Convergence, Divergence or Lost in Translation to Sino-Capitalism?
Legal Transplants in Corporate Governance in China

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Abstract

China has experienced exponential economic growth in the last four decades. Today, it is not simply the world's biggest manufacturing facility, but has also become the second largest economy in the world. Such a phenomenal economic success was not achieved without hiccups and challenges. This was largely due to the fact that China has been pursuing ongoing economic reforms, a large part of which encompasses reforming inefficient or underperforming state-owned enterprises (SOEs), corporatising the SOEs, establishing stock markets for the listing of such corporatised SOEs, as well as regulating the rapid growth of private enterprises. These business changes were not initially supported by a well-established governance and regulation system due to the fact that China did not have any 'indigenous' laws to regulate its business and corporate growth. Hence, Chinese lawmakers had to 'transplant' corporate laws and governance instruments from developed Western countries. After all, China has come a long way from having no corporate governance system or legislation to the installation of a corporate governance law system that is, to its mind, largely in conformity with international standards and practices. Against such an unusual background, China naturally becomes one of the green fields for the study of legal transfers given its expeditious law-making processes through legal transfers.

However, most legal research typically focuses on theoretical models and their quality assessments. Little attention has been given to the analyses of the correlation between China's domestic conditions and the implantation of the corporate governance institutions. This research shows that China's approach to corporate governance 'transplantation' has usually been in form rather than in substance. It also finds that China has been modifying such transplants by infusing and incorporating its own local conditions and characteristics to suit its agenda of sustaining economic growth and in turn the 'one-party' rule.

This thesis thus raises the question of whether such phenomenal and yet unsophisticated transplants of corporate governance systems into China actually constitute convergence towards or divergence from the "best" practices of corporate governance systems from the West. Alternatively, this form of transplant may be misunderstood or lost in translation creating a different pathway for economic growth to a specific type of capitalism unique to China – Sino-Capitalism.

Focusing on the study of the relevant legal framework and practical operations associated with China's corporate and economic development since its adoption of an 'Open Door Policy' in 1978, this thesis puts the case of China into the 'convergence-or-divergence' debate on corporate governance transplants and develops a theory of Sino-Capitalism which befits the finding that China's *modus operandi* vis-à-vis transplantation of concepts and institutions from the West is indeed in form rather than in substance. This is largely due to inculturation of such transplants with China's own local features and characteristics during the transplantation and implantation process.

Contrary to the common misconception of commentators that China has been diverging from the civil law traditions and converging towards the Anglo-American models (albeit in a far from satisfactory manner), this thesis argues that this debate is lost in translation that the transition is to Sino-Capitalism. The dynamic process of corporate governance and economic reform in the last

four decades shows that China has not stopped 'finding its own feet' by attempting to develop its own system through conceptualising and absorbing foreign norms and institutions into the Chinese context in order to facilitate a basis or platform for its economic reforms. This thesis also intends to elucidate that the understanding of how legal transplants have worked with China's economic development, which in turn has brought about the emergence of Sino-Capitalism, may be significant beyond China's corporate governance law system as China's constant improvements might provide a beneficial reference point for other economies.

The emergence of Sino-Capitalism presents diverse implications for both legal and economic reforms in the transition economies and for the global convergence-or-divergence debate vis-à-vis corporate governance transplants and reforms. In the transition economies, the interplay between the foreign and local contexts deserves further careful investigation. As for the global convergence-or-divergence debate, a 'one-size-fits-all-or-best-practice' global corporate governance model does give rise to a misunderstanding or is lost in translation to Sino-Capitalism in the case of the world's second largest economy – China.

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I dedicate this thesis to the memory of Heming, my dad, who always encouraged me to pursue excellence in whatever I do, and Phyllis, my grandmother-in-law, who did not live to see one of her own complete a PhD. Phyllis was dedicated to academic achievement of her children and grandchildren, herself being deprived by circumstances of ever reaching university.

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Chapter I Introduction

A Background and Literature Review

1 Background

Legal transplants, whether derived from common law or civil law origins, have always been present in different legal systems.[1] Indeed, as Alan Watson elucidated almost four and half decades ago, "the transplanting of individual rules or of a large part of a legal system is extremely common".[2] At the turn of this century, Watson reiterated that "at most times, in most places, borrowing from a different jurisdiction has been the principal way in which law has developed."[3] Today, legal transplants may be considered one of the major forms of legal development. This is especially so in transition economies, such as China, which are characterised by far-reaching reforms through a high concentration of law-making and an encompassing breadth of new institutions, features not readily observable in advanced market economies in the West.[4] With rapidly progressing law-making processes, transition economies, such as China, naturally emerge as one of the major green fields for the study of legal transplants.[5]

China has experienced unprecedented economic growth and development over the last four decades.[6] Its ongoing market economy transition and accession to the World Trade Organisation (**WTO**) in 2001 have intensified the demand for new laws and regulations and in turn the increase of institutional changes, especially in the

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1 Salvatore Mancuso "Legal Transplants and Economic Development: Civil Law Vs. Common Law?" in *One Country, Two Systems, Three Legal Orders-Perspectives of Evolution* (Springer, 2009), at 76. See also Simon Deakin, Prabirjit Sarkar and Ajit Singh "An end to consensus? The selective impact of corporate law reform on financial development" (2011) Centre for Business Research, University of Cambridge Working Paper No 423, at 1-2.

2 Alan Watson *Legal transplants: An approach to comparative law* (University of Georgia Press, 1974), at 95.

3 Alan Watson *Society and Legal Change* (2nd ed, Temple University Press, 2001), at 98.

4 Sonja Opper and Sylvia Schwaag-Serger "Institutional analysis of legal change: the case of corporate governance in China" (2008) 26 Wash UJL & Pol'y 245, at 245-246.

5 Ibid, at 246.

6 Idea inspired by Peter Hugh Nolan "China at the Crossroads" (2005) 3(1) Journal of Chinese Economic and Business Studies 1, at 1.

context of corporate governance.[7] In order to develop and promote legislation in a relatively swift and effective manner to keep up with China's economic growth rate, Chinese lawmakers, like those in other transition economies, borrow institutions, legal and policy solutions and legislative texts and norms from Western jurisdictions.[8]

This borrowing has opened a unique window of opportunity for legal research. As a matter of fact, the institutions of Chinese corporate governance have been studied extensively inside and outside China. Thus far, the majority of legal research typically focuses on a plethora of theoretical models to identify the basic features of and rationales for the installation of corporate governance systems through legal transplants and their quality assessments derived by cross-national and "best practice" comparisons.[9]

The Chinese institutional environment and local conditions that determine or affect whether and how far such new institutions, solutions, texts and norms may be made effective and meaningful have been given very little attention. While complaints about the general want of enforcement mechanisms are prevalent, analyses that correlate institutional capacity to specific enforcement issues are much less common.[10]

This thesis proposes to examine the compatibility of transplanted Western corporate governance systems in China with China's institutional environment and local conditions. This research thus aims to explore and address the following questions to facilitate a coherent assessment. First, what are the characteristics and nature of the Watson-Kahn-Freund-Legrand debates in terms of the legal-transplants-scholarship and the relevance to such debates of China's case as one of the major recipients of legal transplants in the corporate governance context, especially after the turn of this twenty-first century almost two decades ago?

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7 Opper and Schwaag-Serger, above n 4, at 245.

8 Helen Xanthaki "Legal Transplants in Legal Legislation: Defusing the Trap" (2008) 57 Int'l & Comp LQ, at 659.

9 Frances H Foster "American Trust Law in a Chinese Mirror" (2010) 94 Minn L Rev 602, at 606; see also above n 5.

10 Donald Clarke "The Ecology of Corporate Governance in China" (2008) (433) GWU Legal Studies Research Paper, at 1-2.

The case of China is particularly noteworthy in the 'law-and-finance' and 'convergence-or-divergence' debates in the context of its transplantation and implantation of western corporate governance systems into the Chinese system because there is a general want of detailed discussions in the current comparative corporate governance scholarship involving transition economies like China.[11] China, as a 'rising star' amongst the numerous modern transition economies, provides a meaningful story to fill this research gap. Given its significance, the second research question is more importantly whether the transplants of corporate governance systems into China actually constitute convergence towards or divergence from the "best" practices of corporate governance systems from the West or whether this creates a different pathway for economic growth and hence whether there is a profound misunderstanding of the transplantation or it is lost in translation? This thesis will explore and identify the trajectory of China's economic reforms, evaluate their implications, and last but not least, set out the emergence of China's unique form of capitalism – Sino-Capitalism. This thesis will argue that the paramount concern of China is not whether corporate governance transplants will function as expected by China's counterparts in the West despite all odds. Rather those transplants merely serve as an instrument to facilitate the implementation of other agendas. For instance, such agendas may canvass China's realisation of its goal of becoming one of the (if not the) largest and most influential economies in the world without getting involved in social and economic crises or unrests.

Rather importantly, this research finds that China's transplantation of western corporate governance institutions has been in form rather than in substance. Commingling foreign transplanted institutions with domestic features and characteristics to facilitate sustainability of its own economic growth, has, in the alternative, given rise to the emergence or development of its own *sui generis* form of capitalism – Sino-Capitalism. Hence, the 'text-book' application of the 'law-and-finance' and 'convergence-or-divergence' debates on the legal transplantation of corporate governance systems into China will likely be an unfortunate misunderstanding or will be lost in translation.

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[11] Curtis J Milhaupt "The Governance Ecology of China's State-Owned Enterprises" in Jeffrey N Gordon and Wolf-Georg Ringe (eds) *The Oxford Handbook of Corporate Law and Governance* (Oxford University Press, 2018), at 778.

The following section investigates the characteristics and development of the legal-transplants-thesis, uncovers the intricacies of the Watson-Kahn-Freund-Legrand-legal-transplantation-debates and in turn sets the stage for this research.

2 Literature Review

Legal transplants have long been employed as the metaphor for the analyses of the transfers of legal institutions from one legal system to another. Today, legal transplantation has been recognised as the principal means to implement legal reforms and changes across the world.[12] For instance, Langer observes that Watson has shown through numerous books and articles that legal transplants "have been common since time immemorial".[13] Legal transplants can be found by way of borrowing of an entire legal system, an entire area of law or certain individual legal concepts or practices.[14] The transplant metaphor canvasses the comparison between the original and transplanted legal institutions, rules and norms. It presents a useful means to analyse the phenomena of legal differences, the necessity for adjustment by the receiving legal system, and the possibility of rejection by the receiving legal environment.[15]

Decades before Alan Watson "popularised"[16] the metaphor "legal transplants" in 1974 in his seminal book *Legal Transplants: An Approach to Comparative Law* (*Watson's Legal Transplants*)[17], legal scholars such as Charles de Montesquieu,[18]

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12 Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard "The Transplant Effect" (2003) 51 Am J Comp L 163, at 163-165. See also Alan Watson *Comparative Law: Law, Reality and Society* (3rd ed, Vandeplas Publishing, USA, 2010), at 5.

13 Watson, above n 2, at 21. See also Máximo Langer "From Legal Transplants to Legal Translations: the globalization of plea bargaining and the Americanization thesis in criminal procedure" (2004) 45 Harv Int'l LJ 1, at 29.

14 Wentong Zheng "Transplanting antitrust in China: economic transition, market structure, and state control" (2010) 32 U Pa J Int'l L 643, at 645. See also Watson, above n 2, at 21.

15 Langer, above n 13, at 26-25.

16 Julie Mertus and Elizabeth Breier-Sharlow "Power, Legal Transplants and Harmonization" (2003) 81 U Det Mercy L Rev 477, at 479. See also Langer, above n 13, at 29 and F Foster, above n 9, at 608, who concurred that Alan Watson "popularised" legal transplants and made a significant contribution to the field of comparative law.

17 Watson, above n 2.

18 Charles de Secondat, Baron de Montesquieu *The Spirit of Laws* (1748) (Thomas Nugent trans, Cosimo Incorporated, 2011).

Roscoe Pound,[19] and Albert Kocourek[20] had drawn on this metaphor in their discussions of legal changes, reforms and developments. This transplant metaphor has not only attracted scholarly but also judicial attention. Lord Denning, for instance, likened the English common law to an English oak tree in one of his 1956 judgments to advocate that one cannot simply transplant the tree to Africa and expect it to retain its original character and that it needs "careful tending" before it may flourish in the new continent.[21] Indeed, Watson acknowledged in *Watson's Legal Transplants* that he was not the first to engage in legal discussions of "transplants" or "transplantation" regarding transnational movements of laws.[22] He believes that one of the earlier examples of transplantation of private law can be traced back to the Babylonian Code of Hammurabi in the early 17th century B.C.[23]

That said, the debate on the theory of legal transplants was sparked off in 1974[24] between Alan Watson, a Scottish comparative legal historian, and English legal comparatist Otto Kahn-Freund, who, in unrelated papers, postulated competing theories on the viability of legal transplants.[25]

Watson's theory began with his definition of legal transplants as "the moving of a rule or a system of law from one country to another, or from one people to another".[26] He later clarified that there is no inherent relationship between law and the society in which it operates and that law develops by transplanting simply because those with control over law-making perceive the merits of adapting a foreign rule or law into their society for its betterment.[27] He further identified nine

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19 Roscoe Pound "The Theory of Judicial Decision I. The Materials of Judicial Decision" (1923) Harvard Law Review 641-662.

20 Albert Kocourek "Factors in the Reception of Law" (1935) 10 Tul L Rev 209.

21 *Nyali Ltd v Attorney-General* (1956) 1 QB 1, at 16.

22 F Foster, above n 9, at 605.

23 Watson, above n 2, at 22-24.

24 In the same year, Watson published *Watson's Legal Transplants*, whilst Kahn-Freund published "On Uses and Misuses of Comparative Law" (1974) 37(1) The Modern Law Review 1-27.

25 Loukas A Mistelis "Regulatory Aspects: Globalization, Harmonization, Legal Transplants, and Law Reform—Some Fundamental Observations" (2000) The International Lawyer 1055, at 1065-1067.

26 Watson, above n 2, at 21.

27 Alan Watson "Comparative law and legal change" (1978) 37(02) The Cambridge Law Journal 313, at 313-315 and 321.

interacting factors that he believes must be considered to determine if situations are mature for legal transfers.[28]

Watson recognised that legal transplants "come in all shapes and sizes."[29] They include "imposed reception, solicited imposition, [and] penetration".[30] The main theme of Watson's theory is that foreign legal rules, norms and institutions are transplantable to a recipient system irrespective of the social, economic and political differences between the donor and the recipient systems.

To Watson's mind, law is an independent element in a social structure with its own "life and vitality"[31] and "successful borrowing could be achieved when nothing was known of the political, social or economic context of the foreign law".[32] He is largely optimistic that "the transplanting of legal rules is socially easy" and that "legal rules move easily and are accepted into the system without too great difficulty".[33]

Kahn-Freund identified three purposes for which foreign laws are employed in the law-making process: first, "international unification of the law"; second, "giving adequate legal effect to a social change shared by the foreign country with one's own country"; and third, "promoting at home a social change which foreign law is designed either to express or to produce".[34] He also proposed the criteria that might assist lawmakers in deciding the degree of transferability of legal rules and institutions by relying on the view of Montesquieu, the "first of all comparative lawyers", who believed that it would be "the most exceptional cases that the institutions of one country could serve those of another at all".[35] Hence, if one country's law fits into the legislative system of another, it is "a great coincidence".[36] In other words, legislative transplantation can, to Kahn-Freund's mind, prove to be difficult between the donor and the recipient countries, and one should not take it

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28 Watson, above n 27, at 322. The relevant nine factors are: source of law, pressure force, opposition force, transplant bias, law-shaping lawyers, discretion factor, generality factor, inertia, and felt-needs.

29 Watson, above n 2, at 30.

30 Ibid.

31 Watson, above n 27, at 314-315.

32 Alan Watson "Legal transplants and law reform" (1976) 92 Law Quarterly Review 79, at 79.

33 Watson, above n 2, at 95-96.

34 Kahn-Freund, above n 24, at 2.

35 Ibid, at 6.

36 Ibid, at 7.

for granted that parts of the donor's legal system may be readily transplantable into the recipient's system.

This difficulty raises a further question about the obstacles to legal transplantation. Kahn-Freund asserted that such obstacles may be determined by two groups of variables: *environmental factors* (for instance, geographical, social, economic and cultural factors) and *"purely political" factors* (such as the nature of the government).[37]

It is Kahn-Freund's central thesis that in the course of over two hundred years since Montesquieu's time, the geographical, economic, social and cultural elements have greatly lost importance due to industrialisation, urbanisation, the development of communications and the increased mobility of people. These changes have given rise to the "process of economic, social, cultural assimilation or integration among the developed countries (and also the dominant classes of the developing countries)",[38] and have in turn largely diminished the environmental obstacles to legal transplantation.[39]

On the other hand, Kahn-Freund believed that the political factors have greatly gained in importance given the increasing growth of political differentiation, which "can prevent or frustrate the transfer of legal institutions"[40] from one country to another. The political differentiation can be viewed in three stages: first, "the gulf between the communist and the non-communist world, and that between dictatorships and democracies in the capitalist world"[41]; second, the variations on the democratic types, which include the presidential type developed in the United States and the parliamentary type developed in the United Kingdom, and "an untold number" of mixed systems developed in the Continent;[42] and third – and in many ways, to Kahn-Freund, the most important differentiation - "the enormously increased role which is played by organised interests in the making and in the maintenance of legal institutions".[43]

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37 Eric Stein "Uses, Misuses--and Nonuses of Comparative Law" (1977) 72 Nw UL Rev 198, at 199.

