be classified according to whether they are registered companies or legal persons shielded by limited liability. An alternative, simpler way is to classify them as business individuals, business partnerships, and business legal persons. Business individuals comprise individual industrial and commercial business/household businesses and sole proprietorships. Business partnerships encompass general partnerships, limited partnerships, and special general partnerships (limited liability partnerships). Business legal persons include companies, state-owned enterprises, collectively-owned enterprises, and some foreign-invested enterprises.[10]

[7] Clarke (2005), p. 55.
[8] Clarke (2005), p. 58.
[9] Jiang Ping (2006).
[10] Some foreign investment projects, for example, Sino-foreign cooperative enterprises, can form partnerships.

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A WIOE is not registered under the Company Law, which distinguishes it from one-person LLCs and WFOEs (which could also be a single-person LLC). As noted in Chapter 2, there are further differences with respect to liability: the investor in a one-person LLC is protected by limited liability provided he can prove he has not co-mingled his personal and company assets. A WIOE owner always has to bear unlimited liability. However, a sole foreign investor in a WFOE enjoys limited liability, as the WFOE receives super-national treatment because under Company and WFOE Laws, the foreign company is regarded as a standardized LLC in which there is the protection of limited liability.

2.5 PARTNERSHIPS

2.5.1 Partnerships in Civil Law and Commercial Law

China governs partnerships through two major statutes, namely the GPCL and the PRC Partnership Enterprise Law (PEL). To some extent, this resembles the distinction between civil law and commercial law partnerships in German law.[53] Under the GPCL, a partnership is a contractual arrangement in which two individuals contribute cash, property, or technology and conduct business together on negotiated terms.[54] The formation of the civil law partnership is fairly simple: in most cases a written agreement between the partners suffices.[55] In the absence of a written agreement or official registration, a Chinese court will still 'confirm the relationship of a partnership' if 'two uninterested witnesses attest to the existence of an oral partnership agreement'.[56] The civil law partnership may adopt a business name through registering with the state, but this is not compulsory. The partners are jointly liable under the GPCL.[57]

employ more than eight persons. See Zhao Xudong (2006), p. 25. In that case, the WIOE owner was considered to belong to the 'exploiting class'.

[53] See Liu Kaixiang (2003), pp. 113–14. For partnerships in German law see Horn, Kotz and Leser (1982), Chapter 14.

[54] GPCL, Article 30.

[55] GPCL, Article 31.

[56] Zuigao Renmin Fayuan Guanyu Guanche Zhixing <Zhonghua Renmin Gongheguo Minfa Tongze> Ruogan Wenti de Yijian [Supreme People's Court Opinions on Questions Concerning the Implementation of the General Principles of Civil Law], promulgated on 2 April 1988, Article 50.

[57] GPCL, Article 35.

The PEL, as its name suggests, is the law intended for commercial partnerships registered as enterprises. It governs partnerships established by natural persons, legal persons, or other organizations.[58] To establish a partnership enterprise, the state obliges parties to enter written agreements and register with the state. The PRC Partnership Enterprise Law was first promulgated in 1997 (hereinafter the PEL 1997). It purported to establish a comprehensive legal framework for commercial partnerships, covering partnership registration, ownership, management, partnership rights and obligations, relations with third parties, admittance and retirement of partners, and termination. The PEL was amended in August 2006 (PEL 2006). The amendments brought three significant changes to the regime. The first was the introduction of the limited partnership. PEL 1997 only allowed general partnerships. The second was the introduction of the limited liability partnership, officially known as a 'special general partnership' in China. The third concerned the identity of partners. PEL 1997 only permitted natural persons to be partners but with PEL 2006, now legal persons and other organizations can be partners.

2.5.2 General Partnership Enterprises

The general partnership enterprise (GPE) is the classic form of commercial partnership under the PEL 2006. A general partnership comprises general partners who assume unlimited liability for the debts of the partnership.[59] General partnerships in China have the following characteristics:

Qualifications of investors. The Company Law does not impose any restriction on the qualifications of shareholders. That is to say, any person can be a corporate shareholder. Under the PEL 2006, although all 'persons' (including natural persons, legal persons, and other organizations) may in principle assume the role of partner, it prohibits SOEs, listed companies, and charitable institutions from being general partners.[60]

Investor's liability. The principle of limited liability protects corporate shareholders in the sense that their liability is confined to their initial capital contribution. General partners in China undertake unlimited *liandai zeren* liability, which refers to joint and several liability. According to Articles 38 and 39, a partnership enterprise shall first use its own

[58] PEL 2006, Article 2.

[59] PEL 2006, Article 2.

[60] PEL 2006, Article 3.

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The Chinese version of *ultra vires* was thus used to limit the capacities of SOEs to conclude and perform contracts not authorized by the state. Consequently, it also limited the counterparties' legal ability to enforce contracts against SOEs in case the latter acted *ultra vires*. With the emergence of non-state sectors in China, the downfall of the *ultra vires* doctrine became inevitable. Since the late 1990s, several legislative and judicial efforts have been made to alleviate the negative impact of the doctrine.

First, the Company Law now allows a broader power clause in the Company's articles. Article 12 of the Company Law provides that the 'scope of business of a company shall be specified in its articles of association and registered according to the law'. The company may revise its articles but this should be followed by a matching change of the registration information.[20] This implies that the company has the freedom to specify its own business scope, which must be registered with – rather than approved by – the registration authority. Only those items in the business scope under which the relevant laws or administrative regulations must be approved shall be approved.[21] Essentially, this refers to businesses such as banking, insurance, the manufacturing of special products, etc., for which special licenses are required under the law.

Article 12 begs the question of whether a company could provide in its articles a broad power clause such as 'this company shall be engaged in any lawful business'. It is submitted that literally Article 12 does not prohibit such a clause. But in practice, no Chinese companies have been seen to have attempted to do this. Instead, they provide in their articles a very lengthy power clause that contains a long list of things they are doing or plan to do in the future.