38 Kahn-Freund, above n 24, at 8.

39 Stein, above n 37, at 199.

40 Kahn-Freund, above n 24, at 13.

41 Ibid, at 11.

42 Ibid, at 12.

43 Ibid.

Kahn-Freund provided a few examples to support this point. For instance, he cited that the political power of the Catholic Church in Ireland explains the Irish rejection of the new developments in the laws of divorce and alimony.[44] These new developments include the successful legal transplants from Australia[45] and New Zealand[46] to the United Kingdom[47], the radical changes in the same direction in Canada and New York, as well as the earlier but similar transformations in Japan and the Scandinavian countries in this field.[48]

Kahn-Freund concluded that the use of the comparative method as an attempt to use a legal institution outside the environment of its origin (that is, its legal transplant from one system into another) entails the risk of rejection and that such a use requires a knowledge not only of the foreign law but also its social, and above all, its political context. Otherwise this use of comparative law will become a misuse (in other words, a kind of failed legal transplantation).[49]

Watson challenged the fundamental tenets of Kahn-Freund's thesis in his theory of legal transplants.[50] To Watson's mind, Kahn-Freund's pessimistic view of legal transplants is not borne out by history, which clearly shows that successful transplantation from very different legal systems has frequently been accomplished. Watson believes that systematic knowledge of the foreign donor system is not necessary. He refers to the reception of Roman law by Western Europe in the Middles Ages as a principal illustration of successful legal transplantation. He finds it questionable whether environmental factors are nowadays less important than political factors.[51] He maintains that it is enough to look at the recipient's power structure to assess whether the donor's law could be

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44 That is, according to Kahn-Freund, the acceptance of the new idea in various legal systems that divorce is a relief of the misfortune of marriage failure rather than "a redress for fault or sin" - see generally Kahn-Freund, above n 24, at 14 and Stein, above n 37, at 200.

45 Matrimonial Causes Act 1959; Commonwealth Statute No. 104 of 1959. See Kahn-Freund, above n 24, at 14.

46 Matrimonial Proceedings Act 1963; Statute No. 71 of 1963. See Kahn-Freund, above n 23, at 14.

47 Divorce Reform Act 1969. The Law Commission's Report: *Reform of the Grounds of Divorce.* See Kahn-Freund, above n 24, at 14.

48 Kahn-Freund, above n 24, at 13-14.

49 Ibid, Kahn-Freund, at 27.

50 See generally Watson, above n 32.

51 Ibid, at 79-83.

successfully introduced into the recipient. Hence, for instance, the success of the transplant of Western law into Japan was due to the "Japanese desire for it, not their knowledge of the French and German political context or any similarity of that political context with what existed in Japan."[52]

The Watson-Kahn-Freund debate did not continue. No further response was made by Kahn-Freund following Watson's publication of his article "Legal transplants and law reform" in 1976. Kahn-Freund died in 1979. The debate was however picked up by Eric Stein in 1977.[53] Stein's view on the Watson-Kahn-Freund debate appears to be balanced. Stein finds that their different views of legal transplants are simply "in the eye of the beholders" perception-based or are due to the particular focus of each of their inquiries.

Watson, the lawyer-historian, took a "macro-legal" view that contemplated massive transplants from the sophisticated to the less developed systems which serve as milestones in world history, whilst Kahn-Freund, the lawyer-sociologist, took a "micro-legal" view that concentrated primarily on modern law reforms in developed countries.[54] In sum, it can be said that their debate did not revolve around the possibility of legal transplants, but rather on the degree of this possibility from different perspectives.

Stein also postulates that an historian (like Watson) who sees a wealth of legal transfers across centuries is bound to blur the detail and soften the difficulties, whereas a sociologist (like Kahn-Freund) who sees the law in its operational context would understandably take a different interpretation. He further suggests that what may appear to be transplants may be examples of parallel developments.[55] In this regard, it is interesting to see that almost 40 years later, Mathias Siems appears to have taken this further by coining in the term "overfitting legal transplants" (that is, legal transplants that work even better in the transplant country than in the origin country).[56]

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52 Watson, above n 32, at 83.

53 John W Cairns "Watson, Walton, and the History of Legal Transplants" (2013) 41 Ga J Int'l & Comp L 637, at 648.

54 Stein, above n 37, at 203-209.

55 Ibid, at 204-207.

56 Mathias M Siems "The Curious Case of Overfitting Legal Transplants" (final version for publication) in Maurice Adams and Dirk Heirbaut (eds) *The Method and Culture of*

Also in 1974, Rodolfo Sacco, an Italian comparatist whose theory of "legal formants" has recently been cited as "probably the most important and lasting contribution of Italian scholarship to the discipline of comparative law,"[57] linked the phenomena that Watson called legal transplants and receptions with methodological issues of comparative law.[58] By 1984, *Watson's Legal Transplants* was published in an Italian edition.[59] It is understandable that John Cairns has recently commented that Sacco is the Italian comparatist scholar who "popularised" Watson's work on legal transplants in continental Europe (in particular, Italy and France) in the process of developing his own theory of "legal formants".[60]

Sacco believes that legal rules, institutions and styles change continually either through slow evolution or by overall superimposition and that the cause of this change can be traced by drawing the basic distinction between two principal types of legal changes: original innovation and imitation.[61] He claims that "[o]f all the legal changes that occur, perhaps one in a thousand is an original innovation."[62] In other words, only very few legal changes can be truly classified as an original innovation, this leaves the other cause – imitation.

Sacco identifies that there are two fundamental causes of imitation: imposition and prestige. Anyone with the power to spread his own country's legal institutions would tend to impose his own institutions upon the others. That said, Sacco concedes that receptions due to pure force or imposition are relatively rare in history and that receptions usually take place because of the desire to appropriate the work of

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Comparative Law: Essays in Honour of Mark Van Hoecke (Hart Publishing, Oxford, 2014) 133-146.

57 Elisabetta Grande "Development of Comparative Law in Italy" in Mathias Reimann and Reinhard Zimmerman (eds) *The Oxford Handbook of Comparative Law* (Oxford University Press, Oxford, 2006) 107, at 115. Grande also clarifies therein "legal formants" as being "a legal landscape consisting of components not necessarily coherent with each other" which requires one "to discover, analyse and contrast with each other, a variety of 'formants' in order to capture the complexity of a legal system and of its 'rules'."

58 Michele Graziadei "Comparative Law as the Study of Transplants and Receptions" in Mathias Reimann and Reinhard Zimmermann (eds) *The Oxford Handbook of Comparative Law* (Oxford University Press, Oxford, 2006) 441, at 442.

59 Cairns, above n 53, at 671.

60 Ibid.

61 Rodolfo Sacco "Legal formants: a dynamic approach to comparative law (Installment II of II)" (1991) The American Journal of Comparative Law 343, at 397.

62 Ibid, at 398.

others, which is desirable due to its quality – often described as "prestige".[63] In this regard, Sacco is *ad idem* with Watson who has been advocating that transplantation takes place and is successful because of the recipient's desire for it. [64] In other words, prestige motivates or triggers imitation, transplant or reception.[65]

In the opposing camp, despite the passing of Kahn-Freund, his focus on the dangers and difficulties of legal transplantation appears to have paved the way for Pierre Legrand's argument that legal transplantation is impossible due to the embedded differences between the donor and the recipient systems involved.[66]

To Legrand's mind, a rule is "necessarily an incorporative cultural form" which "is buttressed by important historical and ideological formations" and which "does not have any empirical existence that can be significantly detached from the world of meanings that defines a legal culture".[67] Its meaning is thus to be found through subjective interpretative processes that are "a function of the interpreter's epistemological assumptions which are themselves historically and culturally conditioned."[68] Hence, legal transplant simply does not happen because the key feature of the rule – its meaning – stays behind. In other words, "a crucial element of the ruleness of the rule – its meaning – does not survive the journey from one legal culture to another."[69] Accordingly, the rule that is transplanted from its donor to the recipient is therefore "not the same rule"[70] as a different meaning will be adapted or adopted by the recipient in which case the rule itself changes.

Gunther Teubner believes that the "metaphor of legal transplants, suggestive as it is, is in itself misleading" and that "'legal irritant' expresses things better than 'legal

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63 Sacco, above n 61, at 398.

64 Watson, above n 32, at 83.

65 Graziadei, above n 58, at 458.

66 Margit Cohn "Legal transplant chronicles: the evolution of unreasonableness and proportionality review of the administration in the United Kingdom" (2010) 58(3) American Journal of Comparative Law 583, at 587.

67 Pierre Legrand "What 'Legal Transplants'?" in David Nelken and Johannes Feest (eds) *Adapting legal cultures* (Hart Publishing, Oxford, 2001) 55-70, at 59.

68 Ibid, at 58.

69 Ibid, at 60. See also Pierre Legrand "The Impossibility of 'Legal Transplants'" (1997) 4 Maastricht Journal of European and Comparative Law 111, at 117.

70 Legrand, above n 67, at 61.

transplant'".[71] The core of Teubner's thesis is that when a foreign rule is transplanted to a new system, it works as a fundamental irritation which triggers reconstruction or transformation during the implantation process that may in turn result in the new system's undergoing unexpected changes. Teubner's theory of "legal irritant" does sound less pessimistic than Legrand's. It in effect takes the transplant argument to a vast middle ground by admitting that some laws in some systems will be more amenable to transfer than others.

In truth, the extreme visions of the two competing camps have gradually merged into a middle ground over the past four decades. Much of the study has followed the culturalist pathway on which legal culture is considered as a key determinant of the viability of transplantation.[72] Numerous scholars have documented the spread of legal transplants across the world to countries or regions as diverse as Africa,[73]Argentina,[74] China,[75] Indonesia,[76] Japan,[77] Russia and Eastern Europe[78]

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71 Gunther Teubner "Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences" (1998) 61 Mod L Rev 11, at 12.

72 David Nelken and Johannes Feest (eds) *Adapting legal cultures* (Hart Publishing, Oxford, 2001).

73 Elisabetta Grande "Alternative Dispute Resolution, Africa, and the Structure of Law and Power: The Horn in Context" (1999) 43 Journal of African Law 63 (in which issues relating to the transplant to Africa of the alternative dispute resolution (ADR) model developed in the modern Western societies are discussed).

74 Jonathan M Miller "A Typology of Legal Transplants: Using Sociology, Legal History and Argentine Examples to Explain the Transplant Process" (2003) The American Journal of Comparative Law 839 (in which different types of legal transplants in Argentina are canvassed).

75 Shaohong Zhuang "Legal Transplantation in the People's Republic of China: A Response to Alan Watson" (2005) 7 Eur JL Reform 215 (in which an overview of legal transplantation in China is given).

76 Jeremy J Kingsley "Legal Transplantation: Is This What the Doctor Ordered and Are the Blood Types Compatible? The Application of Interdisciplinary Research to Law Reform in the Developing World - A Case Study of Corporate Governance in Indonesia" (2004) 21 Ariz J Int'l & Comp L 493 (in which the development of corporate governance law through transplantation in Indonesia is discussed).

77 Hideki Kanda and Curtis J Milhaupt "Re-Examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law" (2003) The American Journal of Comparative Law 887 (in which issues regarding the transplantation of director's duty of loyalty in Japanese corporate law are examined).

78 Gianmaria Ajani "By Chance and Prestige: Legal Transplants in Russia and Eastern Europe" (1995) The American Journal of Comparative Law 93 (in which a widespread borrowing of

and Vietnam,[79] to name a few.

The study of legal transplants has developed in a multitude of directions. Scholars have over the years taken on the task inspired by Watson's theory to classify legal transplants in various different contexts.[80] Daniel Berkowitz, Katharina Pistor and Jean-Francois Richard, for instance, have, following their comprehensive empirical study of legal transplants, found that transplants may be categorised as "receptive transplants" and "unreceptive transplants".[81] They postulate that a transplant is less likely to be a success "where foreign law is imposed and legal evolution is external rather than internal."[82]

Peerenboom and DeLisle have placed emphasis on the participants in legal transplants, for instance, the international development agencies such as the World Bank, the International Monetary Fund (**IMF**), the WTO and the agencies under the United Nations (**UN**).[83]

Jonathan Miller, on the other hand, provides a typology of legal transplants to facilitate understanding of the legal transplant process. He shifts the transplant focus from the donor's perspective to the recipient's and identifies four types of legal transplants which canvass various factors that can motivate a transplant: (i) cost-saving transplant, (ii) externally dictated transplant, (iii) entrepreneurial transplant and (iv) legitimacy-generating transplant. He believes, in practice, "many

legal models in the post-Soviet States and Central and Eastern Europe and its effects are explored).

79 John Gillespie "Transplanted Company Law: An Ideological and Cultural Analysis of Market-Entry in Vietnam" (2002) 51 International and Comparative Law Quarterly 641 (in which the transplant of company law to Vietnam is analysed).

80 F Foster, above n 9, at 610.

81 Berkowitz, Pistor and Richard, above n 12, 179-180, which is also referred to by Margit Cohn as the study of the "success" and "failure" of transplants: see above n 66, at 588.

82 Cohn, above n 66, at 589.

83 Randall Peerenboom "What Have We Learned about Law and Development? Describing, Predicting and Assessing Legal Reforms in China" (2006) 27 Mich J Int'l L823, at 831. See also Jacques DeLisle "Lex Americana: United States Legal Assistance, American Legal Models, and Legal Change in Post-Communist World and Beyond" (1999) 20 U Pa J Int'l Econ L 179, at 179.

transplants are a mix of the four types, and one rarely encounters a type in pure form."[84]

It is worth noting that while legal transplantation from one country to another has been commonly observed by numerous scholars across the globe over the past four decades, one question, which Watson has largely ignored,[85] has dominated the discussions: why do some legal transplants succeed while others fail?[86] As Kanda and Milhaupt have pointed out, "[d]espite the importance of transplants to legal development around the world … there is little analysis of how the success or failure of legal transplants relates to the achievement of larger goals, such as economic development."[87]

This thesis will argue that although China has experienced unprecedented economic success through various reforms canvassing an exceptionally high concentration of law-making by way of legal transplants from the West over the last four decades, China's overriding consideration is not whether such transplants will implant and function easily or with difficulties in its system as debated amongst the advocates supporting the respective Watson-Kahn-Freund-Legrand camps. Nor does it appear that China is too concerned about whether and how law influences corporate ownership structures or whether such transplants will end up steering China to be converging towards or diverging from its western counterparts' corporate governance practices and institutions in the international arena (albeit legal transplantation *per se* is deemed to be imperative to its economic growth and sustainability) as it appears that such a speculation is possibly lost in translation to

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84 Miller, above n 74, at 842, and generally 842-867 for the discussions of the four types of transplants.

85 David Nelken "The Meaning of Success in Transnational Legal Transfers" (2001) 19 Windsor YB Access Just 349, at 352, in which Nelken sums up Watson's main thesis is to show that law travels easily between systems and that Watson is not too interested in whatever happens to it afterwards.

86 This issue has been dominating the scholarship of transplants to the extent that those who wish to explore other issues under this premise would usually expressly clarify that the impact of transplants would not be considered in their theses, examples of which include Kingsley, above n 76, at 510; Joel M Ngugi "Promissory Estoppel: The Life History of an Ideal Legal Transplant" (2006) 41 U Rich L Rev 425, at 495; and Beverly I Moran "Homogenized Law: Can the United States Learn from African Mistakes" (2001) 25 Fordham Int'l LJ 361, at 361.

87 Kanda and Milhaupt, above n 77, at 887.

Sino-Capitalism.[88] Rather, legal transplants (which are largely in form but not in substance and more importantly adapted and implanted with Chinese characteristics) simply serve as an instrument to facilitate China's agenda to realise its goal of becoming one of the (if not the) largest and most influential economies in the world and in turn sustaining its one-party rule. This thesis will examine the role of legal transplants in the context of corporate governance and legislation in China, one of the (if not the) most successful transition economies nowadays, having recently overtaken the United States (**US**) as the world's largest economy based on gross domestic products (**GDP**) adjusted for purchasing power parity (**PPP**), according to the data released by the IMF in October 2014.[89]

According to Donald Clarke, the concept and definition of corporate governance can vary and be "extremely broad"[90] with which this thesis concurs. The simplest definition can be found in the 1992 Cadbury Report which defines corporate governance as "the system by which companies are directed and controlled."[91] The narrowest definition has been adopted by two of the prominent 'law-and-finance' scholars who advocate that corporate governance centres around finance suppliers, stakeholders, board directors and professional managers and deals with "the ways in which suppliers of finance to corporations assure themselves of

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88 Idea inspired by David Hundt and Jitendra Uttam *Varieties of capitalism in Asia: Beyond the developmental state* (Springer, 2017), at 139, in which Hundt and Uttam find that "China combined the market's competitive zeal with the power of communist mass-mobilisation, and thereby created a new pragmatic ideology of prosperity. This was aptly symbolised in Deng's words, 'to get rich is glorious'." For the purposes of this thesis, this research takes this "new pragmatic ideology of prosperity" further and elucidates that China has in fact developed its own form of capitalism – Sino-Capitalism. Refer to Chapters IV and VI below for discussions regarding the development of the theory of Sino-Capitalism.

89 Mike Bird "China Overtook The US As The World's Largest Economy" *Business Insider Australia* (Sydney, 9 October 2014): http://www.businessinsider.com.au/china-overtakes-us-as-worlds-largest-economy-2014-10; and Hugo Duncan and David Martosko "America usurped: China becomes the world's largest economy – putting USA in second place for the first time in 142 years" *Mail Online* (London, 9 October 2014): http://www.dailymail.co.uk/news/article-2785905.

90 Donald Clarke "The independent director in Chinese corporate governance" (2006) 31(1) Delaware Journal of Corporate Law 125, at 143.

91 Adrian Cadbury, Report of the Committee on the Financial Aspects of Corporate Governance (The Committee on the Financial Aspects of Corporate Governance, The London Stock Exchange, 1 December 1992), at 14 (Introduction, paragraph 2.5) [**1992 Cadbury Report**].

getting a return on their investment."[92] For the purposes of this thesis, corporate governance is defined as the practices and ecosystems regulating the interactions and relationships amongst the stakeholders and participants in modern Chinese big businesses and canvassing decision-making in those businesses.[93]

The following section will discuss the research justification, possible contribution, scope and structure of this thesis based on the above discussion.

B Research Justification, Contribution, Scope and Structure

1 Justification and Contribution

China has experienced exponential economic growth and legal transformation in the past four decades. Its on-going economic transition and its entry to the WTO at the turn of the twenty-first century have significantly intensified far-reaching and unprecedented legal changes through transplantation within a relatively short time span. This phenomenon is simply non-observable in the advanced market economies in the West in this twenty-first century.