Second, the uniform Contract Law of 1999, which was adopted by the NPC to unify the rules governing contracts dispersed in several different laws, has revised a principle of agency law with respect to the legal representatives. Previously, even the contracts signed by the legal representatives, if going beyond the representatives' power of representation, would be voided by the courts.[22] Article 50 of the Contract Law now states, 'If the legal representative or a person in charge of a legal person or an organization acts *ultra vires* when concluding a contract, the act of representation is valid unless the other party knew or ought to have known that the contract was concluded *ultra vires*'. As such, a contract

[20] Company Law, Article 12, para. 1.
[21] Company Law, Article 12, para. 2.
[22] Ling (2002), p. 150.

signed by the legal representative in violation of the legal person's scope of business is not necessarily void, and its validity depends on whether the counterparty has actual or constructive notice of the violation.[23]

Thirdly, since 1993 the judiciary has been increasingly taking a liberal approach to *ultra vires* contracts, which peaked with the adoption of an SPC judicial interpretation on the Contract Law in 1999.[24] Article 10 of the interpretation provides, 'The People's Court shall not declare a contract invalid because a party exceeded its scope of business in concluding the said contract, unless such party has violated provisions whereby the state restricts or requires special permission of a business activity or whereby laws or administrative regulations prohibit a business activity'. By this rule, the Supreme Peoples' Court, as the leading authority of the judiciary, simply disallows all courts from using *ultra vires* as a ground to invalidate contracts.

Obviously, the aforesaid Article 10 almost amounts to the abolition of the *ultra vires* doctrine, but this judicial abolition is binding upon only the judiciary. The object/power clause still has remaining relevance in other areas. For example, acting beyond the scope of authorized business may still constitute an administrative offence. Article 73 of the Administrative Regulations on Registration of Companies provides that if there is a change in the registered items of the company's business scope and the company fails to register it with the company registrar as requested by the registrar, it will be fined an amount between RMB10,000 and RMB100,000. That is to say, it is still important to define carefully the business scope of the company.

3.4 PIERCING THE CORPORATE VEIL

3.4.1 Development of the Veil-piercing Doctrine

Piercing the corporate veil, also known as disregarding the corporate personality, occurs when the court takes away the legal shelter of limited liability from the shareholders and allow the company's creditors to pursue all reasonable avenues to reach the personal assets of the shareholders, on the grounds that the company is not truly a separate

[23] Ling (2002), p. 150.
[24] *Zuigao Renmin Fayuan Guanyu Shiyong <Zhonghua Renmin Gongheguo Hetongfa> Ruogan Wenti de Jieshi* (1) [Interpretation I of the Supreme People's Court on the Application of the PRC Contract Law], Fashi (1999) 19 Hao, adopted 1 December 1999. See also, Ling (2002), p. 138.

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Provisions are legally binding. The Circular promulgating the provisions' Essential Clauses mandates that 'companies seeking to list shares overseas shall include the contents of the Essential Clauses in their articles of association and must not alter or delete the contents of the Essential Clauses without authorization'.[57]

4.7.3 Adoption and Amendment of the Corporate Charter

According to the Company Law, incorporating shareholders of an LLC draft the company's articles and file them with the AIC for registration.[58] The law does not specify the percentage of votes required for adoption but presumably, the shareholders must reach a consensus with respect to the articles.[59] For a JSLCs established by promotion, the promoters shall draft the articles and summit them at the company's inaugural meeting for adoption.[60]

The Company Law does not restrict companies from amending their articles, but it does provide that that the power to amend remains in the hands of the shareholders. The CSRC Guiding Articles provide that the shareholders may amend the articles under the following circumstances: (i) the articles conflict with new laws or regulations; (ii) the company's situation no longer conforms with its original articles; or (iii) the shareholders' decide to amend the articles at their meeting.[61]

A question remains as to who may propose amendments at the shareholders' meeting. The Company Law is silent on this but presumably, the board of directors, the supervisory board, and the shareholders can all propose amendments at the shareholders' meeting. In any event, amendments require a two-thirds majority vote of the shareholders for passage.[62]

the Economic System in 27 August 1994 (hereinafter the Circular on Essential Clauses).

57 Id.

58 Company Law, Article 23(3).

59 A legislative annotation suggests that 'The Articles of Association should be made collectively by all the shareholders, representing the will of all the shareholders.' See An Jian (2005), p. 50.

60 Company Law, Article 77(4).

61 Model Charter, Article 188.

62 Company Law, Articles 44 and 104.

4.7.4 Charter and Corporate Autonomy

Corporate literature in China views the articles as the most important self-governing tool the company has to safeguard its autonomy against arbitrary state intervention and regulatory abuse.[63] The 2005 Company Law is the embodiment of a shift from a restrictive to an enabling regime, which has significantly increased corporate autonomy by giving more weight to the corporate charter. Compared with the 1993 law, the new legislation contains more empowering provisions and allows the charter to regulate certain corporate affairs. For example, Article 12 permits the company to stipulate its scope of business in its charter. Article 13 allows the Company to decide whether the chairman of the board or company manager should serve as the company's legal representative. Article 16 authorizes the company to stipulate whether the board of directors or the shareholders (at their annual meeting) have the competence to decide the company's capacity to make external investment and provide guarantees to third parties. In addition, the new Company Law adds numerous provisions that grant companies the exclusive power to regulate their own corporate affairs, including profit distribution, shareholder participation, powers and duties of the corporate organs, transferability of shareholders' equity interests, and more.

4.7.5 Binding Force of a Company's Charter

Academics have long debated the legal nature of the articles. Whatever the nature of the document, it has the binding force of law. Article 11 of the Company Law mandates that '[t]he articles of association of the company shall be binding upon the company, shareholders, directors, supervisors, and senior management personnel'.[64] Article 10 of the Model Charter also provides:

> The Articles of Association shall, as of the date of its entry into force, become a legally binding document governing the organization and conduct of the company and the relations between the company and its shareholders as well as that between the shareholders. It has legally binding force on the company and its shareholders, directors, supervisors, and senior management personnel.

63 See Liu Junhai (2008), p. 85; Gan Peizhong (2007), pp. 256–8; Shi Tiantao (2006), p. 117.

64 According to Article 217 of the Company Law, senior management personnel refers to the company's manager, deputy manager, senior corporate finance officers, the secretary to the board of directors, and other personnel stipulated in the articles.