Given its rapidly progressing law-making processes, China, like other transition economies, naturally becomes one of the green fields for the study of legal transfers. Virtually no other period in economic history provides such a high concentration of law-making and such a variety of encompassing approaches to introduce new institutions through legal transplantation as this early twenty-first century, especially in the case of China.[94] Indeed, it has been reported that over 3,000 legal institutions were introduced or revised within less than two years following China's accession to the WTO at the end of 2001.[95]

Within just over one and a half decades from the promulgation of its first corporate law in 1993, China went from having no corporate governance system or legislation to a position whereby China could claim it had 'successfully' installed a

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92 Andrei Shleifer and Robert W Vishny, "A survey of corporate governance", (1997) LII (2) The Journal of Finance 737, at 737.

93 Idea inspired by Donald Clarke, above n 90, at 145.

94 Opper and Schwaag-Serger, above n 4, at 246.

95 Shuguang Li "*Lun xian fa yu si you cai chan quan bao hu*" (translation: "An Analysis of the Constitution and the Protection of Private Property Rights") (2003) 1 *Bi jiao xian fa xue yan jiu* (translation: Comparative Study of Constitutionalism) 23, at 123.

comprehensive corporate governance framework and legislation that is largely in conformity with international standards and practices by the end of 2010.[96]

Understanding whether and how such corporate governance transplants have worked and examining the compatibility of legal transplantation in China of the Western corporate governance systems with China's institutional environment and local conditions will bear significance beyond Chinese corporate governance and legislation. Today, given that China has become one of the (if not the) largest economies, there is growing call for greater attention to the development of China's enforcement of corporate governance and the constant improvement of its legal system. These could provide beneficial reference points for corporate governance for other countries in the region.[97]

More broadly, China is nowadays viewed as a rare example of a successful transition economy that gains its position in the international economic arena through transplantation. There has been, however, very little analysis of what this means, beyond the fact that subsequent to China's implantation of certain Western corporate governance systems, it has developed into a highly prosperous and relatively politically stable country. Deeper analysis of China's experience with the transplantation of Western corporate governance systems and legislation may advance both debates and perhaps fill the analysis gap.

2 Scope and Structure

Although legal transplantation that touches and concerns various aspects of life in China has taken place and been developing since the Qing Dynasty,[98] this thesis aims to look at legal transfers in the context of corporate governance since China's adoption of an 'Open Door Policy' in late 1978.[99] Hence, issues relating to private

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96 OECD "Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission" (OECD Publishing, Paris, 2011) [**CSRC Report (OECD publication)**]; Preface by CSRC's Chairman Fulin Shang, at 9 to 10; and Preface by OECD's Deputy Secretary General Richard Boucher, at 11.

97 Ibid, at 11.

98 Zhuang, above n 75, at 216. The Qing Dynasty was the last imperial dynasty of China, ruling from 1644 to 1912.

99 In late 1978, China adopted its new economic development strategy and open-door policy at the Third Plenary Session of the 11th Central Committee of the Communist Party of China led by Deng Xiaoping.

property or intellectual property rights, human rights, antitrust, trust or civil law,[100] to name a few, will not be explored in this thesis, even though they may be related to the installation and enforcement of imported corporate governance institutions in China.

Note also that as at the time of writing (April 2017), there are a number of proposed new laws and substantive revisions to the various corporate and governance related laws and regulations (for example, the securities law (as discussed in Section B, Chapter III below) and the foreign investment law (as discussed in Section D, Chapter V below)) which have yet to be published. Hence, for the purposes of this thesis, proposed new laws and revisions which are not enacted in China as of April 2017 will not be considered, discussed or included in this thesis.

This thesis will review existing literature and comprise of six chapters. Chapter I sets the stage for this research. It uncovers a synthesis of legal transplants which will include their definitions, theories, debates and problems, the relevance of the case of China to the legal transplant debate, and the proposed contribution and significance of this thesis by attempting to fill the gap that current debates on corporate governance transplants have left unfilled by using China as a case study. Chapter II provides a comparative analysis of corporate governance transplants as regulatory conversations amongst interested parties and regulators. It gives an overview of corporate governance institutions and systems in the global context. It then discusses the reasons for using China as the case study. Chapter III presents an overview of the economic reforms and development of corporate governance and legislation in China, rolls out issues with China's corporate governance through the conventional lens from the western "best" practice perspective, and critiques China's self-assessment of the development of its corporate governance regime. Chapter IV provides a contextual review of the transplantation and implantation of

[100] For discussions of legal transplants in these areas, see generally Robert Bejesky "Investing in the dragon: Managing the patent versus trade secret protection decision for the multinational corporation in China" (2003) 11 Tulsa J Comp & Int'l L 437; Shawn Comeau-Gallimore "Towards a trans-systemic approach to observing Chinese civil law development" (2013) 2(3-4) China-EU Law Journal 161; F Foster's "American Trust Law in a Chinese Mirror", above n 9; Pitman B Potter "Globalisation and Local Legal Culture: Dilemmas of China's Use of Liberal Ideals of Private Property Rights" (2000) 2(1) Australian Journal of Asian Law 1; Pitman B Potter "Selective Adaptation and Institutional Capacity: Perspectives on Human Rights in China" (2006) 61(2) International Journal 389; and Zheng's "Transplanting antitrust in China", above n 14.

corporate governance laws into China which gives rise to Sino-Capitalism through the fostering of big businesses in China. This Chapter also critically uncovers the intricacies of China's unique big business ecosystems under the watch of SASAC and assesses the ways corporate governance transplants may work in such ecosystems. Chapter V uncovers that substantially similar (if not identical) *modus operandi* of 'in-form-not-in-substance' transplantation of foreign governance systems (more particularly the controversial VIE and dual-class-share structures employed by numerous Chinese conglomerates which have 'gone out' of China like the other Chinese SOE big businesses for overseas or cross listing) has been adopted for the construction of Chinese big business ecosystems through the prism of the development of Alibaba Group (**Alibaba**). This Chapter concludes that Alibaba serves as a mirror of the development of the Chinese economy using western business and legal transplants as a means to achieve its agenda vis-a-vis economic growth and sustainability. Chapter VI sums up the findings set out in this thesis, discusses the discovery of Sino-Capitalism, and provides suggestions for future research.

C Research Methodology

A combination of research methodologies will be employed in this thesis. A suite of methodologies with the components as set out below will be applied as and when appropriate for the preparation of this thesis.

1 Theoretical Component

The research contains a theoretical component as and when it analyses and elucidates principles and theories in relation to legal transplants and corporate governance following careful examination and study of the relevant existing literature.

2 Comparative Study

The research is comparative since it studies and compares corporate governance systems in various jurisdictions, for instance, Germany, the United States and the United Kingdom, from which China has, or appears to have, borrowed their corporate governance institutions, rules and norms.

3 Legal Realism Component

This thesis attempts to serve the function of a legal realist to work to uncover the reality behind, or correlation between, corporate governance transplants in China and China's institutional environment and local conditions. This approach enhances awareness of the consequences of law-making decisions on society. Hence, the research embraces a legal realism component.[101]

4 Socio-Legal Approach

This thesis also encompasses socio-legal research which situates law and legal analysis in a social context. It looks beyond 'law in books' and opts for 'law in action' to attempt to understand law as a social phenomenon or experience. By linking law with policy goals for economic development, it is hopeful that it may shed light on how law really operates in practice through investigation into the local conditions of the society involved.[102]

5 Analytical Component

This research is explicitly analytical as data will be collected from existing literature to explain and critique the theories, principles, practices and phenomena involved. The purpose of this data collection exercise is to attain a clearer perspective regarding the laws, institutions, rules, norms, systems and practices that are applicable to the field of corporate governance in the donor countries which will in turn assist in the analysis of the impact of legal transplantation in the context of corporate governance in the recipient country, that is, China in this case.

6 Evaluative and Normative Component

This research is evaluative and normative in that it will analyse the impact of legal transplants on corporate governance in China and may conclude with relevant suggestions to actual implications of corporate governance legal transplants in China and the direction to which such transplants have taken China vis-à-vis its economic growth and sustainability.

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101 Idea borrowed from Caroline Morris and Cian C Murphy *Getting a PhD in law* (Hart Publishing, Oxford, 2011), at 32.

102 Ibid, at 35.

D Conclusion

In summary, the scene has been set for this thesis to argue through the employment of the 'Watson-Kahn-Freund-Legrand-debates' that the legal transplants from the West do not necessarily present convergence or divergence. Rather, the whole situation could be misunderstood or lost in translation to Sino-Capitalism in the case of China which is likely to be unexpected by commentators who concentrate on the incompatibility and inadequacy of China's corporate governance development pathway. As discussed earlier, corporate governance transplants may facilitate implementation of China's other agendas, for instance, its goal of becoming one of the (if not the) largest and most influential economies in the world without embarking into social and economic crises or unrests. This Chapter has explored the relevant literature, justification and contribution, research scope and methodology of this thesis. The next chapter will roll out a comparative analysis of legal transplants in the corporate governance context.

Chapter II Comparative Analysis of Corporate Governance Transplants

A Legal Transplants as Regulatory Conversations on Corporate Governance

Comparative analysis of legal transfers is employed as a methodology in this thesis because legal transplants do not simply passively reflect what lawmakers of the recipients think but also actively shape the regulatory interpretation, selection, adaptation and implementation of the recipients. Comparative analysis of legal transfers serves as a law-making impetus which will in turn attain goals, set benchmarks which govern the recipients' performance, and coordinate the way the recipients' regulatory systems perform.[103] Legal transfers thus function as regulatory conversations, which may operate at a transnational, national or sub-national level between governments, associations, firms and/or individuals involved in the regulatory process to facilitate the operation of a regulatory system.[104] In the context of corporate law and governance, analyses of legal transfers serve to direct the recipient's attention beyond regulatory conversations simply associated with state organs towards conversations amongst government, quasi-government and private organisations, including peripheral regulatory networks.[105] Indeed, this thesis suggests that such regulatory conversations and discussions are the primary conduit through which corporate law and governance principles and systems from the developed economies transfer into developing or emerging economies such as China.

This methodological approach synthesised from comparative analysis will potentially improve the recipient's understanding of the legal transfers that facilitate the development of its regulatory system, which may in turn provide positive reference to, or at least shed some light on, the implications for its own economy or even other economies. This can be manifested in numerous respects. For instance, it provides a methodology for the assessment of whether and how lawmakers and regulators in the donor, recipient and perhaps other systems may

[103] Idea inspired by John Gillespie "Towards a Discursive Analysis of Legal Transfers into Developing East Asia" (2008) 40(657) New York University Journal of International Law and Politics 657, at 683.

[104] Idea borrowed from Julia Black "Regulatory conversations" (2002) 29(1) Journal of Law and Society 163, at 170-171.

[105] Gillespie, above n 103, at 684.

learn from each other. It sheds light on the significance of the interpretative and constitutive role played by regulators and reformers in the installation of new regulatory systems and institutions to support the development of their economies through corporate law and governance transfers. It sensitises the possibility of generating different regulatory outcomes and even phenomena from legal transfers in the commercial world. It may also assist regulators and lawmakers to consider how and why advocates in competing interpretative communities elucidate legal transplants as something that would (or would not) or should (or should not) flourish.[106]

B Overview of Legal Transplants on Corporate Governance

Globalisation has led to a focus on the study of legal transfers on corporate governance. Transnational relationships on the national and international levels give rise to the development of one global capitalist system consisting of various territorial and functional business and legal orders which regulate social and economic life. Consequently, such dynamic and cooperating business legal orders as the Organisation for Economic Co-operation and Development (**OECD**) and the WTO[107] have been developed to deal with the growing fluidity of an ever-developing business world since the Second World War. With the entry of multi-national agreements amongst their member states, taxes and tariffs will gradually disappear and acceptable business practices and accounting standards will appropriately develop. Such business legal orders aim to achieve the highest possible economic growth and a rising standard of living and social well-being in member states. They delineate acceptable international trade policies and practices and require member governments to be transparent vis-à-vis their laws in force and implementation of such policies and practices by way of legal transfers and/or adaptation.[108] Corporate governance adopted and/or adapted through legal transfers within these business legal orders provides a viable mechanism to contain risks for corporations and assist them in regulating their economic activities internally (or domestically) and externally (or internationally).

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[106] Gillespie, above n 103, at 683-687.

[107] Formerly the General Agreement on Tariffs and Trade (GATT) prior to the WTO's establishment on 1 January 1995 by 123 nations.

[108] See www.oecd.org/about/ and www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm.

1 Harmonisation

Harmonisation of corporate and commercial law played a significant role in terms of legal transplants in the global arena before 1989. The Vienna Convention on the International Sales of Goods 1980 (**Vienna Convention**) which has been adopted in over 70 countries is a representative example.[109] That said, harmonisation of this nature concerned international trade in goods and services and touched upon very little on domestic legal systems in its member states. The global scenario took a drastic turn after 1989 with the presence of massive worldwide transplants which has been affecting many legal systems' domestic laws.[110]

Harmonisation processes can be categorised as institutionally organised, customary/market-based, and pressure to conform/inter-jurisdictional competition.[111] Institutionally organised harmonisation is developed in the context of an institution. They can be governmental or public institutions, for instance, the European Bank for Reconstruction and Development (**EBRD**), the United Nations Commission on International Trade Law (**UNCITRAL**), the International Institute for the Unification of Private Law (**UNIDROIT**) and the World Bank, and non-governmental institutions, such as the International Chamber of Commerce (**ICC**).[112]

These institutions have developed numerous projects, rules and laws to give effect to a rather diverse variety of harmonisation. For example, the Vienna Convention, the UNCITRAL Model Law on International Commercial Arbitration, [113] the UNIDROIT Principles of International Commercial Contracts,[114] the EBRD Model

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109 See www.uncitral.org and Ewan McKendrick (ed) *Goode on Commercial Law* (4th ed, Penguin, London, 2010), at 1016.

110 One of the notable examples includes the European Bank for Reconstruction and Development's 'Law in Transition': www.ebrd.com/what-we-do/sectors/legal.../transition-programme.html.

111 Nicholas HD Foster "Transmigration and Transferability of Commercial Law in a Globalised World" in Esin Örücü and Andrew Harding (eds) *Comparative Law in the 21st Century* (Kluwer, The Hague, 2002), at 57.

112 See the websites of these institutions: www.ebrd.org; www.uncitral.org; www.unidroit.org; and www.iccwbo.org.

113 See www.uncitral.org/uncitral/en/uncitral_texts/arbitration/1985Model_arbitration.html.

114 See www.unidroit.org/english/principles/contracts/principles2010/integralversionprinciples2010.

Law on Secured Transactions produced for its Secured Transactions Project,[115] and the ICC Incoterms[116] and Uniform Customs and Practice for Documentary Credits.[117]

Customary/market-based harmonisation canvasses harmonisation processes arising out of international transactions which are not confined within any institution. Such transactions may lean on standard international legal practices and documentation, for instance, one that embraces the ICC Incoterms and uses the law of a common law host jurisdiction as the transaction's governing law, or they may be transactions adopting common law practices that are novel to the host jurisdiction which may be under a legal system practising civil or continental law.[118]

The third scenario is manifested by a general pressure on states to conform to certain international legal standards to keep themselves abreast with other states and in turn compete with them. Elements which sustain such cross-border or inter-jurisdictional competition may include (i) the need of certain economies to maintain being compliant with the World Bank's requirements to qualify for financial assistance, (ii) the wish of such relatively new entrants as China[119] and Russia[120] to conform to international legal practices by way of import or transplant of such practices into their own legal systems to qualify for, and maintain, membership of the WTO, (iii) the necessity of emerging or transition economies, for instance, Russia, China, Vietnam and Taiwan, to attract foreign direct investment (**FDI**) into such economies, and (iv) the desire of such emerging economies to opt for harmonisation with international standards by way of legal transfers to enable their

115 See www.ebrd.com/what-we-do/legal-reform/access-to-finance/transactions.html.

116 See www.iccwbo.org/products-and-services/trade-facilitation/incoterms-2010/.

117 This is a set of rules used by bankers and commercial parties in over 175 countries in trade finance:www.iccwbo.org/news/articles/2006/icc's-new-rules-on-documentary-credits-now-available/.

118 Idea inspired by N Foster, above n 111.

119 It took China, the first former communist state to gain membership to the WTO, 15 years and 5 months to gain accession to the WTO.

120 Likewise, Russia went through 19 years and 2 months to gain accession and is still the country which took the longest time to gain entry to the WTO. See also Larry Elliott, "Russia's entry to WTO ends 19 years of negotiations" *The Guardian* (London, 22 August 2012): https://www.theguardian.com/business/economics-blog/2012/aug/22/russia-entry-world-trade-organisation?newsfeed=true.

domestic trading entities and/or outbound investors to be internationally competitive.[121]

2 Global Initiatives for Developing 'Good' or 'Best' Corporate Governance Codes

Over the last two decades, international bodies have also become active in promoting co-operation and harmonisation of the institutions of corporate governance. The OECD was the first international body to form an inter-governmental task force in 1998 to develop a set of globally acceptable standards of corporate governance. The task force was composed of representatives of 29 OECD states, the European Union (**EU**) commission, the World Bank, the IMF, the Bank for International Settlements, business, labour and investment communities to propose principles of corporate governance and ensure acceptance and application of such principles.

In May 1999 ministers representing the 29 governments which comprised the OECD voted unanimously to endorse the *OECD Principles of Corporate Governance* (**OECD CG Principles**). These principles are not prescriptive regarding corporate board structures and operations but instead provide a viable framework to support countries, whether member or non-member states, in developing corporate governance systems and approaches to corporate governance which may reflect their own institutional and regulatory environments. In June 1999, the OECD and the World Bank agreed to co-operate on the improvement of corporate governance through a range of initiatives including the annual Global Corporate Governance Forum and Policy Dialogue, and the Development Round Tables. In another international initiative in the same year, the Commonwealth Association for Corporate Governance (**CACG**) stipulated the "Principles of Corporate Governance in the Commonwealth" which were, like the OECD, intended to help developing national strategies for the promotion of good corporate governance.[122]

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121 Idea inspired by N Foster, above n 111.