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heaviest weight and constitute a sufficient basis for determining shareholder status; (2) the register of shareholders of the company should serve as prima facie evidence, which might be successfully challenged by counter-evidence that proves the self-claimed shareholder does not meet other more important substantive or formal conditions; and (3) registration with the AIC is important evidence, especially for a bona fide third party, but does not have the determining effect.[18]

It is submitted that the SPC Company Law Interpretation III suggests an approach that is more oriented towards substantive conditions. Under this, as long as a person can prove that he has actually made a capital contribution or acquired the equity interest in a way not inconsistent with the mandatory rules of the law, the court will very likely treat him as a shareholder. Since the Interpretation does not specify the scope of evidence, presumably any lawful form of evidence will be admissible, which can include but is not limited to the corporate charter, register of shareholders, and registration information with the AIC. That said, the SPC Civil Division II has also pointed out that a distinction has to be made between capital contribution and shareholder status. If the documents were properly presented, 'then even though the shareholder has not fulfilled his obligation for making a capital contribution, he shall be treated as a shareholder'.[19]

On the other hand, it could happen that a person has lawfully made a capital contribution or otherwise succeeded to and obtained the equity interest, but the company fails to issue a capital contribution certificate, enter his name in the register of shareholders, and/or carry out the registration with the competent AIC. In such cases, a legal remedy is available under the Interpretation III that enables the shareholder to institute a legal action in the court to compel the company to perform those obligations.[20]

The anonymous shareholder

The existence of *Yinming Gudong*, or anonymous or undisclosed shareholders, is understood to be widespread in China.[21] In a society that is undergoing rapid transformation, it is understandable that some investors would maintain anonymity so that they can hide their wealth and

[18] SPC Civil Division II (2011), pp. 353–4.
[19] SPC Civil Division II (2011), p. 355.
[20] Company Law Interpretation III, Article 24.
[21] SPC Civil Division II (2011), p. 371 (noting the relationship between the actual investor and nominal investor has always been among the hottest and most difficult issues in corporate law disputes).

investment to avoid resentment. More often, anonymity is used – lawfully or unlawfully – to overcome some legal barriers, such as the requirements that prohibit government officials from owning equity interests in certain business entities.

The Company Law does not explicitly address the problem of shareholder anonymity. On the surface, its rules seem to suggest that the identity of all shareholders shall be disclosed within at least a limited scope of persons, examples being the mandatory rules of registration of shareholder information with the AIC and the establishment of a register of shareholders in an LLC. As common sense, knowing who your fellow shareholders are is a fundamental right of a shareholder. The anonymity of some shareholders gives rise to legal uncertainty that disadvantages both the other shareholders and third parties such as the company's creditors. However, given the existence of shareholders whose identity was unknown, the courts had no other choice but to devise a legal theory to distinguish different types of anonymous shareholders and recognize some of them. This task falls on Article 25 of the SPC's Company Law Interpretation III, which provides the following three rules:

1. In the case that an actual investor and a nominal investor of an LLC enter into a contract to provide that the actual investor makes a capital contribution and actually enjoy the rights and benefits of the investment and that another person (the nominal investor) is to hold the nominal title of shareholder, if a dispute concerning the validity of the contract arises between the actual shareholder and the nominal shareholder, the court should uphold the validity of the contract unless it was an illegal contract or one concluded under fraud or coercion according to Article 52 of the PRC Contract Law.[22]
2. If a dispute over vesting of the investment rights and interests arises between the actual investor and the nominal shareholder, if the actual investor asserts rights – on the grounds that he has actually performed the capital contribution obligation – against the nominal shareholder, he will have the support of the court. On the other hand, the court will not support the nominal shareholder who is only able to prove that his name is included in the company's register of shareholders or registered with the AIC as a shareholder.[23]

[22] Company Law Interpretation III, Article 25, para. 1.
[23] Company Law Interpretation III, Article 25, para. 2.

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6.3.5 Attending and Voting at Board Meetings

It is an implicit requirement that the board of directors exercises its powers collectively by meeting. A director must join this collective decision-making process to perform his duties. In the Chinese context, he has no power of his own to act on the company's behalf. A JSLC director could attend the meeting in person or authorize someone to represent him at the meeting, but his representative must be another director.[66] In this digital age, a board meeting could be held in the form of a teleconference or videoconference, so that the directors do not have to travel to the same location for the meeting. A resolution could also be adopted by way of a circular instead of convening a meeting, which requires the directors to sign and return the circular within a given period of time.[67]

Procedurally, the director is entitled to receive a notice of the two statutorily required regular meetings 10 days prior to the meeting.[68] The law is silent about the notice period for special board meetings, which is normally a matter for the corporate charter to decide.[69]

If the director properly participates in the meeting, his vote is equally as important as that of any other director since board meetings follow the 'one-person-one-vote' rule.[70] Notably, a mandatory quorum requirement, which is a majority of the directors, exists for board meetings in JSLCs, whereby a valid meeting must have more than half of directors present. Further, a board resolution has to be passed by more than half of all directors, no matter whether they have attended the meeting or not. That is, if a board has 19 directors, 10 directors must be present for a valid meeting to be held, and all 10 of them must unanimously vote for a resolution for its adoption by the board.