122 Paul Collier and Mahbub Zaman "Convergence in European corporate governance: The audit committee concept" (2005) 13(6) Corporate Governance: An International Review 753, at 754; see also Marlene Davies and Bernadette Schlitzer "The impracticality of an international "one

At a non-governmental level, the International Corporate Governance Network (**ICGN**) produced in July 1999 a more robust statement on global corporate governance principles following ICGN's bringing together key international investors to facilitate international dialogue on issues of concerns to investors to in turn further the development of global corporate governance practices. The ICGN, founded in 1995 at the instigation of major institutional investors, represents investors, companies, financial intermediaries, academics and other parties interested in the development of global corporate governance practices. The ICGN principles not only endorse the OECD principles as its bedrock but also provide further guidance on how to put the principles in practice.[123]

At the regional level, the European Commission of the EU has initiated numerous projects to foster a common understanding of corporate governance, however, has not attempted to produce a corporate governance code of best practices to be adopted by all member states. This is because the European Union believes that harmonisation should develop alongside with the emerging need for it. One significant development in European company law has been the establishment of the *Societas Europea* (**SE**) (that is, the European company) which comprises a general meeting and either a one-tier or two-tier governance system. The fact that the SE is free to adopt either system exemplifies that fundamental differences vis-à-vis corporate governance systems still exist in the European Union[124] and that the EU member states are not ready for convergence.

Alongside the pan-national movement for the development of codes of corporate governance, there has been an expansion in corporate governance codes and principles issued by individual countries. Codes of good corporate governance have become an increasingly visible phenomenon over the past few decades. The United States in 1978 and the United Kingdom in 1992 were the first two major economies that have issued codes of good corporate governance. During the 1990s, the United States and the United Kingdom became benchmarks for best practices in corporate governance for other economies that recognised Anglo-American governance models as drivers for economic development and growth.

size fits all" corporate governance code of best practice" (2008) 23(6) Managerial Auditing Journal 532, at 533-544.

123 ICGN *Statement on Global Corporate Governance Principles* (International Corporate Governance Network, London, 1999, revised in July 2005).

124 Davies and Schlitzer, above n 122, at 534.

Consequently, current governance codes usually contain a complement of traditional Anglo-American best practice provisions in terms of board composition, auditor and director independence, shareholders' rights protection, financial reporting, disclosure and transparency, and so on. Many of such provisions have been based on the agency theory which is currently the overarching tenet of the Anglo-American style of corporate governance.[125] To date, the European Corporate Governance Institute's (**ECGI**) codes database encompasses over 460 corporate governance codes, principles and recommendations which have been produced respectively by the Commonwealth, the EBRD, the Latin American Corporate Governance Roundtable, the OECD, various pan-European organisations and the UN as well as approximately 95 individual countries/jurisdictions across the globe.[126] Although the specific contents of every code may vary across economies or business systems, the codes tend to share an ultimate objective of attempting to enhance the quality and sustainability of corporates' board governance, and improve their accountability to shareholders with the view to maximise shareholder and/or stakeholder value.[127] These codification movements for the development of corporate governance codes and practices epitomise the globalisation of the international economy and the debate about whether this will lead to the global dominance by, or convergence to, an Anglo-American optimum approach.[128]

3 Comparative Corporate Governance: Convergence or Divergence

As mentioned above, each country may have its unique corporate governance processes depending on its corporate ownership structure, legal framework and financial system. That said, the most commonly adopted corporate governance systems appear to be the Anglo-American 'outsider' model, with its emphasis on shareholder rights and transparency as opposed to the Continental 'insider' model, with typically fewer listed companies and a concentration of ownership either in

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125 Mario Krenn "Decoupling as a sustainable firm response to pressures for convergence and divergence in corporate governance: The case of codes of good corporate governance" (2014) 15(4) Journal of Management Policy and Practice 103, at 103.

126 See ECGI's 'Search for a code' webpage: http://www.ecgi.org/codes/search.php [accessed on 25 February 2017] and http://www.ecgi.global/content/codes [accessed on 28 June 2018].

127 Krenn, above n 125, at 103-104.

128 Collier and Zaman, above n 122, at 755.

families, holding companies or other stakeholders. The terms 'outsider' and 'insider' represent two extreme forms of corporate governance systems. Many countries may in reality have corporate governance systems with a mixture of the characteristics of these two different forms. An 'outsider' model is characterised by a diverse ownership of corporate equity with numerous outsider investors which gives rise to a market-oriented system canvassing separation of ownership from control. The United States and the United Kingdom embrace the 'outsider' model as large corporates are run by managers whilst owned by outsider shareholders. As institutional investors in the United States and the United Kingdom increase their equity in the corporates and establish strong foothold in their management, their position may evolve, and they would in such event gradually act like those insider shareholders. Interestingly and consequently, it is argued that the wheel will then be turning to the point where the corporate governance systems in the United States and the United Kingdom are slowly converging to the other end of the spectrum.[129]

Unlike the 'outsider' model, an 'insider' or 'relationship-based' model exists where ownership is concentrated with shares or equitable interests being owned by either the holding companies, the relevant families, or the state. Most countries in Continental Europe and East Asia tend to have an insider-oriented corporate governance system, which embraces the stakeholder theory. Although some scholars opine that the 'insider' corporate governance system enjoys superiority over the 'outsider' model, there are prevalent problems revolving around the 'insider' model. For instance, the low level of separation between ownership and control is more likely to give rise to higher possibilities of abuse of power and want of transparency. This form of generic categorisation of corporate governance systems facilitates better understanding of how economies interact with each other but does not shed any light as to the causes that lead to different designs of national corporate governance systems, especially their legal system, corporate structure and financial/economic system.[130]

In the recent years, desirability and inevitability of convergence in corporate governance across the globe has been a subject of interest and debate in various

[129] See generally Jill Solomon *Corporate governance and accountability* (John Wiley & Sons, 2007); and Davies and Schlitzer, above n 122, 534-535.

[130] Ibid, Davies and Schlitzer.

disciplines. Hansmann and Kraakman put forward a forceful and provocative argument when they claimed in their article entitled "The End of History for Corporate Law" in 2001 that the world is converging towards a "shareholder-centred ideology of corporate law" and that the "basic law of corporate governance – indeed, most of corporate law – has achieved a high degree of uniformity across developed market jurisdictions" and "[t]his emergent consensus has already profoundly affected corporate governance practices throughout the world." They argue that there is a normative consensus that corporate governance and practice converges towards a shareholder-value-maximisation model. The principal factors driving consensus on such a standard model are (a) the failure of such alternative models as the manager-oriented, labour-oriented and state-oriented models because they are not viable competitively in the globally integrated product markets, (b) the competitive pressure of global commerce in that the search for low-cost capital contributes to pushing firms to comply with the shareholder-value-maximisation model, and (c) the shift of interest group influence from managers in favour of an emerging shareholder class.[131] They further argue that the shareholder-value-centric model tends to sustain a supportive ideological and political consensus in its favour. Many scholars, for instance, Reed,[132] Garrett,[133] and, to a certain degree, Coffee,[134] concurred with this convergence scholarship. Not all, on the other hand, are convinced that the world is converging towards a shareholder-oriented model whereby the interest of shareholders will be the dominating force in corporate governance.

Other scholars argue that economic institutions are apt to adapt foreign practices to fit in local institutional and economic contexts. According to Rose, this may lead to a hybridisation or hybrid convergence. Hybrid convergence occurs where investors or corporates elect to avoid domestic law by shifting incorporation to another region or country. A typical example can be found in the United States where Delaware has become the jurisdiction of choice for incorporations due to its

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131 Henry Hansmann and Reinier Kraakman "The End of History for Corporate Law" (2001) 89 The Georgetown Law Journal 439, at 439, and 443-453.

132 Darryl Reed "Corporate governance reforms in developing countries" (2002) 37(3) Journal of Business Ethics 223, at 243.

133 Allison Dabbs Garrett "Themes and variations: The convergence of corporate governance practices in major world markets" (2003) 32 Denv J Int'l L & Pol'y 147.

134 John C Coffee Jr "Future as history: The prospects for global convergence in corporate governance and its implications" (1998) 93 Nw UL Rev 641-707.

flexible corporate laws. Rose also believes that this hybrid convergence can take place in the EU.[135] Gilson and Coffee consider that functional convergence is more likely to occur than formal convergence.[136] In this context, functional convergence takes place when institutions are able to respond to market demands without having to change the core characteristics of the institutions which means it is less likely to involve major political and economic changes. Some scholars, for instance, Bebchuk and Roe, simply dismiss the convergence argument by arguing that corporate governance systems in various countries will never converge despite the powerful forces pressing towards convergence because their structures and rules are path dependent.[137] There may however be contractual convergence where corporates may change their own corporate governance practices by committing to other 'better' systems, in which event formal differences may be functionally relevant but equivalent effects may be attained by way of contractual arrangements.[138]

Amongst those who are unconvinced of the 'global' convergence argument, Branson for one cautions that there is no massive "global" convergence in corporate governance and "[a]t best the evidence is of some incomplete transatlantic convergence with an outlier here and there."[139] He points out the relative insularity and the cultural and economic insensitivity of the Anglo-American convergence thesis. He also highlights the fact that there is a backlash against passing off the United States' culture, including its economic and legal culture, as the universal or "one-size-fits-all" culture that purportedly presents the solution to national and regional problems. He believes that there is a fundamental misunderstanding of what globalisation is and what may be expected of it – in other

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135 Paul Rose "EU company law convergence possibilities after Centros" (2001) 11 Transnat'l L & Contemp Probs 121, at 134-135.

136 Ronald J Gilson "Globalizing corporate governance: Convergence of form or function" (2001) The American Journal of Comparative Law 329, at 337-345. See also Coffee, above n 134, at 679-680.

137 Lucian Arye Bebchuk and Mark J Roe "A theory of path dependence in corporate ownership and governance" (1999) Stanford Law Review 127, at 132.

138 Gilson, above n 136, at 346-350; see also Christoph Lattemann "On the convergence of corporate governance practices in emerging markets" (2014) 9(2) International Journal of Emerging Markets 316, at 318.

139 Douglas M Branson "The Very Uncertain Prospect of Global Convergence in Corporate Governance" (2001) 34 Cornell Int'l LJ 321, at 325.

words, a basic "lost in translation" scenario. He concludes that globalisation is a technological and tele-communicational phenomenon of this information age but not necessarily a movement for the elimination of all differences and barriers between nations and cultures. He emphasises the significant role that cultural values play in corporate governance in different countries in the world. He argues that "[g]lobalisation thus portends convergence but it will not be global."[140]

Bebchuk and Roe had earlier elucidated a similar sentiment to Branson's by pointing to the importance of cultural values and political ideologies to the ethics of corporate governance[141] and developing a theory of path dependence of corporate ownership and governance structures which sheds light on why the advanced economies, against the background argument in favour of global convergence, differ so much in their patterns of corporate ownership and governance, and why certain key differences persist. Bebchuk and Roe advocated that path dependence could be structure-driven and rule-driven and that it formed the key basis for continued divergence. First, the corporate structures that an economy has partly depend on the ownership structures that the economy had earlier on. Such initial structures might persist because players that enjoy returns under them might have both incentive and power to impede changes in these structures. Second, corporate rules which affect choices of ownership structures are path dependent in that they will themselves depend on the corporate structures with which the economy started. Initial or existing structures and institutions can affect both the lawmakers' choice of rules that would be efficient and the interest group politics that can decide which rules would actually be chosen.[142]

Recently Rossouw also cautions that there is no conclusive evidence to support a global convergence towards an Anglo-American-shareholder-oriented tenet of corporate governance. He says this because, based on his comparative analysis of corporate governance systems across the globe, there are clashing views (such as those differing views of Young, Koslowski, West and Reddy as discussed below) in the convergence-or-divergence debate on corporate governance practices. His comparative analysis of perspectives offered in North America, Continental Europe, Africa and Asia does in fact point to divergence rather than convergence

140 Branson, above n 139, at 325-327.

141 Bebchuk and Roe, above n 137, at 166-169.

142 Ibid, at 127, 153 and 166.

without any indication of immaturity or confusion in international corporate governance, but rather an indication of corporate governance being influenced by a variety of context-specific factors such as ownership structures, corporates' societal positions, cultural and societal norms and socio-economic priorities.[143]

Young opines that there is a convergence towards the Anglo-American shareholder-oriented approach from the perspectives on corporate governance grounded in the Anglo-American-common-law legal traditions. He believes that the North American 'one-size-should-fit-all' model will provide principles and practices which may be adapted in many national cultural environments to permit the upholding of the two very important global standards of corporate behaviour: transparency and accountability.[144]

Koslowski argues against such a convergence and advocates for a synthesis of the Anglo-American shareholder-and-capital-market-oriented model and the Continental European co-determination-oriented model (which is shaped by the participation and consensual decisions of stakeholder groups in corporate governance through representation in the advisory board) as a possibility even under the conditions of globalisation. He also points out that the European model emphasises that a corporate is a multi-purpose institution in which shareholder value plays a pivotal but not the only role, whereas the Anglo-American model places shareholder value as the only or ultimate purpose of the corporate to which the other stakeholder purposes are merely instrumental or functional. He believes that the development will go towards the more inclusive and stakeholder-oriented European model.[145]

West, on the other hand, examines the (South) African corporate governance model which can be seen as traditionally following the Anglo-American approach with the notable exception of its stakeholder participation approach which encourages stakeholder engagement in corporate strategy. Further, its socio-

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143 GJ Rossouw "Balancing corporate and social interests: Corporate governance theory and practice" (2008) 3(1) African Journal of Business Ethics 28-37. See also GJ Rossouw "The ethics of corporate governance: Global convergence or divergence?" (2009) 51(1) International Journal of Law and Management 43, at 45, 49-50.

144 Stephen B Young "The ethics of corporate governance: The North American perspective" (2009) 51(1) International Journal of Law and Management 35, at 40-42.

145 Peter Koslowski "The ethics of corporate governance" (2009) 51(1) International Journal of Law and Management 27, 28-31 and 34.

political agenda for economic development which runs in parallel with the society-centred African values does mark an apparent divergence from the shareholder-oriented approach of the Anglo-American model. That said, West also notes that there is no formal incorporation of stakeholder interests into the formal corporate governance structures in the African context, meaning that the Anglo-American corporate governance agendas are largely maintained despite the existence of national and regional differences.[146]

Reddy identifies the risk of others being easily misled into settling for a superficial analysis showing convergence towards a shareholder-dominated approach in Asia. His analysis reveals that whilst the shareholder supremacy view might have been officially adopted in voluntary international corporate governance codes either under the auspices of such global economic institutions as the OECD and the World Bank, or out of the Asian players' desire to gain and maintain access to the shareholder-dominated capital markets in the West, the actual corporate governance practice within corporates in the Asian context depicts a much more relationship-based and stakeholder-oriented picture. This expansive ethic of corporate governance represents a hybrid between a shareholder approach and a stakeholder approach to corporate governance which may not be so much divergent but rather a balancing and harmonising scenario that aligns well with Asian traditions. Reddy thus concludes that the dualism of the culturally determined Asian practices and the Anglo-American oriented international standards adopted in the Asian context appear to co-exist well and may perpetuate.[147]

Interest in corporate governance have been on the increase especially following major corporate failures such as Enron, WorldCom, Tyco and Parmalat at the turn of this century and then the global financial crisis in 2008 which is considered by many economists to be the worst financial crisis since the Great Depression in the 1930s. Such corporate failures and recent global financial crisis have, to a significant extent, shaken the institutional norms and foundations of all advanced economies, consequential market and regulatory adjustments and settlements have yet to be completed. They highlight the exigent need for the installation and

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146 Andrew West "The ethics of corporate governance: A(South) African perspective" (2009) 51(1) International Journal of Law and Management 10-16.

147 YRK Reddy "The ethics of corporate governance: An Asian perspective" (2009) 51(1) International Journal of Law and Management 17-26.

maintenance of good corporate governance systems to restore investor confidence in business investment, be it voluntary or mandatory, by way of promoting and ensuring accountability, fairness, responsibility and transparency in corporates and in turn capital markets for countries across the globe.[148] As such regulatory and market settlements are still occurring, the future trends of corporate governance are questioned, it is contemplated that greater complexity and divergence rather than further uniformity and convergence will emerge.[149]

Based on the above review and analysis of the convergence-or-divergence thesis, it appears that this scholarship subsists alongside the legal transplant thesis discussed in Chapters I and II above. Scholars embracing the convergence-or-divergence debate do not seem to be concerned about the legal transplants' discussion and vice versa. The focus of the following sections of this thesis may not necessarily be on how well such transplantations fare in the recipient jurisdiction, in particular, given the subject of the case study of this thesis is China. Rather, the discussion may steer towards whether such transplantations bring along convergence, divergence or simply misunderstanding, or put simply, it is lost in translation. Prior to embarking onto further discussion on the 'convergence-or-divergence-or-lost-in-translation' eventualities, the following section will look at legal transplants as a vehicle to gain economic success and explore the correlation between legal origins for corporate governance transplants and corporate performance.

4 Legal Origins and Frameworks

Most corporates around the world will strive to improve their corporate performance in order to gain success; albeit that how success is gauged is usually arbitrary and defined differently. La Porta, Lopez-de-Silanes, Shleifer and Vishny (**LLSV**) investigated the correlations between legal systems and corporate governance of 49 countries between 1982 and 1995 and published their findings in 1997.[150] As a starting point, they agree with Watson[151] and recognise that laws in various

[148] Davies and Schlitzer, above n 122, at 532. See also Thomas Clarke "The continuing diversity of corporate governance: Theories of convergence and variety" (2016) 16(1) Ephemera 19.

[149] Ibid, Thomas Clarke, at 20.

[150] Rafael La Porta and others (**LLSV**) "Legal determinants of external finance" (1997) Journal of finance 1131, at 1131-1133.