The right to vote comes with an important restriction for directors in listed companies. In brief, a director is prohibited from voting on a resolution if he is affiliated with – or a related party to – an enterprise involved in the resolution matter. He may also not be represented by another director on this matter. 'Affiliation' or 'related-party relationship'

[66] Company Law, Article 113, para. 1.
[67] Liu Junhai (2011), p. 488.
[68] Company Law, Article 111.
[69] Model Charter, Article 116. In an interesting contrast, in the U.S., unless otherwise required by the Articles of Incorporation, no notice is needed for regularly scheduled board meetings, but a two-day advance notice should be given for special meetings. See Model Business Corporation Act (MBCA), §8.22(a) and §8.22(b).
[70] Company Law, Article 112, para. 2.

is defined as 'the relationship between the controlling shareholder, de facto controlling person, director, supervisor or senior management executive of a company and an enterprise under their director or indirect control, or any other relationship that may lead to the transfer of any interest of the company'.[71] In such a case, a valid board meeting may be held if attended by more than half of the directors without such affiliation, and a resolution can only be passed by more than half of the unaffiliated directors. The company will have to submit the resolution matter to the shareholders' general meeting when the number of unaffiliated directors is less than three.[72]

The Company Law says little about the procedures for calling and conducting board meetings in LLCs. Apart from requiring the board to keep minutes of the meeting and follow the rule of one-director-one-vote, it permits the corporate charter to make rules for the board's 'method of deliberation and voting procedures'.[73]

6.3.6 Director's Liability for Illegal Board Decisions

The decisions on the matters deliberated at the board meetings shall be put into board minutes, which shall be signed by all the directors present at the meeting.[74] Consequently, a liability is imposed on the directors with respect to the resolutions adopted. That is, when a resolution of the board violated the provisions of laws, administrative regulations, the corporate charter, or the resolution of the shareholders' meeting and caused the company to suffer serious losses, the directors who participated in adopting the resolution should bear compensation liability to the company. There is only one way for a director to get out of this: if he proves before the dispute settlement tribunal that he expressed his objection to the resolution and such objection is recorded in the minutes of the meeting, then he will be exempt from liability.[75]

6.3.7 Judicial Interference to Revoke Illegal Board Actions

Pursuant to Article 22 of the Company Law, board resolutions, like the resolutions passed by the shareholders' meeting, are void if they violate

[71] Company Law, Article 217 (4).
[72] Company Law, Article 125.
[73] Company Law, Article 48.
[74] Company Law, Article 49, para. 2; Article 113, para. 2.
[75] Company Law, Article 113.

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and inflexible – unless they are arranged with sufficiently contiguous density, and often fail to account for changing circumstances.

7.2 FIDUCIARY DUTIES AS CODIFIED AND UNDERSTOOD IN CHINA

With Articles 148, 149, 150, 152, and 153, China appeared probably to be the first major jurisdiction that systematically – not yet entirely – confided the contents and enforcement of fiduciary duties.[10] Article 148 of the Company Law requires the senior personnel in a company to act in accordance with due care and loyalty: [11]

> Directors, supervisors and senior management executives shall abide by laws, administrative regulations and the corporate charter, and have a duty of loyalty (zhongshi yiwu) and duty of care (qinmian yifu) to the company.

This provision sets forth a general, statutory, standard of corporate fiduciary duties in China. Other than this, there are no general principles or guidelines to elaborate upon the contents of the standards of fiduciary duties. As Professor Nicolas Howson has observed with respect to the duty of care, 'the 2005 statutory formulation passes upon the opportunity to … articulate a specific *standard* for the duty of care prong, or any instruction to regulators or judges who might be employed as a "business judgment rule" for newly authorized duty of care inquiries'.[12]

An interesting comparison is the articulation of the general standard for directors' 'duty to promote the success of the company' in the UK Companies Act 2006, which reads:[13]

> Article 172 Duty to promote the success of the company
>
> (1) A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to
>
> (a) the likely consequences of any decision in the long term,
> (b) the interests of the company's employees,
> (c) the need to foster the company's business relationships with suppliers, customers and others,
> (d) the impact of the company's operations on the community and the environment,
> (e) the desirability of the company maintaining a reputation for high standards of business conduct, and
> (f) the need to act fairly as between members of the company.

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[10] After the 2005 PRC Company Law, the United Kingdom codified its body of directors' duties in Part 10 of the Companies Act 2006.

[11] Company Law, Article 148, para. 1 (Chinese pinxin added). There is a similar general standard of fiduciary duty in Article 33 of the Code of Corporate Governance, which states, 'Directors should act in the best interest of the company and all the shareholders, performing their duties loyally, in good faith and diligently'.

[12] Howson (2008), p. 198.

[13] UK Companies Act 2006, Article 172(1).

One may easily notice the words such 'good faith', 'benefit', 'success', 'fairly', which feature a high degree of flexibility and uncertainty; all require clarification and interpretation in a specific context. Likewise, the duty of loyalty in the U.S. requires a director to act 'in the good faith belief that her actions are in the corporation's best interest'.[14] Flexible terminology like 'good faith', 'best interest', 'fair', 'reasonable', and 'adequate' also compels judicial interpretation. That is to say, in applying a standard of fiduciary duties, courts everywhere will always have to interpret the doctrine and terminology to determine, on the facts and context of each case, whether the standard was met.[15] China in theory is not an exception, but whether the Chinese judiciary is able to undertake such a task is an open question.[16]

Although it is overwhelmingly agreed that the doctrine of fiduciary duties in Chinese corporate law has its Anglo-American origins, it can also find part of its roots in Chinese civil law, which was styled after the Continental legal family. The majority view is that the relationship between the company and its directors, supervisors, and executives is based on an agency-based 'contract of mandate' (*weiren hetong*, officially called *weituo hetong* in the PRC Contract Law), in which the principal

[14] *Stone, ex rel. AmSouth Bancorporation v. Ritter*, 911 A 2d 362, 370 (2006), cited in Cahn and Donald (2010), p. 344.

[15] Cahn and Donald (2010), p. 343.

[16] See below, Chapter 8 on judicial enforcement of shareholders' rights and management duties. See also Howson (2008), p. 202 (noting 'the application of fiduciary duties requires extraordinary flexibility and complex fact analysis, and thus a demanding level of technical competence among the judicial corps (or state regulator) wielding the doctrine').

the shareholder in his individual capacity, which means the suit is not directly on behalf of the company and for the company's interest. For example, the shareholder may directly sue the directors or officers for the following reasons:

- to enforce his informational rights
- to compel payment of dividends declared but not distributed to him
- to compel the repurchase of his equity interest in the company under the circumstances prescribed in the Company Law
- to challenge the denial or dilution of voting rights
- to compel the holding of a shareholders' meeting
- to stop the management from engaging the company in an acquisition deal
- to compel dissolution of the company
- to redress the oppression of, or fraud on, minority shareholders
- to recover investment losses from wrongdoers in insider trading.

Thus the direct suit is a mechanism for shareholders to vindicate their own financial and limited participation rights in the company. Its general legal basis is the 'proper plaintiff rule' in Article 108(1) of the PRC Civil Procedure Law, which states, 'the plaintiff shall be a citizen, legal person or organization that has direct interest in the case'. 'Direct interest' is the Chinese expression of standing or *locus standi*. It does not deal with the situations in which the interests of the company, not those of the shareholders, are directly harmed. When the company sues, it must only be represented by its legal representative or a person appointed by the legal representative.[3] Shareholders are thus not entitled to bring a lawsuit in these cases, as they could not demonstrate to the court their own sufficient connection to and harm from the infringement action. Individual directors, supervisors, and senior executives have fiduciary duties to the company.[4] When they encroach upon the property of the company, steal corporate funds, take kickbacks or bribes, transact with the company, or trap the company in unfair related-party transactions, the separate and independent legal personality of the company suggests it is the company whose interests are directly harmed and who should initiate a legal action against the wrongdoers before the court. Unfortunately, sometimes the company has no intention to pursue such an action, simply

[3] PRC Civil Procedure Law, Article 49.

[4] As clearly stated in Article 148 of the Company Law, the key players 'own the duty of loyalty and duty of care to the company' (*dui gongsi fuyou zhongcheng yiwu he qinmian yiwu*).

because the company is controlled by the directors or senior executives who have committed the wrongdoing, or by the majority shareholders who instruct the directors or executives to do so. Shareholders are indirectly affected, but they don't have the standing to sue under both Article 153 of the Company Law and Article 108 of the Civil Procedure Law.

In this sense, the introduction of derivative suits by the 2005 Company Law is a major breakthrough in the development of shareholders' protection in China. This peculiar form of action, embodied in Article 152 of the Company Law, permits an individual shareholder to bring suit, in the interest of the company, against the individual wrongdoer who has injured the interests of the company. Detailed rules of the Chinese mechanism for derivative suits will be examined in the following sections. Suffice it to say that, as Reisberg (2007) notes, since derivative suits 'operate to deter mismanagement by imposing the threat of liability [on the key players in the company]', they provide a strong incentive for key players to act in the interest of the company and the shareholders, so as to reduce agency costs and enhance corporate governance.[5] Further, from the perspective of private enforcement, derivative actions are practically the only legal tool possessed by shareholders to deal with insider wrongdoing. When insiders (the key players including the directors and senior executives) breach their duties to the company, the company itself will rarely take action against them as the company is actually controlled by the insiders. Giving shareholders the standing to sue the insiders is then the best choice to redress the injury to the company.

8.2 DEVELOPMENT OF SHAREHOLDERS' LITIGATION IN CHINA

8.2.1 Shareholders' Right to Sue: From the 1993 to 2005 Company Law

Before the recent development brought by the new Company Law, legal provisions concerning private enforcement contained in the 1993 Company Law were vague and rudimentary, and for all intents and purposes unenforceable. One terse provision, Article 111, provided the only legal basis for private enforcement. It allowed shareholders to bring a lawsuit

[5] Reisberg (2007), p. 23.

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9.3.6 Use of Funds Raised through IPO

The IPO Measures stipulate a principle that the funds raised through the IPO must be used for specified purposes, mainly for developing the company's core business. Unless the issuer is a financial institution, the funds cannot be used to purchase, hold, and trade in financial assets. The issuer is prohibited from using the proceeds to invest in companies that engage in securities trading.[70]

The rules in the IPO Measures on the issuer's use of IPO funds demonstrate strong paternalism by setting not only specific restrictions and directions on the specific uses of the money. For example, it is required that 'the amount of funds raised and the project they are to be invested in shall be commensurate with the issuer's existing production and operation scale, financial position, level of technology, and management capabilities'.[71] The use of funds should also comply with 'state industrial policy, investment regulation, environmental protection, [and] land management', along with other laws.[72] The board of the issuer is required to present an analysis of the investment project to ensure its market prospects and profitability.[73] Further, the use of the funds should not give rise to intra-industry competition or have an adverse impact on the independence of the issuer.[74]

9.4 IPO PROCESS

9.4.1 Starting the Process

The IPO process must be kicked off by the JSLC, which will later be called the issuer. Under China's corporate laws, the plan to issue new shares must be endorsed by a resolution of the shareholders' general meeting, which determines the type and quantity of shares to be offered, the offerees, the price or pricing method, use of proceeds, etc.[75] However, the initiation of the offering plan must come from the company's board

70 Id, Article 38.
71 Id, Article 39.
72 Id, Article 40.
73 Id, Article 41.
74 Id, Article 42.
75 Company Law, Article 134; IPO Measures, Article 45.

of directors, which shall pass a resolution on the specifics of the plan and present it to the general meeting for approval.[76]

As noted above, the issuer normally should be an already established JSLC. In many cases, the enterprise that wishes to raise money from the capital market has yet to be converted into a JSLC. The enterprise could initially be a traditional state-owned enterprise, a collectively-owned enterprise, a privately-owned enterprise that is not registered under the Company Law, a foreign-invested enterprise, or a standardized LLC registered under the Company Law. Naturally, the first step is to restructure such an enterprise into a JSLC. In practice, it could be a partial restructuring (*bufen gaizhi*), whereby the original enterprise uses only its quality assets as capital contributions to establish a subsidiary JSLC in which the original enterprise remains as the controlling shareholder. It could also be a complete restructuring (*zhengti gaizhi*), whereby the original enterprise dissolves and deregisters itself immediately after investing all its assets to incorporate a JSLC. In this case, the JSLC takes all of the original enterprise's assets and liabilities. Lots of house-cleaning work needs to be done before an IPO-eligible JSLC is established, which provides tremendously lucrative business for investment bankers and lawyers.