[151] Watson, above n 2.

countries are typically not written from scratch, but rather transplanted, whether voluntarily or otherwise, from a few legal traditions or families. LLSV believe that commercial laws originate from two broad traditions – common law, which has an English origin, and civil law, which derives from Roman law. Within the civil law tradition, they find that there are three major legal families from which modern commercial laws originate: French, German and Scandinavian. The common law tradition, and the French and German civil law traditions have 'travelled' across the globe as a result of conquest, colonisation, imperialism, outright borrowing, transfer or transplant, as well as more subtle imitation. The resulting laws adopted or adapted by the recipient countries thus epitomise both the influence of these legal traditions or families and the revisions or variations specific to the individual countries.[152]

This spread of legal traditions or families by way of legal transplants enables LLSV to compare both the individual legal rules and institutions and whole legal families across their target countries. They find that legal rules from different traditions vary in content as well as in the history of their adoption. Likewise, they describe the corporate governance systems in those target countries as generally based on three legal traditions: (1) English common law, (2) French civil law, and (3) German and Scandinavian civil law. LLSV find that civil law countries, in particular, those of French origin, have the weakest investor-and-creditor protections and incidentally the least developed capital markets as compared to common law countries, with German and Scandinavian civil law countries posit in the middle.[153]

Common law countries such as the United Kingdom, the United States, Canada, Australia and New Zealand have adopted corporate governance codes that place an emphasis on shareholders' rights protection. For instance, the United Kingdom issued the Combined Code: Principles of Good Governance and Code of Best Practice in 2000 (which was replaced by their Financial Reporting Council's Combined Code on Corporate Governance in 2003), and the United States introduced their corporate governance code, Sarbanes-Oxley Act in 2002, with a view to enhance corporate disclosure and responsibility, and improve transparency and quality of financial reporting to safeguard shareholders and stakeholders'

152 LLSV "Law and finance" (1998) 106(6) Journal of political economy 1113, at 1115.

153 Ibid.

rights.[154] The same principles apply when the Australian Stock Exchange Corporate Governance Council and Canada's Office of the Superintendent of Financial Institutions respectively introduced the Principles of Good Corporate Governance and Best Practice Recommendations for Australia and the Corporate Governance Guidelines for Canada in 2003, and when the New Zealand Securities Commission adopted the Corporate Governance in New Zealand: Principles and Guidelines in 2004.[155]

LLSV also consider measures of the quality of enforcement of legal rules in different countries where their legal traditions vary. They find that the quality of law enforcement is the highest in Scandinavian and German civil law countries, next in common law countries which law enforcement is considered strong, and again the lowest in French civil law countries. Their findings also indicate that legal families with 'investor-friendlier' laws are the ones with stronger enforcement of laws. Poor law enforcement and accounting standards (which potentially play an important role in corporate governance because they render corporate disclosures interpretable and verifiable) aggravate the difficulties encountered by investors in the French civil law countries. Another interesting finding is that being a shareholder or investor in different legal jurisdictions entitles such an investor to very different bundles of rights. Such rights are largely determined by laws due to the fact that they are generally not inherent in the securities they acquire.[156]

Meanwhile, many of the civil law (albeit French, German or Scandinavian) economies like Austria, France, Germany, Japan, Norway and Sweden have established corporate governance codes to strengthen investor confidence in their economies. For instance, the Austrian Code of Corporate Governance 2002, the French Corporate Governance of Listed Companies 2003 (which principles were consolidated from the 1995 and 1999 Viénot Reports and the 2002 Bouton Report and later developed into the Corporate Governance Code of Listed Companies by the recommendations of the Association Française des Entreprises Privées (**AFEP**) and the Mouvement des Entreprises de France (**MEDEF**) in 2008), the

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154 Davies and Schlitzer, above n 122, at 535.

155 ECGI, above n 126, 'Search for a code' webpage [accessed on 25 February 2017]:
Australia: http://www.ecgi.org/codes/documents/asx_recommendations.pdf;
Canada: http://www.ecgi.org/codes/documents/cg_guideline_canada_jan2003_en.pdf;
New Zealand: http://www.ecgi.org/codes/documents/cg_nz2004.pdf.

156 LLSV, above n 152, at 1116, 1140-1145 and 1151-1152.

German Corporate Governance Code 2002, the Japanese Principles of Corporate Governance for Listed Companies 2004, the Norwegian Code of Practice for Corporate Governance 2004 and the Swedish Code of Corporate Governance 2004.[157]

In sum, LLSV's findings support their earlier assertion that the quality of a nation's legal system which facilitates the establishment of a sound corporate governance system and renders protection to the investors in the nation is an important determinant of the development of its capital market and financial resources. Strong investor-protection laws and their enforcement are usually linked with broader and more valuable capital markets. Further, differences amongst countries in the structure of laws and their enforcement, for example, their historical legal origins, account for the differences in their financial development.[158]

Lenssen, Van Den Berghe, Louche and Cornelius, however, do not concur with LLSV's views. They argue that there are other factors than national legal infrastructure which may be equally (if not more) important in deciding on the development of corporate governance systems.[159]

Siems's research findings show that in the modern world, legal differences, in particular, the distinctions between common law and civil law legal origins, have become more blurred, less important, or "to a large extent arbitrary".[160] He cites China, which, according to the classification by Djankov, McLiesh and Shleifer

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157 ECGI, above n 126 (accessed on 8 March 2017):
Austria: http://www.ecgi.org/codes/documents/cg_code_en.pdf;
France: http://www.ecgi.org/codes/documents/cg_oct03_en.pdf; and
http://www.ecgi.org/codes/documents/afep_medef_code_dec2008_en.pdf;
Germany: http://www.ecgi.org/codes/documents/corgov_endfassung_e.pdf;
Japan: http://www.ecgi.org/codes/documents/principles.pdf;
Norway: http://www.ecgi.org/codes/documents/cg_norway_en.pdf;
Sweden: http://www.ecgi.org/codes/documents/swedish_cg_070913_en.pdf.

158 LLSV "Investor Protection and Corporate Valuation" (2002) 57(3) The Journal of Finance 1147, at 1147.

159 Gilbert Lenssen and others "Good corporate practices in poor corporate governance systems: Some evidence from the Global Competitiveness Report" (2005) 5(3) Corporate Governance: The international journal of business in society 12-23.

160 Mathias M Siems "Legal Origins: Reconciling Law & Finance and Comparative Law" (2007) 52 McGill LJ 55, at 58, and 66-69.

(who expanded LLSV's study from 49 to 129 countries[161]), comes under the German legal origin,[162] as a classic example.

Siems contends that treating China as being of German legal origin "does not make sense at all".[163] He considers this categorisation is probably the result of the obvious traces of export of German law to China. China's Company Law 1993[164] was primarily prepared based on the company laws of Germany, France and Japan. He observes that China's Company Law was principally based on German and Japanese laws on one hand, but on the other hand, like the Japanese law, largely under the United States' influence after the World War II. Further, certain notions of the corporate law in the United States (for instance, cumulative voting and derivative suits) have also been transplanted to China's Company Law 2005.[165] That being the case, as the State has controlling influence in numerous companies in China, it is doubtful whether there is any need for vote-capping or multiple-or-cumulative voting rights. It may again be deemed another example of legal transplants in form but not in substance when legal institutions are implanted into the Chinese systems. This point regarding "in-form-not-in-substance" transplants will be further discussed in Chapters III and IV below. Specifics and examples of legal transplants regarding the Company Law will be discussed in Section D 1 in Chapter III and Sections B and C in Chapter IV below. Also, the PRC Securities Law[166] is in principle based on borrowings from the West, in particular, the United States model. Again, details relevant to such borrowings which formulate the Securities Law will be discussed in Section D 2 in Chapter III below.

In sum, the Chinese corporate law (which in turn forms an integral part of China's corporate governance system) is to a significant extent a mixture of various legal influences, and the by-product of a multitude of legal transfers. Hence, it does not

161 Simeon Djankov, Caralee McLiesh and Andrei Shleifer "Private credit in 129 countries" (2007) 84(2) Journal of Financial Economics 299-329.

162 Siems, above n 160, at 63-64. See generally Djankov, McLiesh and Shleifer, above n 161.

163 Ibid, Siems, at 65.

164 Company Law 1993, below n 184

165 Company Law 2005, below n 184, art 106.

166 Securities Law, below n 185.

simply have German legal origin. Also, China, unlike Germany or France, does not have a comprehensive civil code.[167]

C China as a Case for Legal Transplants on Corporate Governance

As part of its efforts to fulfil its needs to evolve from a completely state-controlled economy to a market economy, China has been striving to re-invent itself by gradually moving towards the creation of a modern legal system through legal transfers or borrowings from various jurisdictions. This follows the adoption of an 'open-door' policy in 1978 and a corporate governance regime following its accession to the WTO in late 2001. Today, China is the second largest economy in the world and can certainly stand tall amongst its counterparts in the West. Its economic success may largely be attributed to the fact that China has been highly motivated by its strong desire to evolve from a stagnant economy beleaguered by three decades of unsuccessful political and cultural reforms adopted since the country's inception in 1949 into an economic superpower in the international market almost four decades after its adoption of the 'open-door' policy in 1978. In this connection, it is important to note that China was, and still is, a single-party-socialist-state encumbered with a transition or developing economy, a legal system in its infancy, and a legacy of over five millennia in which the subordinate role of law curbed the growth of a legal culture. Despite all odds, China has become a green pasture to receive legal transplantation of the very institutions, rules and practices that play a pivotal role in modern western democracies with mature market economies. To what extent has the process been a response to, or shaped by, the forces of globalisation or convergence, or to what extent is China converging into, or diverging from, such forces, or is this a misunderstanding or is it lost in translation? Will these transplants take root and flourish in China's rather different system? Is China's newly adopted corporate governance law system converging towards the best practices of corporate governance systems elsewhere, in particular, in the West, or will the path-dependent or Sino-centric nature of its reforms steer China to a different direction?[168]

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[167] Siems, above n 160, at 65-66. See also Mathias M Siems *Convergence in Shareholder Law* (Cambridge University Press, 2007), at 22-23.

[168] Idea borrowed from Randall Peerenboom "Globalization, Path Dependency and the Limits of Law: Administrative Law Reform and Rule of Law in the People's Republic of China" (2001) 19(2) Berkeley J Int'l L 161, at 161-162.

The forces of globalisation have shaped developments in China in a multitude of areas although the degree of such effect varies in different areas. The economic arena is seen to have encountered the most noticeable effects. The Chinese economic reforms have resulted in China's economy becoming increasingly assimilated in the regional and global economies. That said, whether one finds convergence, and hence globalisation, or divergence, thus path dependence, or it being a misunderstanding or loss in translation vis-à-vis legal transplants in its corporate governance law system to facilitate China's growing economy, depends to a large extent on the local conditions and canvassing the cultural, economic, legal and political realms, each of which is capable of considerable variation in theory and practice. China's economic growth has been attributed to the development of its own form of managed capitalism, Sino-Capitalism, which is characterised by the fact that the state intervenes or at least influences the market – market economy with Chinese characteristics, a counterexample of western capitalism. This unique form of capitalism diverges in significant ways from the more familiar liberal democratic market economies in the West. This is largely due to the fact that it is implanted in a cultural, historical and ideological context in which the role of the state and the "top-down-and-bottom-up" relationship between individual entrepreneurs and the state differ considerably from its Western counterparts.[169] Aspects of Sino-Capitalism will be discussed in Chapters IV and VI below.

Despite the fact that China has not been immune from the forces of globalisation, economic reforms in China have been, and will continue to be, driven by domestic needs and factors. Those Chinese leaders who survived the Cultural Revolution[170] emerged from its ashes with one mission – modernise the country to achieve

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169 Idea borrowed from Peerenboom, above n 168, at 162-163.

170 The Cultural Revolution was a socio-political movement which took place from 1966 to 1976. The movement paralysed China politically, economically and socially until Mao Zedong's death in 1976. Thereafter, reformers led by Deng Xiaoping gradually dismantled the extreme policies and eliminated the violent class struggle. In 1981, the Communist Party of China (CPC) declared that the Cultural revolution was "responsible for the most severe setback and the heaviest losses suffered by the Party, the country, and the people since the founding of the People's Republic of China". See "Resolution on Certain Questions in the History of Our Party Since the Founding of the People's Republic of China", adopted by the Sixth Plenary Session of the Eleventh Central Committee of the CPC on 27 June 1981, in *Resolution on CPC History (1949–81)* (Foreign Languages Press, Beijing, 1981), at 32.

economic growth and then supremacy. Deng Xiaoping and other leaders realised that survival depended on improving people's living standards. Upon his return to power, Deng emphasised the "two hands policy" and the "four modernisations". The "two hands policy" meant that on one hand, the economy must be developed; and on the other hand, the legal system must be strengthened. The "four modernisations" emphasised the necessity to modernise agriculture, industry, national defence, science and technology. Although China's economic reform is partly a reaction due to the forces of globalisation, such as the WTO accession requirements and the demands of foreign investors following the adoption of the "open door" policy which did assist in attaining the "four modernisations", the initial driving forces behind its economic reforms had been a primeval reaction to the setbacks suffered as a result of the Cultural Revolution.[171]

D Conclusion

After almost three decades of self-reliance, or in a sense self-isolation, a new policy in the name of "economic reform and open door" was adopted in 1978 to attempt to integrate the Chinese economy into the world market. Following just over a decade's implementation by way of 'trial and error' of this policy, it evolved into a 'Socialist-Market Economy' adopted by the CPC in 1992. Thereafter, "abiding by international practices" or "harmonisation with international practices" became the keywords for China's market economy reforms. That the internationalisation of the Chinese corporate governance law system by way of legal transplants only makes sense when one understands the role and development of law in the transformation of the Chinese economy from 1978.[172]

Chapter III thus critically reviews the development of corporate governance law surrounding the Chinese economic reforms since 1978. A better understanding of the nature and development of the Chinese corporate governance law system may result in a better appreciation of the misunderstanding or loss in translation vis-à-vis the 'law-and-finance' and 'convergence-or-convergence' debates in the context of China's corporate and economic reform pathways and development of big

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171 Peerenboom, above n 168, at 163; see also Jianfu Chen "Market Economy and the Internationalisation of Civil and Commercial Law in the People's Republic of China" in Kanishka Yayasuriya (ed) *Law, Capitalism and Power in Asia: The Rule of Law and Legal Institutions* (Routledge, London and New York, 1999) 69, at 70-71.

172 Ibid, idea inspired by Chen, at 70.

businesses and a unique form of capitalism – Sino-Capitalism, which will be discussed in Chapters IV and VI below.

Chapter III Development of Corporate Governance and Legislation in China

A Introduction

In late 1978, China's then party leader, Deng Xiaoping, postulated an open-door and market-oriented policy. Since then, the Chinese economy has been growing from strength to strength gradually becoming relatively more open and more compatible with its western counterparts. By October 2014, it was reported that China had surpassed the United States to become the largest economy in the world based on GDP adjusted for PPP, putting the United States in the second place for the first time in 142 years.[173] As at mid July 2016, China's GDP based on PPP was US$19.4 trillion and the United States' US$17.95 trillion, meaning that China held onto its recently acquired spot as the number one economy in these terms. However, with a US$10.98 trillion economy in terms of nominal GDP, China is still behind the US$17.95 trillion US economy in the same terms. China thus holds the second place.[174]

With China's accession to the WTO soon after the turn of this century, corporate governance is a concept which has attracted attention in academic, business and policy discussions in China. China's transition from a completely state-controlled economy to a market-based economy is the *quid pro quo* for the sustainability of (i) its entry into, and maintenance of membership of, the WTO, (ii) FDI into (and recently out of) China, and (iii) its competitiveness domestically and internationally. It will be helpful to elucidate the impact on its reform and growth.

Following more than 15 years of negotiations and lobbying, China finally joined the WTO on 31 December 2001. Joining the WTO has largely expedited China's pace of internationalisation of its economy. Due to the trade and investment liberalisation under the WTO, China's entry has presented numerous challenges and intensified competition between Chinese and foreign firms, both inside and outside China.

Following the adoption of its open-door policy in 1978, China has consequently attracted a massive influx of FDI into the country which can be recognised as an

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[173] See articles respectively by Bird, and Duncan and Martosko, above n 89.

[174] Prableen Bajpai "The World's Top 19 Economies" *Investopedia* (18 July 2016), http://www.investopedia.com/articles/investing/022415/worlds-top-10-economies.asp.

unprecedented FDI boom, compared to its situation prior to 1978 when the country had virtually no FDI. In 2000, China became the second largest recipient of FDI (US$41 billion) in developing Asia, only after Hong Kong, which was the top FDI recipient (US$64 billion) in Asia as well as in developing countries. An interesting phenomenon was the increased importance of China. Foreign investors planning to invest in China appeared to have been "parking" funds in Hong Kong in anticipation of China's entry into the WTO. Whereas Hong Kong was also the most important source of outward FDI (US$63 billion) in developing Asia in 2000, it was reported that more than half of its outward FDI went to China. [175] By 2014, FDI in China amounted to US$129 billion, accounting for 27.74% of the total flow of US$465 billion to Asia.[176]

In 1990, China was the fourth largest exporter and fifth largest importer in Asia, and its trade was about one-fifth that of Japan. In 2000, not only that China became Asia's second largest trader, accounting for 15% of Asia's trade, which was equivalent to one half of Japan's trade. China was also the world's seventh largest exporter (totalling US$249.3 billion) and eighth largest importing country (totalling US$225.1 billion) and one of the most trade-dependent countries in the world.[177]

Prior to joining the WTO as its 143rd member, China's merchandise exports accounted for 3% of the total world exports in 1995, increasing to 4% by 2000. Its share of the world's total exports rose to 5% in 2002, then to 6% in 2003. In 2004, three years after China's accession to the WTO, China overtook Japan to become the leading Asian exporter and the world's third largest exporter, behind Germany (which sat at the top) and the United States (which took the second place). China then surpassed the United States in 2007 and Germany in 2009 to be the world's largest exporter. By 2014, having held the top spot since 2009, China's

175 United Nations Conference on Trade and Development (UNCTAD), "World Investment Report 2001: Promoting Linkages" (United Nations Publication, New York and Geneva, 2001), at xiv; http://unctad.org/en/Docs/wir2001_en.pdf.

176 UNCTAD, "World Investment Report 2015: Reforming International Investment Governance" (United Nations Publication, New York and Geneva, 2015), at 3; http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf.