9.4.2 Sponsorship and Guidance

Article 11 of the PRC Securities Law sets forth the requirement for sponsorship (*baojian*) in a public offering and listing of shares. Sponsorship involves documented due diligence examination of the issuer's offering documents and information disclosure by qualified sponsoring institutions (*baojianren,* or sponsors). Since 2004, sponsorship has been relied on as a market-oriented tool by the CSRC to shift some supervisory responsibility originally reserved for the regulators to external verification of the information provided by the issuer by professional intermediaries (e.g., the securities companies, accounting firms, law firms). The sponsorship system was finalized with the promulgation of the *Measures for the Administration of the Sponsorship System of Issuance and Listing of Securities* in 2008 (hereinafter the Sponsorship Measures).[77]

Under the sponsorship system, a CSRC-licensed sponsoring institution (which is normally a securities company licensed to underwrite securities

76 IPO Measures, Article 44.
77 Zhengquan Faxing Shangshi Baojian Yewu Guanli Banfa, adopted by the CSRC on 14 August 2008 and revised on 13 May 2009.

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a gift. Shares originally possessed by these persons must be transferred to others after they become such personnel.

These restrictions aim to address the conflict of interest problems in China's capital markets, indicating that the lawmakers considered the above persons as regulators, semi-regulators, or administrators in the securities markets. The rationale was stated by NPC's Working Group on Securities Law revision for the restrictions:[145]

> These persons are involved in the supervision and administration of securities activities, including making of the relevant policies and laws on securities transactions, review and approval of share offering, and inspections and investigations of securities activities. If they also hold and trade securities, there will be a major conflict of interest with their official duties and powers.

Disgorging short-swing profits

Under Article 47 of the Securities Law, if a director, supervisor, senior management executive, or shareholder owning 5 percent or more of the total shares of a listed company sells company shares within six months after purchase of the shares, or purchases the shares within six months after selling the shares, any gains so obtained are regarded by the Law to belong to the company. The board of directors of the company is obliged to recover such gains. A cause of action for derivative suit is conferred upon the shareholders to sue the key player who is involved in such short-swing transactions. One should note, however, that this is not a prohibition as such – the key player may freely engage in short-swing transactions as long as the gains are confiscated by the company.

Share repurchase restrictions

JSLCs are generally not allowed to buy back their own shares unless for the following reasons: (1) reducing the company's registered capital; (2) merging with another company that owns this company's shares; (3) awarding the shares to employees; and (4) being requested by a shareholder to buy back company shares owned by the shareholder since he objects to a resolution of the shareholders' general meeting on the merger or division of the company.[146] Shares repurchased for awarding to employees will have to be distributed to the employees within one year. In addition, the number of shares repurchased may not exceed 5 percent of the company's total outstanding shares, and the repurchase should be

145 NPC Working Group (2006), p. 50.
146 Company Law, Article 143, para. 1.

paid out of the company's after-tax profits.[147] Shares repurchased for other purposes shall be cancelled within 10 days of the repurchase.[148]

Restrictions by the CSRC for investigating illegal securities activities

Article 180(7) of the Securities Law authorizes the CSRC, when investigating major violations of securities law such as securities market manipulation or insider trading, 'to restrict trading in securities by the parties involved in the incident under investigation'. The period of the restriction is limited to not more than 15 trading days, and may be extended by another 15 trading days if the case is complex. Based on this, the CSRC enacted the Implementing Measures for Restricting Securities Trading in 2007 to prescribe the specific procedures for the authorized restrictions.[149]

9.9 INSIDER TRADING LAW

9.9.1 Development of Insider Trading Law in China

Rules prohibiting persons who possess inside information were put in China's corporate and securities law almost at the same time that capital markets were re-established in the PRC, even before the 1993 Company Law was promulgated.[150] The national Securities Law, in its first version adopted in 1998, contained five articles dealing with insider trading, all of which are incorporated and further refined in the 2005 revision to the Securities Law. Meanwhile, the NPC amended the PRC Criminal Law several times to criminalize insider trading. Arguably, these rules have not been effectively and rigorously enforced by the regulators and courts in China as insider trading remains pervasive in the secondary market, despite the waves of government-launched 'wars' against such trading.[151]

147 Company Law, Article 143, para. 3.
148 Company Law, Article 143, para. 2.
149 Xianzhi Zhengquan Maimai Xingwei Shishi Banfa, promulgated by the CSRC on and effective as of 18 May 2007.
150 The CSRC promulgated its first set of rules against fraudulent securities activities, Jinzhi Zhengquan Zhaqi Xingwei Zanxing Banfa (Interim Measures on the Prevention of Securities Fraud), issued by the CSRC and approved by the State Council Securities Committee on 15 August 1993, effective as of 2 September 1993. The measures were abolished on 15 January 2008 by State Council Order 516.
151 See e.g. 'China Steps Up Insider Trading Crackdown', *Financial Times* online, 14 May 2007; 'The Battle Against Insider Trading', *Wall Street Journal*

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The payment of the purchase price can take the form of cash, stock, in kind, intellectual property, or any other form allowed by the law. For cash payment, normally foreign currencies are required, unless the foreign investor is approved by the SAFE to use Chinese Renminbi it lawfully owns to make the payment.[33]

11.4.5 Share Swaps

Part IV of the Foreign Acquisition Provisions is a welcome new addition to the law of cross-border M&A in China. It provides a comprehensive framework for using equity (shares) to pay the purchase price by foreign investors. In the Provisions' own language, 'the use of equity as method of payment in the acquisition of domestic companies by foreign investors' shall mean that 'a shareholder of an overseas company uses the equity it owns in the overseas company, or the overseas company uses the shares purchased from a new offering, as the consideration paid to purchase the equity in a domestic company from its shareholder or shares available in a new share offering by the domestic company'.[34] In summary, a share swap will occur if shares of an overseas company (the foreign investor/acquirer) are used to buy equity interests in a domestic company.

Qualified foreign investors and their shares

The foreign company which wishes to use its shares to purchase an equity interest in a domestic company must meet the following qualifications:[35]

- the company must be legally incorporated in a foreign jurisdiction that has a sound corporate law system;
- the company and its management team have not been subject to regulatory sanctions by the relevant authorities in the past three years; and
- the company should be listed in a place with a sound securities trading system (unless it is an SPV mentioned below).

The shares used by the foreign investors as acquisition consideration shall meet the following requirements:[36]

33 Foreign Acquisition Provisions, Article 17.
34 Id, Article 27.
35 Id, Article 28.
36 Id, Article 29.

- they are lawfully held by shareholders and freely transferable;
- they are not under any ownership dispute or constrained by pledge or any third-party rights;
- they are traded on a legally established, public securities market (but not an over-the-counter market); and
- the trading prices of the shares have been stable during the most recent year.

The use of special purpose vehicles for overseas listing

The Foreign Acquisition Provisions set out detailed rules on the use of special purpose vehicles (SPVs, or *teshu mudi gongsi*) in cross-border acquisitions. An SPV is an overseas company controlled, directly or indirectly, by a domestic company or natural person inside China for the purpose of realizing overseas listing of its/his rights and interests in a domestic company. The SPV, like any other foreign investor, could use its own existing shares or shares issued in a subsequent suffering to purchase the existing equity interest or newly offered equity interest of a domestic company.[37] Clearly, the provision of the SPVs indicates the government's willingness to legitimize – and tightly regulate – one of the typical paths for Chinese-owned companies to list shares overseas. These companies are the so-called 'red-chip' companies, as they are legally incorporated in foreign jurisdictions but are controlled by Chinese nationals. In any case, the red-chip companies are also subject to the regulatory authority of the Chinese government according to China's own laws.

The establishment of an SPV in an overseas jurisdiction, as a form of outbound investment, must be approved by the MOFCOM.[38] When the SPV comes back to acquire the domestic company, additional MOFCOM examination and approval are required.[39] Further, both MOFCOM and CSRC will be involved if the SPV is to be turned into a listed company in a foreign stockmarket. For such listing applications, the MOFCOM will review the documents first and render a preliminary decision as to whether it is suitable for overseas listing. With the MOFCOM's preliminary approval, the domestic company shall proceed to seek the CSRC's approval for the SPV's overseas listing. The MOFCOM will allow the acquisition to happen by issuing an FIE certificate only after the CSRC

37 Id, Article 39.
38 Id, Article 42.
39 Id, Article 44.

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private agreements.[62] The acquirer and group members are not allowed to buy or sell the target company's shares during the reporting period and for two days after the disclosure is made.[63]

Second, if the acquirer (and persons acting with it) is the largest shareholder or actual controlling person of the target company, when its shareholding exceeds 5 percent but has not reached 30 percent of the target company's outstanding shares, it (or they) are mandated to disclose the following information by way of a short-form report: (1) names and addresses of the acquirer and group members; (2) purpose of the shareholding and whether they intend to continue to increase their shareholding in the company in the next 12 months; (3) name of the target company as well as the class, quantity, and percentage of shares held by them; (4) when and how the share interests owned by them in the target company reached or exceeded 5 percent of the outstanding shares of the target company and when and how any additional 5 percent increase or decrease occurred; (5) a summary of the purchase and sale of the shares of the target company through securities trading on the stock exchange within the six months prior to the occurrence of the change of interest; (6) the controlling shareholders and actual controlling persons of the acquirer and persons acting in concert with it, as well as the charts illustrating their equity control relationships; (7) the price, amount of required funds and funding sources for acquiring the relevant shares, and other payment arrangements; (8) whether competition and/or affiliated transactions exist between the business of the acquirer and persons acting in concert with the acquirer (and their controlling shareholders and actual controlling persons) and that of the target company; (9) the follow-up plan for adjustments to be made to the assets, business, personnel, organizational structure, and corporate charter of the target company in the next 12 months; and (10) the major transactions between the acquirer (and group members) and the target company in the preceding 24 months.[64] If the acquirer (and group members) are not the largest shareholder or actual controlling person of the company, it only needs to disclose the first five items above.[65]

[62] Securities Law, Article 86, para. 1; Takeover Measures, Article 13, para. 2 and Article 14, para. 2.

[63] Takeover Measures, Article 13, para. 2 and Article 14, para. 3.

[64] Takeover Measures, Articles 16 and 17.

[65] Takeover Measures, Article 16.

11.6.3 Tender Offer

In a takeover by tender offer, the acquirer makes a public, open, offer to purchase shares directly from the shareholders of the target company, with a view to acquiring control of the target company. As provided in Article 23 of the Takeover Measures, 'an investor who wishes to acquire shares of a listed company by way of an offer may issue an offer to all shareholders of the target company to acquire all of the shares held by them (a "general offer") or issue an offer to all shareholders of the target company to acquire part of the shares held by them (a "partial offer")'. A partial offer is defined as an offer to buy less than the whole of the target's outstanding shares, which must be at least 5 percent of the target's outstanding shares.

The traditional form of merger, be it merger by absorption or merger by new establishment, has a few disadvantages. The single largest barrier is that a merger requires the consent of both the power organ and the management organ of the target company. In short, it involves the target's board of directors, which should draft the merger plan, and the shareholders' general meeting, which should adopt resolutions to approve the merger plan and amend the corporate charter accordingly. That is, opposition from either the board or the general meeting may kill the merger deal. But even if the plan is endorsed by both the board and the general meeting, the approval process could still be time-consuming and costly. The tender offer is devised as a mechanism to bypass such barriers by allowing the acquirer to make a public offer to shareholders of the target company to buy their shares at a specified price, upon specified terms, and within a fixed period of time. If shareholders holding the majority of the target company's equity interests tender their shares to the acquirer, the acquirer can effectively take control of the target even over the fiercest opposition by the target's management and board. As such, the tender offer is supposed to be used normally in hostile takeovers, which are rather rare in China's stockmarket today.

11.6.4 Mandatory Bid Rule for Tender Offer

The Takeover Measures distinguish between voluntary and mandatory offers. An acquirer can voluntarily choose to make a public offer to acquire the company. Such an offer can be either a general offer or a partial offer.[66] Sometimes the acquirer might be legally 'forced' to issue a

[66] Takeover Measures, Article 23.

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11.6.10 Exemptions

Compliance with the complicated tender offer rules, especially the MBR, is a tremendous task. From the acquirer's perspective, the obligations are very demanding, and even draconian, in terms of being both time-consuming and costly. The Takeover Measures provide a back door for the acquirers who do not wish to go through the tender offer process. That is, the acquirers and persons acting in concert with it could seek exemptions from CSRC so that they could avoid launching a tender offer to increase their shareholding or launching a general offer, which is otherwise required under the MBR.[100] In fact, almost all the takeover transactions in China's stockmarket have been carried out under exemptions rather than by standard tender offers.