177 WTO, "International Trade Statistics 2001" (WTO, Geneva, 2001), at 15 and 21; https://www.wto.org/english/res_e/statis_e/its2001_e/stats2001_e.pdf.

merchandise exports accounted for 12% of the world's trade merchandise exports.[178]

The trajectory of China's reform process over the two decades prior to China's WTO entry mirrors its exceptionally lengthy process of WTO accession. China's unique experience as a WTO member has acted as a lever which gives rise to a profound impact on its economic, legal and political development. China has achieved remarkable economic growth over the last three and half decades managing nearly double-digit growth rates since the commencement of its economic reforms in 1978. Such achievements have partly been the result of a robust export-oriented economic policy. With such growth rates and export outputs, it is inevitable that China gradually becomes one of the major actors in the international trade system. Many WTO members contemplated that China's WTO accession would bring about the advantages of gradually decreased trade policy interventions by the Chinese government and the consequent increased access to the growing Chinese market. On the other hand, some observers were concerned that China would paralyse the WTO following accession to the extent that it was even asserted that "China is broken, and a broken China could break the WTO" and that the only means of redemption is for China to develop a good corporate governance system which resembles its counterparts in the West.[179] An overview of the historical background which led to China's plan to develop its own form of market economy may assist in shedding some light on which direction China is heading vis-à-vis the transplantation of institutions and practices for the development of its corporate governance. This overview is set out in the following sections.

B Historical Background

The development of the corporate law and governance regime is closely related to China's ongoing economic reforms, especially those of the state-owned enterprises (**SOEs**), the development of its financial and securities systems and its ability to withstand economic crises. China was not one of the Asian countries

[178] WTO, "International Trade Statistics 2015" (WTO, Geneva, 2015), at 25 and 34; https://www.wto.org/english/res_e/statis_e/its2015_e/its2015_e.pdf.

[179] Susan Ariel Aaronson "Is China Killing the WTO?" (2010) 24(1) The International Economy 40; and Susan Ariel Aaronson "How disciplining China could save the WTO" (2010) 9 VoxEU.Org [accessed on 28 January 2017].

which were severely hit by the Asian Financial Crisis which took place at the end of the 1990s. However, the collapses and comprehensive restructurings (due to insolvency) of some of its high-profile finance and investment institutions in the late 1990s and the early 2000s, such as the Guangdong International Trust and Investment Company, China's then second largest non-bank financial institution and the Guangdong Enterprises which included five listed 'red chip' companies,[180] did expose the vulnerability of China's burgeoning financial and securities systems.[181]

Following the Asian Financial Crisis in the late 1990s, the Chinese government launched a massive campaign to regularise its financial institutions and revealed overwhelming evidence regarding the want of corporate governance in its corporate and finance sectors.[182] The Chinese Government did not simply introduce its reforms in the wake of the Asian Financial Crisis and the revelation of serious weaknesses of its corporate and financial markets but had made the development of a modern and appropriate corporate system the focus of its economic reform and mandated the establishment of corporate governance structures as the crucial means to achieve this goal as early as 1993.[183]

In fact, 1993 was a year of significance because China's first Company Law[184] was enacted in 1993 (taking effect in 1994). Five years later in 1998, its first Securities

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180 Nolan, above n 6, at 7.

181 On Kit Tam "Models of corporate governance for Chinese companies" (2000) 8(1) Corporate Governance: An International Review 52, at 52.

182 Nolan, above n 6, at 7.

183 The Decision of the Central Committee of the Communist Party of China on Some Issues Regarding the Establishment of the Socialist Market Economic System (adopted by the Third Plenary Session of the Fourteenth Congress of the Communist Party of China, November 1993) [**1993 Decision**]: www.news.xinhuanet.com/ziliao/2005-03/17/content_2709770.htm.

184 The Company Law of the People's Republic of China (adopted at the 5th Session of the Standing Committee of the 8th National People's Congress on 29 December 1993 [**Company Law 1993**]; revised for the first time on 25 December 1999 in accordance with the Decision of the 13th Session of the Standing Committee of the Ninth People's Congress on Amending the Company Law of the People's Republic of China; revised for the second time on 28 August 2004 in accordance with the Decision of the 11th Session of the Standing Committee of the 10th National People's Congress of the People's Republic of China on Amending the Company Law of the People's Republic of China. Revised at the 18th Session of the 10th National People's Congress of the People's Republic of China on 27 October 2005 [**Company Law 2005**]; revised for the third time on 28 December 2013 in accordance with the Decision on

Law[185] was promulgated (taking effect in 1999). The Company Law and Securities Law were revised in 2005 (respectively Company Law 2005 and Securities Law 2005) to give new and hopefully improved attention to various aspects of corporate governance imported from the West. These amendments included the rights of shareholders, protection of shareholders' rights and equitable treatment of all shareholders. Other changes related to the corporate board and its directors, duties of directors and officers, and an improved balance between directors' responsibilities and reasonable protection of directors on one hand, and corporate disclosure and transparency on the other.

The Company Law 2005 has since been amended by the Standing Committee of the National People's Congress (**NPC**) at its sixth session on 28 December 2013. This latest round of amendments has come into effect on 1 March 2014 and reflected further reform postulated by Premier Li Keqiang to streamline company registration formalities, relax incorporation threshold and simplify incorporation procedures in order to encourage and promote investment, entrepreneurship,

Amending Seven Laws Including the Marine Environment Protection Law of the People's Republic of China at the 6th Session of the Standing Committee of the 12th National People's Congress, promulgated on 28 December 2013 and came into effect as of 1 March 2014 [Company Law 2013]) [collectively **Company Law**]: http://www.fdi.gov.cn/1800000121_39_4814_0_7.html#_Toc381707445.

185 The Securities Law of the People's Republic of China (adopted at the Sixth Session of the Standing Committee of the Ninth National People's Congress on 29 December 1998 [Securities Law 1998]; amended for the first time according to the Decision on Amending the Securities Law of the People's Republic of China as adopted at the 11th Session of the Standing Committee of the Tenth People's Congress on 28 August 2004; revised at the 18th Session of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on 27 October 2005 [**Securities Law 2005**]; amended for the second time in accordance with the Decision of the Standing Committee of the National People's Congress on Amending the Cultural Relics Protection Law of the People's Republic of China and Other Eleven Laws as adopted at the Third Session of the Standing Committee of the Twelfth National People's Congress on 29 June 2013; and amended for the third time in accordance with the Decision of the Standing Committee of the National People's Congress on Amending Five Laws Including the Insurance Law of the People's Republic of China as adopted at the Tenth Session of the Standing Committee of the Twelfth National People's Congress on 31 August 2014) [collectively **Securities Law**]: http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=233280.

innovation, commercial freedom and business development.[186] At the time of writing it is expected that the Securities Law 2005 will be amended as part of China's attempt to implement its stock issuance registration system reform.[187] It appears corporate law reform in China is likely to be an on-going process.

C Traditional SOEs Governance Systems and their Evolution

Since China became a socialist state in 1949,[188] the State assumed the ownership of most of the land and the properties on China's vast territory. Its industrial and commercial activities were conducted largely by enterprises and units owned and controlled by the State, later referred to as SOEs. By the end of the 1970s, China remained a static and underdeveloped economy. Having undergone a gradual and evolutionary process of economic reforms since then, China has transformed its SOE system from a completely state-controlled model where the State holds all property ownership and managerial rights to a contract-based model where enterprises become responsible for their own profits and losses and further to a model where a high proportion of large SOEs are listed on the local and overseas stock exchanges in just over three and half decades. Today, China is one of the largest economies in the world in nominal GDP terms. The evolution of its SOEs governance systems may be categorised as follows: (1) traditional system (1949 – 1984); (2) transitional system (1984 – 1992), (3) modern enterprise system (1993

186 Premier Li Keqiang set out his instructions regarding the State Council's reform on the registered capital system for companies in China at its Executive Meeting held on 25 October 2013. See also Shen Wei "Fading Registered Capital Rules under the Amended Chinese Company Law: Sweeping Changes in Uncertain Contexts" (2014) 8 International Company and Commercial Law Review 270, at 270.

187 The Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Adjust the Relevant Applicable Provisions of the Securities Law of the People's Republic of China in the Implementation of Stock Issuance Registration System Reform (27 December 2015) [**NPC Decision 2015**]. See also Nicholas Calcina Howson "Amending China's Insider Trading Prohibition - An Immodest Proposal" (21st Century Commercial Law Forum 15th Annual International Conference "Modernization of the Lega Framework for the Capital Markets", Commercial Law Research Center, Tsinghua University, 31 October - 1 November 2015), at 1.

188 The year in which the People's Republic of China was founded.

– 2003),[189] and (4) 'promoting good governance' system (2004 – present). Salient characteristics of the four systems are set out below.

1 Traditional System (1949 – 1984)

Traditionally, most of the production and provision of goods and services in China were conducted by SOEs which were referred to as 'factories' (*gong chang*). This model was the only legal form available to protect and manage State property from the 1950s to 1984. Concepts such as 'corporation', 'company', or 'legal person' were non-existent under the regime of this traditional 'state-controlled' or 'central-planning' model.[190]

Accordingly, the governance structure in SOEs mirrored that of the government framework. The executives or managers of the SOEs were assigned and removed by the government authorities in charge of the relevant industry sectors and enjoyed the same political and economic treatments as those rendered to government officials of similar ranks.[191] They were responsible and accountable to their respective supervising government authorities in the bureaucracy. Their achievements were not assessed based on the SOEs' financial performance but by the SOEs' compliance with the plans stipulated by their supervising authorities. This model binds the State, the SOEs and their employees together in that the State organised the SOEs' economic resources and activities with the SOEs serving as the production and social security units for the State and the 'work units' (*gong zuo dan* wei) or an 'iron rice bowl' (*tie fan wan*) for their employees.[192]

Consequently, the State was weighed down by a static and uncompetitive economy with a high proportion of under-or-non-performing SOEs and a workforce with little incentive to perform.

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189 Cindy Schipani and Junhai Liu "Corporate governance in China: then and now" [2002] Columbia Business Law Review 1, at 5. See also Yan-Leung Cheung and others "Corporate governance in China: A step forward?" (2010) 16(1) European Financial Management 94, at 99.

190 Ibid, Schipani and Liu, at 7.

191 This practice continued until the issuance of the Decision on the Implementation of the State-owned Enterprises Reform in 1999 in which the Chinese Government declared that official rankings would no longer be bestowed to enterprises leaders.

192 Schipani and Liu, above n 189, at 8.

2 Transitional System (1984 – 1992)

The transitional SOE governance model is also known as the contracting model. Long-term contracts were established between the SOEs and their supervising authorities with a view to improve the SOEs financial performance under the contract management system (*cheng bao zhi)* adopted nationwide by the Central Committee of the Communist Party of China and the State Council in 1988[193] and to turn the SOEs into enterprises responsible for their own profits and losses in the market as part of the nationwide reform of its economic system.[194] The significance of this reform is the Chinese government allowed productive enterprises, including SOEs, which were traditionally not a legal person, to become an enterprise legal person (*qi ye fa ren*). In other words, the substance of what constitutes corporate governance in the West had been gradually gaining a foothold in China despite the fact that the concept of corporate governance was little known at that time.[195]

To facilitate this economic reform, the Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (**SOEs Law**) was promulgated in 1988 to formally convert the traditional SOEs into industrial enterprises with the status of a legal person, which were headed by factory directors (managers) (*chang zhang (jing li)*) whose appointment and removal had to be approved by the State.[196]

The contracting model did not, however, appear to have given the SOE reform much headway largely due to problems arising from its adherence to the basic principle of requiring the SOEs to lock in a minimum amount of profits to pay the State and to remain liable to pay the fixed amounts to the State even if they did not

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193 See the Provisional Regulations on the Contract Management System in State-Owned Enterprises promulgated by the State Council, 27 February 1988 [**SOE Contract Management Regulations**].

194 See the Decision of the Central Committee of the Communist Party of China on Several Issues Concerning the Reform of the Economic System 1984 [**1984 Decision**].

195 On Kit Tam "Ethical Issues in the Evolution of Corporate Governance in China" (2002) 37(3) Journal of Business Ethics 303, at 305.

196 The Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People (adopted at the First Session of the Seventh National People's Congress and promulgated by Order No. 3 of the President of the People's Republic of China on 13 April 1988, and effective as of 1 August 1988) [**SOEs Law**], arts 7 and 44-45: http://english.mofcom.gov.cn/article/lawsdata/chineselaw/200303/20030300072563.shtml.

make any satisfactory profits.[197] This contracting system had its inherent weaknesses in that it failed to avoid arbitrarily decided and short-term performance oriented behaviours whereby contractors shared their gains whilst the enterprises were profitable but not individual liabilities when losses were incurred. It also failed to find a satisfactory solution to the challenge of separating the State from the enterprises.

In July 1992, the State Council stipulated and promulgated the Regulation on the Transformation of Operational Mechanisms of Industrial Enterprises Owned by the Whole People which expressly conferred fourteen independent operational powers to SOEs, with a view to accelerate the pace at which SOEs advanced from a planned economy to a market economy.[198]

The contracting system eventually phased out in the latter half of the 1990s following the issuance of directions by the government in 1994 requiring those SOEs that were completing their contracts not to renew the same.[199] Given all these problems, the Chinese policymakers started to look to modern corporate models in the West for viable solutions.[200]

It should be noted that in the midst of China's transition from a centrally planned economy to a market economy where the legal system was not well defined, China established its own stock market. Regulatory institutions and the relevant laws and regulations were gradually installed after its two stock exchanges began operation in 1990. The Chinese Securities Regulatory Commission (**CSRC**) was later established to monitor and regulate China's stock market in 1992, two years after its installation. This presents a classic example of China's *modus operandi* as being a pioneer to install a green-field for growth first, then a law reform facilitator with a view to forge further market growth. In other words, corporate governance law reforms are employed as a means or an instrument to achieve a different agenda such as economic development.

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197 SOE Contract Management Regulations, above n 193, art 5.

198 CSRC Report (OECD publication), above n 96, at 14.

199 Peixin Yang "Re-examination of the Contract Management System" (1998) *Economic Reference Daily* (China, 24 November 1998), at 4.

200 Schipani and Liu, above n 189, at 12.

3 Modern Enterprise System (1993 – 2003)

In response to the calling by Deng Xiaoping, China's architect of modernisation and economic reforms, for the introduction of a market economy in 1992, the third stage of the SOEs reform began in 1993 when the Third Plenary Session of the Fourteenth Congress of the Communist Party of China (**CPC**) endorsed the installation of a modern corporate system.[201]

In September 1995, at the Fifth Plenary Session of the CPC's Fourteenth Central Committee, the then PRC President Jiang Zemin stated: "We must concentrate our effort to manage large SOEs, and further relinquish control over ordinary small SOEs to revitalise the economy." On 17 March 1996, the economic reform policy of "managing the large enterprises and cutting the small ones loose" (*"zhua da fang xiao"* – literal translation: "grasping the large and letting go of the small") was adopted with the approval of the "Report on the 'Ninth Five-Year Plan' for the Economic and Social Development and Its Long-Range Objectives for 2010" at the Fourth Plenary Session of the Eighth NPC. Consequently, 80% of the state-firms-and-collectives underwent a restructuring process and many of which were privatised.[202] Between 2001 and 2004, the number of SOEs was reduced by half.[203]

This SOE reform policy accelerated the process of promulgation of corporate legislation, which was also perceived as an essential instrument for corporatising SOEs.[204] This reform approves the diversified ownership formats and introduces a modern corporate governance framework for SOEs. More significantly, Company Law 1993 transforms SOEs into limited liability companies which allow the separation of government and business functions and the creation of incentive structures to ensure that managers act on behalf of companies' shareholders or owners. Separate legal personality delineates the boundary between the State and the SOEs. Corporate limited liability provides certain financial alleviation for the

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201 Cheung and others, above n 189, at 99.

202 Xiao Zhao "Competition, Public Choice, and Institutional Change: Searching for Reasons for Improved Policy Efficiency in Institutional Reform from "Managing Large Enterprises and Cutting Small Ones Loose"" (2006) 39(1) Chinese economy 5, at 35-38.

203 Karl Friedrich Schiebe "The Chinese corporate governance mode: adapt or adopt?" (The University of Hong Kong, 2014), at 32.

204 Schipani and Liu, above n 189, at 12.

state-owner as equity and asset transferability amongst SOEs enables the creation of listed companies in the groups which are packed with the groups' crown jewel assets.[205] SOEs may also explore a new source of corporate finance by listing on the stock market. This will in turn optimise their capital structure and lower their debt-to-equity ratios.[206]

In order to facilitate such a reform, a nationwide capital market with the stock exchanges acting as the principal agent has been gradually developed from the early 1990s. This market has since experienced an exponential growth in the number of listed companies, most of which were restructured SOEs that had gone through corporatisation and shareholding reform. As the State or state-owned companies still held controlling stake in such companies, a lot of the old SOE management styles and mechanisms were maintained. At the same time, as the number of listed non-state companies grew, governance became an issue. The improvement of listed companies' corporate governance was a crucial agenda item for the development of China's capital market and in turn its economy.[207]

In December 2001, China joined the WTO and undertook to adopt the OECD Principles of Corporate Governance as an integral part of its commitments to improve corporate governance of Chinese listed companies.[208] This was an instance of wholesale legal transplant by China from the West in order to facilitate its economic reform, a big leap forward to ascend to the international arena.

In 2002, the CSRC and the National Economic and Trade Commission jointly promulgated the Code of Corporate Governance for Listed Companies in China (**PRC Corporate Governance Code**).[209] This Code was based on the OECD Principles of Corporate Governance albeit that it was intended to give specific attention to the circumstances and issues relevant to listed companies in China. It

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205 Li-Wen Lin "A Network Anatomy of Chinese State-Owned Enterprises" (Robert Schuman Centre for Advanced Studies Research Paper No. RSCAS 2017/07, Faculty of Law, University of British Columbia 2017), at 10.

206 Cheung and others, above n 189, at 100.

207 CSRC Report (OECD publication), above n 96, at 14.

208 Ibid.

209 The Code of Corporate Governance for Listed Companies in China (issued by the China Securities Regulatory Commission (CSRC) and State Economic and Trade Commission (SETC) on 7 January 2001) [**PRC Corporate Governance Code**]: http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69223.html.

explicates the fundamental principles of corporate governance, the ways to protect investors' interests, code of conduct and professional ethics to be observed by directors, supervisors, managers and executives of listed companies.[210] Since then, it appears that economic, and in turn corporate governance, reforms have become an ongoing exercise with various reform initiatives being put in place as and when the State deems the same necessary.