The acquirer may apply for an exemption under the following circumstances:[101]

1. The acquirer and the seller of shares are able to prove that the transfer will not result in a change in the actual controlling person of the target company;
2. The target company faces serious financial difficulties, the reorganization plan to rescue the company proposed by the acquirer has been approved by the target's shareholders' meeting, and the acquirer undertakes not to transfer its equity interests in the company for a minimum three-year period;
3. The acquirer's shareholding exceeds 30 percent of the target company's outstanding shares through a directed placement offered in accordance with a resolution of the target's shareholders' meeting, provided that the acquirer undertakes not to transfer the new shares for a three-year period and the shareholders' meeting supports the exemption application.

The CSRC is required to render a decision within 20 days after receiving the exemption application. However, an exemption application would not even be necessary if the acquirer in a directed placement were already the controlling shareholder. In such a case, the legality of the acquirer's purchase without launching a tender offer is based directly on the CSRC's approval of the directed placement.

Article 63 of the Takeover Measures offers a fast-track procedure for some transactions. In these circumstances, the acquirer still has to apply

[100] Id, Article 61.
[101] Id, Article 62, para. 1.

to the CSRC for an exemption, but only needs to wait 10 working days; however, the CSRC's silence during the 10 days – meaning it does not raise an express objection – will be deemed an approval where:

1. Due to the gratuitous transfer, change, or merger of state-owned assets approved by the government or the state-owned assets administration department, the acquirer's shareholding in a listed company reaches or exceeds 30 percent of the listed company's outstanding shares;
2. An investor's shareholding exceeds 30 percent of the company's outstanding shares of a listed company due to the company's repurchase of a designated shareholder's shares at a price approved by the shareholders' meeting;
3. Financial institutions such as securities companies and banks hold more than 30 percent of the listed company's outstanding shares as a result of their underwriting or lending business, but the financial institutions have no intention or acts to effectively control the company and have proposed a plan to transfer the shareholding to non-related parties within a reasonable period.

In addition, the acquirer may directly apply to the stock exchange and securities registration and clearing company to carry out the share transfer without applying for an exemption to the CSRC in the following cases:[102]

1. One year after the acquirer's shareholding reaches or exceeds 30 percent of the listed company's outstanding shares, if its subsequent share purchase in every 12 months does not exceed 2 percent of the company's outstanding shares;
2. The acquirer's shareholding in the listed company reaches or exceeds 50 percent of the company's outstanding shares, and continued increase of its interest in the company will not affect the company's listing status;
3. A person's shareholding exceeds 30 percent of the company's outstanding shares as a result of inheritance.

If the acquirer fails to secure an exemption from the CSRC and it still wishes to acquire the target's shares – which rarely happens in practice –

[102] Id, Article 63, para. 2.

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and could materially harm the interests of the creditors and shareholders.[28] Further, in the second circumstance above, the shareholders can petition the court to appoint a different liquidation group if the creditors don't act.[29] Members of a court-appointed liquidation group can be chosen by the court from the following persons: (1) the company's shareholders, directors, supervisors, or senior management executives; (2) intermediaries such as law firms, accounting firms, or bankruptcy liquidation firms; or (3) licensed individual professionals in the aforesaid intermediaries.[30]

12.4.2 Powers of the Liquidation Group

In general, the liquidation group serves as both the power organ and the management team of the company. It has the following statutory powers as provided in the Company Law:[31]

1. Examining the assets of the company and preparing a balance sheet and a schedule of assets;
2. Notifying the creditors by individual notices or public announcements;
3. Handling the outstanding business of the company that is related to the liquidation;
4. Paying all outstanding taxes;
5. Making settlement for all claims and debts;
6. Disposing of assets remaining after settlement of the company's debts;
7. Representing the company in civil litigation.

In short, during the liquidation process, the company continues to exist as a legal entity, and the liquidation group serves as its 'head'. With the commencement of the liquidation, the board of directors and the management executives cease to control the company and the liquidation group manages the company with a view to winding up all of its affairs. The liquidation group itself is not an independent legal entity. In judicial practice, some courts used to treat the liquidation group as an independent legal person and asked it to participate in civil litigation in its own

28 Company Law Interpretation (II), Article 7, para. 2.
29 Id, Article 7, para. 3.
30 Id, Article 8.
31 Company Law, Article 185.

name.[32] The SPC has recently clarified this conceptual confusion, mandating that all the civil lawsuits involving a company under liquidation should be participated in by the liquidation group in the name of the company, and that the head of the liquidation group be treated as the legal representative of the company.[33]

12.4.3 Liquidation Process

The liquidation group, on behalf of the company, should only carry on the business of the company that is related to the liquidation. It should also pursue the company's claims against third parties and collect the monies owed to the company by others.

The liquidation group is also required to notify the creditors of the company within 10 days from the date of its establishment and, within 60 days, make newspaper announcement of the liquidation. The creditors then have 30 days after receiving the notification to declare the claims to the liquidation group, and those creditors who did not receive the notification have 45 days to declare their claims after the newspaper announcement of the liquidation.[34]

After examining the company's property and preparing a balance sheet and a schedule of assets, the liquidation group will formulate a liquidation plan that shall be submitted to the shareholders' meeting – or the court if the liquidation group was appointed by the court – for approval. The major part of the plan normally concerns the distribution of the company's available remaining assets. In general, the assets are applied in the following order:[35]

1. The proper expenses of the liquidation;
2. Employees' wages;
3. Social security premiums;
4. Statutory compensation of staff and workers;
5. Outstanding taxes;
6. Payment of creditors;
7. Distribution to shareholders.

After examining the company's total assets, if the liquidation group forms the opinion that the company's total assets are insufficient to pay

32 Liu Junhai (2011), p. 935.
33 Company Law Interpretation (II), Article 10.
34 Company Law, Article 186.
35 Company Law, Article 187, para. 2.

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