4 'Promoting Good Governance' System (2004 – Present)

In January 2004, the State Council set out its further policy to promote the reform of governance of SOEs by issuing the "Opinions on Promoting the Reform, Opening and Steady Growth of Capital Markets". Such a policy was stipulated to show the State's commitment to resolve certain long-standing governance issues and clarify the strategic importance of capital markets in China's economic development. In April 2005, the CSRC, as guided by the State Council, launched a reform to address the issues of non-tradability of the state and legal person shares prior to the SOEs' going public. The non-tradable shares reform will be discussed in Section F below. Today, all categories of shares are valued by the market mechanism which forms the basis for common interests amongst all categories of shareholders.[211]

Company Law 1993 and Securities Law 1998 were substantially revised in 2005 to provide the platform for the establishment and development of a corporate governance framework in China. This will be discussed in Section D 1 below. Company Law 2005 attempts to improve companies' corporate governance structure and mechanisms with a view to protect shareholders' rights and public interests. The legal obligations and responsibilities of directors, senior executives and supervisors who should have actual control of the company are highlighted. The improvement of companies' financing and financial accounting systems and corporate mergers, divisions and liquidation mechanisms are contemplated. Whilst the Company Law 2005 aims to facilitate the reorganisation of companies, it is also meant to protect the lawful rights and interests of the creditors.[212]

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210 CSRC Report (OECD publication), above n 96, at 14.

211 Ibid, at 15.

212 Ibid, at 16.

By the same token, Securities Law 2005 assists with the improvement of the system governing issuance, trading, registration and settlement of securities, and provides for the framework for the establishment of a multi-tiered capital market. It aims at enhancing the supervision of listed companies, transparency of issuance examination, and establishing the mechanism for the introduction of a system for recommending or sponsoring listing. Controlling shareholders, directors, supervisors and senior executives of listed companies would be subject to increased legal responsibilities and integrity obligations. (These will be discussed in Section D below). Minority investors' protection was strengthened by the establishment of a securities investor protection fund. The establishment of a civil liability system to enable investors to claim compensation for damages was also stipulated. Following this revision, the relevant departments carried out corresponding re-organisations and adjustments to the relevant laws, rules and regulations to facilitate compliance with the trend of market rules.[213]

The State-owned Assets Supervision and Administration Commission (**SASAC**) was established in 2003 by the State Council to carry out corporatisation reforms of large central government controlled SOEs and pilot the installation of board of directors based on the Company Law and through transplants of institutions of the OECD Guidelines on Corporate Governance of State-Owned Enterprises.[214]

In order to tackle the rampant problem of fund misappropriation by major shareholders and other related parties in listed companies, the Criminal Law[215] was updated by way of Amendment VI[216] to impose heavier penalties on those controlling shareholders and actual controllers involved in fund misappropriation in

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213 CSRC Report (OECD publication), above n 96, at 16.

214 Ibid.

215 The Criminal Law of the People's Republic of China, which was adopted by the Second Session of the Fifth National People's Congress on 1 July 1979 and amended by the Fifth Session of the Eighth National People's Congress on 14 March 1997 [**Criminal Law**]: http://www.fmprc.gov.cn/ce/cgvienna/eng/dbtyw/jdwt/crimelaw/t209043.htm; or http://www.npc.gov.cn/englishnpc/Law/2007-12/13/content_1384075.htm.

216 The Amendment VI to the Criminal Law of the People's Republic of China, adopted at the 22nd Meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China on 29 June 2006, and promulgated and took effect as of the same date [**Amendment VI to the Criminal Law**], arts 7 to 9 (revisions to arts 163, 164 and 169 of the Criminal Law): http://www.npc.gov.cn/englishnpc/Law/2008-01/02/content_1388005.htm.

listed companies.[217] The CSRC also put in place a pilot programme on "shares for debt" to combat the long-standing issues of debt repayment arrears. In March 2007, the CSRC launched a three-year campaign to enhance the governance of listed companies by looking into the existing problems of corporate governance. Instances were incomplete separation of funds and personnel between a listed company and its major shareholders, irregular operations or inadequate internal controls of the board of directors, shareholders' meetings and supervisory boards.[218]

In a nutshell, four specific corporate organs with division of powers and duties serve as an integral organisational structure of a listed company. The general shareholders' meeting is the decision-making organ of the company. It has the primary power to make decisions on all major issues.[219]

The board of directors is the operational execution organ. It is accountable to the general shareholders' meeting. It has decision making power concerning management issues, with that power bestowed through the authority of the general shareholders' meeting. The board of directors may, if so empowered by the general shareholders' meeting by way of passing the requisite resolutions, set up such special committees as the strategy committee, audit committee, nomination committee, remuneration and appraisal committee.[220]

The management of the company is responsible to the board of directors and is in charge of the day-to-day operation and management of the company. The supervisory board is the supervisory organ of the company which oversees compliance by the directors and managers of the company's articles of association and the relevant laws and regulations.[221]

This division of powers and duties sets Chinese companies apart from their Western counterparts – despite the fact that the four corporate structures are transplanted from the West, they are "in-form-not-in-substance" transplants. For

217 OECD Report (OECD publication), above n 96, at 17.
218 Ibid, at 18.
219 Ibid.
220 Ibid.
221 Ibid.

instance, they differ from the norms in the common law jurisdictions[222] in that the shareholders appear to hold the primary power, whereas the board of directors is simply an "operational execution organ" with powers being passed down by the shareholders. Another major difference is the Chinese supervisory board is essentially a "lame duck" which does not possess the same powers as in its "donor" – Germany. These will be discussed in Sections D and E below.

D Key Legal Sources of China's Corporate Governance

China's legal framework for corporate governance comprises four levels: basic or national laws, administrative regulations, regulatory provisions and self-disciplinary rules. The first level consists of certain fundamental laws, stipulated by either the National People's Congress (**NCP**) or its Standing Committee. They include, amongst others, the Company Law, the Securities Law, the Amendment VI to the Criminal Law, and the Law on the State-Owned Assets of Enterprise.[223]

The second level involves the State Council's administrative regulations, in particular, the Opinions on Promoting the Reform, the Opening and Steady Growth of Capital Markets, the Circular of the State Council on its Approval of the CSRC's Opinion on Improving the Quality of Listed Companies.[224]

The third level canvasses departmental provisions promulgated by various Ministries and Commissions, the People's Bank of China, the Auditing Administration and other agencies with administrative jurisdiction directly under the State Council. These include but not limited to: the PRC Corporate Governance Code, the Guidelines on Articles of Association of Listed Companies, the Rules on Shareholders' Meetings of Listed Companies, the Provisions on Strengthening the Protection of the Rights and Interests of Public Shareholders, the Guiding Opinions on the Establishment of the System of Independent Directors in Listed Companies, the Regulations on Information Disclosure of Listed Companies, the Regulations on the Takeover of Listed Companies, the Regulations on Major Asset

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222 For example, the Chinese shareholders-directors-hierarchy appears to go against the rule in *Automatic Self-Cleansing Filter Syndicate Co Ltd v Cuninghame* [1906] 2 Ch 34. In this case, the English Court of Appeal ruled that directors were not agents of the shareholders and hence not bound to implement shareholders' resolutions if the same were passed unconstitutionally.

223 OECD Report (OECD publication), above n 96, at 18 and 19.

224 Ibid, at 19.

Reorganisation of Listed Companies, the Regulations on Option Incentives of Listed Companies (Trial), and the Regulations on the Registration and Settlement of Securities. The fourth level includes self-disciplinary rules, such as the Rules on Listing Stocks and the Trading Rules made by the stock exchanges, amongst others.[225]

The legislature or competent administrative departments will usually conduct an in-depth and thorough research and implement the relevant legal procedures strictly to enlist a multitude of opinions through round-table discussions, deliberations, consultations and comments, following publication of any draft laws, regulations and rules at various levels but prior to adoption and promulgation of such laws, regulations and rules. These requirements are meant to ensure that individual citizens and market entities are able to express their views directly or through their representatives, thereby safeguarding their legitimate rights and interests.[226]

The CSRC may inflict administrative sanctions, such as warnings, fines, disqualifications and bans on entry into the securities market on those companies and individuals responsible for violations of the rules and regulations stipulated by the CSRC or other government regulatory agencies. Offenders who are in breach of the rules and regulations to uphold or safeguard listed companies' corporate governance will be held liable for the relevant administrative, civil and criminal responsibilities and liabilities. Those suspected of a criminal offence will be likely to be transferred to the judicial departments so criminal liability may be ascertained. The company registration authorities and other competent departments may also punish violating companies, intermediaries and persons responsible by ordering them to return company property, confiscating the illicit gains, imposing a fine, cancelling company registration and revoking a business licence, ordering intermediaries to stop business operations and revoking qualification certificates of those directly responsible. Furthermore, shareholders may also, according to law, file lawsuits against those persons and institutions that have undermined the legitimate rights and interests of the company and its shareholders and claim civil damages. Companies which are in breach will have to take responsibility and pay civil compensation and/or the relevant fines. Where such companies' assets are insufficient to cover the compensation or fines, civil damage compensation will be

225 OECD Report (OECD publication), above n 96, at 19.

226 Ibid.

paid out first. Criminal responsibility will be investigated when a criminal offence is involved.[227]

The key legal sources on which China forms its corporate governance framework consist of the Company Law, the Securities Law, the Code of Corporate Governance for Listed Companies in China (PRC Corporate Governance Code) issued by the CSRC and the State Economic and Trade Commission (**SETC**) on 7 January 2001 as well as the Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies issued by the CSRC (Independent Directors Guidelines) on 16 August 2001.[228] The following sections will elucidate various aspects regarding these four pillars which are key to the corporate governance system in China.

1 Company Law

Company Law 1993 was an important starting point in the development of China's corporate governance system as it was China's first attempt since 1949 to create limited liability companies without regard to the nature of ownership as part of a modern economic system.[229] Company Law 1993 was amended in December 1999 and again in August 2004, when a few technical legal issues were touched upon. In October 2005, Company Law 1993 was in essence rewritten leaving only 24 articles unchanged from the original version. Hence, the 2005 enactment is customarily referred to as the new Company Law or simply Company Law 2005 as if it were a new legislation.[230] The 2005 revision was primarily driven, first, by the need to provide equal treatment between the state-owned economy and the private economy, and, second, to strengthen corporate governance for the protection of

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227 OECD Report (OECD publication), above n 96, at 19.

228 Yuan George Shan and David K. Round "China's Corporate Governance: Emerging Issues and Problems" (2012) 46(5) Modern Asian Studies 1316, at 1323. See generally The Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies (stipulated by the CSRC on 16 August 2001 by way of Notice on Issuing the Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies Zhengjianfa [2001] No. 102) [**Independent Directors Guidelines**]: http://www.csrc.gov.cn/pub/csrc_en/newsfacts/release/200708/t20070810_69191.html.

229 James V Feinerman "New hope for corporate governance in China?" (2007) 191 The China Quarterly 590, at 592-593.

230 Jiangyu Wang *Company Law in China: Regulation of Business Organizations in a Socialist Market Economy* (Edward Elgar Publishing, 2014), at 7.

creditors, minority shareholders and employees. The Company Law 2005 was amended in December 2013 to implement further reform in order to liberalise capital requirements for company incorporation. The new amendments came into effect in March 2014.

The Company Law recognises only two types of companies: companies with limited liability and companies limited by shares.[231] A company with limited liability does not issue shares to its shareholders. Its registered capital is the amount of capital invested, in cash or kind, by its shareholders registered with the company registration authority under the State Administration for Industry and Commerce (**SAIC**).[232] There are also different rules in the Company Law for (1) companies with limited liability that are wholly owned by the State (commonly known as corporatised, but not privatised, SOEs where the State retains ownership despite the changes in their corporate structure);[233] and (2) companies that have foreign investor(s). The second category, commonly referred to as foreign-invested enterprises, can be a Chinese-foreign equity joint venture, a Chinese-foreign contractual joint venture or a wholly foreign-invested enterprise. These foreign-invested enterprises are respectively governed by three different laws, namely the Law of Chinese-foreign Equity Joint Ventures of the People's Republic of China (**EJV Law**), the Law of Chinese-foreign Contractual Joint Ventures of the People's Republic of China (**CJV Law**) and the Law of Wholly Foreign-invested Enterprises of the People's Republic of China (**WFOE Law**).[234]

A company limited by shares may be incorporated by way of promotion (which entails the subscription by the promoters of all the issued shares therein) or share offer (in which the promoters take up a portion of the issued shares with the

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231 Company Law 2013, above n 184, art 2. See also Nandini Rajagopalan and Yan Zhang "Corporate governance reforms in China and India: Challenges and opportunities" (2008) 51(1) Business Horizons 55, at 58, and Schipani and Liu, above n 189, at 16.

232 Company Law 2013, above n 184, arts 23-35.

233 Ibid, arts 64-70.

234 As the EJV Law (promulgated in 1979 and revised in 1990 and 2001 respectively), the CJV Law (promulgated in 1988 and revised in 2000) and the WFOE Law (promulgated in 1986 and revised in 2000) were enacted before the Company Law 1993, their relationships are left unclear although the Company Law 2013 provides that it is applicable to the foreign-invested enterprises except otherwise provided by the relevant laws governing these enterprises (in other words, the EJV Law, CJV Law or the WFOE Law, as the case may be): see Company Law 2013, above n 184, art 217.

remainder being offered to the general public or specific groups).[235] Special rules in the Company Law enable companies limited by shares to list on stock exchange(s).[236]

Under the Company Law 1993, traditional SOEs were restructured to become corporatised SOEs with limited liability or corporatised SOEs limited by shares, both with better defined governance structures to enhance shareholders' rights, corporate efficiency and accountability. It would be fair to say that the Company Law provides a solid start for the transformation of SOEs into different business corporations. The crucial features that facilitate this reform were the approval of the development of diversified forms of ownership and the introduction of a modern corporate governance framework for SOEs.

The implementation of SOE ownership reform was twofold under the Company Law. First, SOEs were transformed into limited liability companies.[237] This theoretically enabled the separation of government and business functions and the creation of incentives structures for the managers to act in the interests of the corporate shareholders or owners. Second, SOEs were given a new fundraising avenue through listing on the stock exchanges.[238] Since then, there have been ongoing corporate governance reform initiatives and in turn continuing enactments of numerous laws, rules, regulations and guidelines as and when loopholes were found with a view of enhancing the performance of listed companies in China.

The Company Law requires both companies with limited liability and companies limited by shares to form three governing bodies: (i) the shareholders, acting as a body at the general meeting or assembly,[239] (ii) the board of directors,[240] and (iii) the board of supervisors.[241] The Company Law introduces two corporate positions:

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235 Company Law 2013, above n 184, arts 76-97.

236 Ibid, arts 120-124.

237 Company Law 1993, above n 184, art 64.

238 Ibid, arts 75 and 151. See also Cheung and others, above n 189, at 100.

239 Company Law 2013, above n 184, arts 36-43 (for companies with limited liability) and 98-107 (for companies limited by shares).

240 Ibid, arts 44-48, 50, 67 and 69 (for companies with limited liability) and 108-112 and 114 (for companies limited by shares).

241 Ibid, arts 51-56, and 70 (for companies with limited liability) and 117-119 (for companies limited by shares).

the chairman of the board of directors and the manager (*jing li*).[242] The manager of a company with limited liability is accountable to the board of directors and attends board of directors' meetings as a non-voting attendant.[243] This implies that the chairman of the board of directors of a company with limited liability may not concurrently serve as the manager. However, where a company with limited liability is relatively small in scale, it may have an executive director instead of a board of directors, who may concurrently serve as the manager.[244] The board of directors of a company limited by shares may decide that one of its board members concurrently serves as the manager. This means the chairman of the board of directors of a company limited by shares may concurrently serve as the manager. The chairman of the board of directors, executive director or the manager (as the case may be) shall serve as the legal representative of the company. The legal representative will be registered with the SAIC according to law.[245] In both types of companies, the shareholders have rights to appoint and remove the directors and supervisors and to decide on their remuneration.[246] The board of directors and the supervisory board function on an equal level and are independent of each other.

As discussed in Section B 4 in Chapter II above,[247] in terms of the types of companies and certain rules regarding corporate governance, it is understandable that the law drafters of the Company Law have looked to both the American and continental models and transplanted quite a few features for China's use. For instance, the two-tier board system is considered to be explicitly modelled on, and often compared to, that of the German system.[248] At first glance, China's new corporate governance structure appears similar to the two-tier corporate

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242 The Company Law consistently refers the position to be that of the 'manager' throughout the whole piece of legislation, albeit the office of the manager appears to be akin to that of the chief executive officer (**CEO**) under the Anglo-American models. It therefore appears to be appropriate to adhere to the Chinese lawmakers' choice and refrain from assuming that the 'manager' is the 'CEO'.

243 Company Law 2013, above n 184, art 49.

244 Ibid, art 50.

245 Ibid, art 13.

246 Ibid, arts 37 (for companies with limited liability) and 99 (for companies limited by shares).

247 See Section B 4 in Chapter II above, particularly at 35.

248 Donald Clarke "Lost in Translation? Corporate Legal Transplants in China" (2006) (213) GWU Law School Legal Studies Research Paper (3 July 2006), at 5.

governance system in Germany in that the German companies are similarly governed by a board of directors and a supervisory board.[249]

There are, however, differences between the German and Chinese systems. One significant example of China's "in-form-not-in-substance" legal transplant is the want of a hierarchical relationship between the Chinese board of directors and board of supervisors as both directors and supervisors are appointed and dismissed by the shareholders.[250] In contrast, the German board of supervisors monitors the board of directors and the members of the board of directors are appointed and removed by the board of supervisors.[251] This is a classic example which illustrates that the transplant of the supervisory board system from Germany to China does not transcribe into the expected convergence between Chinese and western corporate governance practices. In fact, the Chinese supervisory boards do operate rather differently from Germany's co-determination system upon which the Chinese system was originally modelled.

This approach in China appears to be consistent with scholars like Young and others' findings that emerging economies have attempted to transplant legal frameworks of developed economies either as a result of internally driven reforms (for instance, China and Russia) or as a response to international demands (for example, Thailand and South Korea).[252] However, the corporate governance structures in emerging economies often adopt or transplant the appearance of corporate governance mechanisms from developed economies but these mechanisms rarely function like their counterparts in the developed economies. In

249 Aktiengesetz 1965 [**German Stock Corporation Act 1965**], § 84. See also Michael Bradley and others "The purposes and accountability of the corporation in contemporary society: Corporate governance at a crossroads" (1999) 62(3) Law and Contemporary Problems 9, at 52-53.

250 Company Law 2013, above n 184, arts 37 (for companies with limited liability) and 105 (for companies limited by shares).

251 German Stock Corporation Act 1965, above n 249; see also David Charny "The German Corporate Governance System" [1998] Colum Bus L Rev 145 at 149, and Thomas J Andre Jr "Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards" (1995) 70 Tul L Rev 1819, at 1823-1824.

252 Michael N Young and others "Corporate governance in emerging economies: A review of the principal–principal perspective" (2008) 45(1) Journal of Management Studies 196, at 198.

other words, their governance structures resemble those of the developed economies in form but not necessarily in substance.[253]

Another significant example of China's "in-form-not-in-substance" legal transplants is the codification of corporate veil piercing principle borrowed from the common law jurisdictions in the West into the Company Law. The corporate veil principle and corporate legal personality where a company's shareholders are separate from the limited liability company in which they hold equity and from the company's debts and liabilities, are manifested by the landmark company law case in the United Kingdom, *Salomon v Salomon & Co Ltd.*[254]

While the western statutes do not normally provide authority for piercing the corporate veil, the common law does, primarily through judicial decisions, provide ways for courts to pierce the corporate veil in certain exceptional cases by allowing the shareholders to be pursued for liabilities incurred by the company that they own. That said, courts have largely upheld the sanctity of the corporate veil since the principle was first enunciated and rarely intervened by imposing liability on a company's shareholders for the company's debts and liabilities.[255]

Again, at first glance, the legal principle that has been incorporated or implanted into the Company Law in China largely resembles the corporate veil piercing principle practised in the common law jurisdictions in the West. However, when it is examined closely, notable differences may be identified in at least two respects. The first difference is the source of authority. In the common law jurisdictions, precedents of creditors successfully convincing the courts to rule in favour of piercing the corporate veil are built on judicial decisions singling out the exceptions to the sanctity of the corporate personality.[256] In China, authority for piercing the

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253 See Mike W Peng "Outside directors and firm performance during institutional transitions" (2004) 25(5) Strategic Management Journal 453, at 457.

254 *Salomon v Salomon & Co Ltd* [1897] AC 22 (HL). The effect of this case is that the House of Lords unanimously upheld the principle of corporate personality as set out in the Companies Act 1862 so that even the creditors of an insolvent company could not pierce its corporate veil at will to make its shareholders pay up the company's outstanding debts.

255 *Prest v Petrodel Resources Limited and others* [2013] UKSC 34. See also Kimberly Bin Yu and Richard Krever "The High Frequency of Piercing the Corporate Veil in China" (2015) 23(2) Asia Pacific Law Review 63, at 64.

256 See generally Robert B Thompson "Piercing the corporate veil: an empirical study" (1990) 76 Cornell L Rev 1036-1074; Charles Mitchell "Lifting the Corporate Veil in the English Courts: An Empirical Study" (1999) 3 Company Finance & Insolvency L Rev 15; John H Farrar "Fraud,

corporate veil is stipulated in the Company Law and found in the quasi-legislative rulings of the Supreme People's Court. The Company Law 2005 introduced three measures which enable creditors to pierce the corporate veil and pursue shareholders of all companies from one-person or single shareholder companies through (theoretically) to listed companies.[257]

The pivotal corporate veil piercing provision is set out in Article 20 of the Company Law:[258]

> Where the shareholder of a company abuses the independent status of the company as a legal person or the limited liability of shareholders, evades debts and thus seriously damages the interests of the creditors of the company, he shall assume joint and several liabilities for the debts of the company.

In sum, if the court were to rule in favour of piercing the corporate veil, three elements have to be satisfied: (i) conduct – it must be established that the company shareholder has abused the independent status of a company as a separate legal personality or the principle of limited liability; (ii) intent – there is an intention on the part of the shareholder to evade debts; (iii) consequence – the abuse has given rise to serious damage to the interests of the creditors of the company. This provision creates an overarching right under the Company Law for creditors to pursue shareholders of both companies with limited liability and companies limited by shares, including listed companies, for debts and liabilities that these companies have incurred.

The second difference rests with a rule that reverses the burden of proof in the case of single shareholder companies pursuant to Article 64 of the Company Law:[259]

> Where the shareholder of a one-person company with limited liability cannot prove that the property of the company is independent of his own property, he shall assume the joint and several liabilities for the debts of the company.

Fairness and Piercing the Corporate Veil" (1990) 16 Canadian Business Law Journal 474-479; Ian Ramsay and David Noakes "Piercing the corporate veil in Australia" (2001) 19 Company and Securities Law Journal 250-271; and Yu and Krever, above n 255, at 65.

257 Ibid, Yu and Krever, at 74.

258 Company Law 2005, above n 184, art 20 (Author's note: the same provision under Company Law 2013).

259 Ibid, art 64 (Author's note: that is, Company Law 2013, art 63).

Article 64 essentially shifts the burden of proof from the plaintiff creditor to the defendant shareholder of a single shareholder company, thereby rendering it much easier to establish an argument to justify piercing of the corporate veil. This strikes an unambiguous contrast to the company laws in the common law jurisdictions in that onus of proof reverses from the norm adopted in those jurisdictions. An important point to note is that the reversed burden only applies to the issue of commingling of assets.[260] The correlation between Article 20 and Article 64 is one of general versus specific. In other words, Article 20 applies where Article 64 is silent regarding issues relating to the piercing of the corporate veil of a single shareholder company. The burden to prove other elements as provided in Article 20, such as intent and consequence, still rests with the plaintiff creditor.[261]

The third difference, albeit not as apparent or direct, that can be seen relevant to the piercing of corporate veil in favour of creditors, is related to members of liquidation teams or committees of companies in the process of dissolution and liquidation. Article 190 of the Company Law provides:[262]

> Where a member of the liquidation team causes losses to the company or its creditors intentionally or through gross negligence, he shall be liable for compensation.

To clarify, the dissolution and liquidation procedures as set out in the Company Law[263] actually differ from those of many common law countries in that the Company Law does pass over the need for independent persons such as an external or independent liquidator to be involved in the dissolution and liquidation of a company. The Company Law simply requires that a liquidation team or committee be composed within 15 days from the date the reason(s) for dissolution prevail(s). However, the team or committee may be composed entirely of the

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260 For examples of targeted legislative intervention in common law jurisdictions which confer powers on courts to hold shareholders liable on liquidation of related companies where company assets or businesses are commingled, see Companies Act 1993 (NZ), s 271; *Lewis Holdings Ltd v Steel & Tube Holdings Ltd* [2014] NZHC 3311; and *Mountfort v Tasman Pacific Airlines of NZ Ltd* [2006] 1 NZLR 104; and Companies Act 1990 (Ireland), ss 140-141. See also John Farrar "Piercing the corporate veil in favour of creditors and pooling of groups – a comparative study" (2013) 25(2) Bond Law Review 31-55.

261 Hui Huang "Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading" (2012) 60(3) American Journal of Comparative Law 743-774.

262 Company Law 2005, above n 184, art 190 (Author's note: that is, Company Law 2013, art 189).

263 Ibid, arts 181 to 191 (Author's note: that is, Company Law 2013, arts 180 to 190).

shareholders of the company.[264] This means that Article 190 potentially gives rise to the possibility of piercing the corporate veil. This is because a liquidation committee member who happens to be one of the shareholders of the company may be required to pay compensation to the company or the creditor pursuant to Article 190 if it is proven that the said shareholder (also acting in his capacity as a liquidation committee member) wilfully or through gross negligence caused any loss to the company or that creditor during the liquidation process.

From the above discussion, it can be inferred that although the courts in China may pierce the corporate veil on behalf of the creditors as a result of China's transplant of the principle from the common law jurisdictions, such a transplant is, like many others, again in form but not in substance, or even lost in translation.

The pathway adopted by, and the authority given to, the Chinese courts are significantly different from their western counterparts. Unlike the judicial systems in the West which possess a judiciary which is completely independent of the legislature and executive, the Supreme People's Court in China is empowered with both an adjudicative and a legislative role. The Supreme People's Court, wearing a quasi-legislative hat, is equipped with the power to issue 'opinions' and give interpretation on questions concerning specific application of laws and decrees in judicial proceedings.[265] This is another phenomenon that has been developed with Chinese characteristics which has no counterpart in the common law jurisdictions.

That said, the recently amended legislation law in China does include a proviso that judicial interpretations made by the Supreme People's Court and the Supreme

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264 Company Law 2005, above n 184, art 184 (Author's note: that is, Company Law 2013, art 183).

265 The Organic Law of the People's Courts of the People's Republic of China (adopted at the Second Session of the Fifth National Congress on 1 July 1979, promulgated by Order No.3 of the Chairman of the Standing Committee of the National People's Congress on 5 July 1979 and effective as of 1 January 1980; amended in accordance with the Decision of the Standing Committee of the Sixth National People's Congress on Amending the Organic Law of the People's Courts of the People's Republic of China adopted at its 2nd Meeting on 2 September 1983, the Decision of the Standing Committee of the Sixth National People's Congress on Amending the Organic Law of the Local People's Congresses and the Local People's Governments of the People's Republic of China adopted at its 18th Meeting on 2 December 1986 and the Decision of the Standing Committee of the Tenth National People's Congress on Amending the Organic Law of the People's Courts of the People's Republic of China adopted at its 24th Meeting on 31 October 2006), art 32: http://www.npc.gov.cn/englishnpc/Law/2007-12/13/content_1384078.htm.

People's Procuratorate shall not contradict the principle, letter and intent of the law being interpreted. Also, a judicial interpretation must be reported to the Standing Committee of the National People's Congress for record within 30 days of its publication. No other judicial or procuratorate authorities than the Supreme People's Court and the Supreme People's Procuratorate may issue judicial interpretations on any applicable law.[266]

A decade after the promulgation of the Company Law 2005, Yu and Krever have found that the Supreme People's Court has issued three interpretations of the Company Law 2005, two of which touch upon the issue of the piercing of the corporate veil.[267]

The first interpretation was issued in 2008 in relation to the obligation of the liquidation committee members to compensate a company or its creditors for damages to the company or the creditors arising from the intentional or wilful acts or gross negligence or mistake of the members (**2008 Interpretation**). The 2008 Interpretation confirms that shareholders (irrespective of whether they sit on the liquidation committee) have joint and several liabilities with the company for the company's debts if the shareholders' actions result in damages to the creditors' interests.[268]

The second interpretation was issued in 2011 in relation to the court's upholding the creditors' claim for compensation against shareholders who have illegally withdrawn their capital contributions to a company, implicitly leaving the company being unable to satisfy its debts (**2011 Interpretation**). In other words, the 2011 Interpretation essentially authorises the people's court to rule in favour of piercing the corporate veil by holding shareholders responsible for the company's debts to

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266 The Legislation Law of the People's Republic of China (adopted at the third Session of the Ninth National People's Congress on 15 March 2000, and amended in accordance with the Decision on Amending the Legislation Law of the People's Republic of China adopted at the 3rd Session of the Twelfth National People's Congress on 15 March 2015), art 104: http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=245693; and http://www.gov.cn/zhengce/2015-03/18/content_2834713.htm.

267 Yu and Krever, above n 255, at 77.

268 The Provisions of the Supreme People's Court on Some Issues about the Application of the Company Law of the People's Republic of China (II) (adopted at the 1447th meeting of the Judicial Committee of the Supreme People's Court on 5 May 2008, promulgated and entered into force on 19 May 2008), arts 18 to 20: http://www.fdi.gov.cn/1800000121_39_977_0_7.html.

the extent of the principal and interest on the illegally withdrawn capital contributions. Other shareholders, directors, senior managers or *de facto* controllers who have assisted with the illegal withdrawal of the capital contributions will bear joint and several liabilities therefor.[269]

Interestingly, the Supreme People's Court made no mention of Articles 20, 64 or 190 in the relevant provisions under the 2008 Interpretation and the 2011 Interpretation when stipulating its support for the piercing of the corporate veil of the companies in question which were in fact under the circumstances set out in Articles 20, 64 and/or 190. This may imply that the Supreme People's Court deems the two Interpretations as its interpretations of that area of law in its entirety thereby creating an independent avenue for the piercing of the corporate veil whenever shareholders directly or indirectly contribute to the inability of the company to repay its debts. This also helps to illustrate that corporate governance legal transplants in China are in form but not in substance as such transplants are implanted in the Chinese system for the attainment of specific agendas as opposed to the enhancement of the intended protection of those minority shareholders' and stakeholders' interests in the West.

2 Securities Law

The Securities Law was promulgated in December 1998 and came into force in July 1999. It is designed to protect investors' lawful and public interests, maintain social and economic order and promote the development of market economy.[270] It regulates the issuance and trading of stocks, corporate bonds and other securities, government bonds and securities investment fund units and related matters. Under the Securities Law, the State audit authority exercises auditing supervision over the stock exchanges, securities firms, securities depository and clearing houses

[269] The Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China (III) (adopted at the 1504th meeting of the Judicial Committee of the Supreme People's Court on 6 December 2010, are hereby promulgated and shall come into force on 16 February 2011), art 14: http://en.pkulaw.cn/display.aspx?cgid=145141&lib=law.

[270] Securities Law, above n 185, art 1; see also CSRC "China Securities Regulatory Commission Annual Report 2012" (2012): www.csrc.gov.cn, at 80 [**CSRC Annual Report 2012**].

and securities regulators.[271] The law also strictly prohibits insider trading, market manipulation and other related fraudulent activities.[272]

Ironically, not long after the Securities Law came into force, it was the corporate scandals that emerged in 2001 that prompted officials of the CSRC and other state regulatory authorities to further improve governance of the Chinese listed companies.[273] In 2001, just as the United States (**US**) was starting to experience a spate of collapses of flagship corporations from Enron to WorldCom to Global Crossing due to corporate governance failures, the exposure by the media of an Enron-type RMB¥745 million fraud committed by Ying Guang Xia, a 'blue chip' company listed in the mainland, the largest economic scandal in China's history,[274] and several other scandals, of similar nature but perhaps a slightly smaller scale, highlighted the importance of effective implementation of good corporate governance in China.[275]

The companies involved were leading businesses and their share prices performed quite well prior to their collapses. CSRC's investigations revealed that their dire predicaments – in general, fabricated sales receipts, inflated profits figures, concocted production facilities and/or manipulated share prices. This resulted in board chairmen and senior managers and executives being sent to prison including the chairman and six executives of Guangdong Kelon Electrical Holdings (for overstating revenues and profits by over RMB¥2 billion), and Zhou Zhengyi of Nongkai Development Group, then one of China's richest men (for manipulating share prices and falsifying registered capital). This case also gave rise to an embarrassing setback for the then newly listed Hong Kong branch of the Bank of China as it exposed their internal governance lapses.[276] These corporate collapses also provided insight into the vulnerability of China's financial institutions. The failures of GITIC and GDE, mentioned earlier, epitomised a disastrous malfunctioning of corporate governance even in its main financial institutions.

In early 2002, it was revealed that five officials in a branch of the Bank of China in Guangdong swindled nearly the equivalent of US$500 million. The problems

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271 Securities Law, above n 185, art 9.

272 Ibid, arts 73 to 84.

273 Rajagopalan and Zhang, above n 231, at 58.

274 Ibid.

275 Feinerman, above n 229, at 595.

276 Ibid.

penetrated to the apex of the country's banking system. One of the former premier's right-hand-men, Zhu Xiaohua, who was the former deputy governor of the People's Bank of China (the equivalent of the reserve bank in a developed economy/country), was arrested in 1999 and subsequently jailed for 15 years. Li Fuxiang, former foreign exchange head of the Bank of China in New York committed suicide in 2000 and Wang Xuebing, former head of the China Construction Bank and then of the Bank of China, was arrested in 2002 and later jailed for 12 years.[277]

In view of such scandals and the subsisting problems encountered, the Securities Law was subsequently revised, alongside with the Company Law, in 2005 to take effect in January 2006, to strengthen the supervisory power of the government supervisory authority, implicitly the CSRC, and the investor protection mechanisms.[278] It is anticipated that ongoing reforms will be imperative for the improvement of the functions of China's stock market.[279]

3 PRC Corporate Governance Code

Even before some of the failures discussed above, the PRC Corporate Governance Code had been developed and came into force in 2002. The corporate financial scandals in early 2001 outlined above simply acted as a catalyst which prompted policymakers, regulators at the CSRC, SETC and other relevant regulatory authorities to make corporate governance a priority issue on their agenda in 2002. Additionally, and importantly, with China's accession to the WTO in December 2001 and according to the terms of the WTO entry agreement, China had to commit to capital market liberalisation and corporate reforms. A workable and viable corporate governance system must coincide with international standards as China was preparing its first step forward to gain its foothold on the international stage.

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277 Nolan, above n 6, at 7-8.

278 Chunxin Jia and others "Fraud, enforcement action, and the role of corporate governance: Evidence from China" (2009) 90(4) Journal of Business Ethics 561, at 563.

279 NPC Decision 2015 and Howson, above n 187.

The PRC Corporate Governance Code follows the US regulatory system[280] and the model of the OECD CG Principles.[281] Since their endorsement by the OECD Ministers in 1999, the OECD CG Principles have been regarded as an international benchmark for policymakers, investors, corporations and other stakeholders across the world. They have also served as a specific guidance for their development of good corporate governance systems in their respective countries, whether they are from an OECD or a non-OECD country.[282]

The 2004 OECD CG Principles comprise six themes. Each of the principles has salience for the situation of China and its corporatisation reforms. These will be further discussed in Section F below.[283]

The PRC Corporate Governance Code is applicable to and mandatory for all companies listed on the two stock exchanges in China and is intended to be the major measuring standard for assessing whether a listed company has a good corporate governance practice. All listed companies are thus required to act in the spirit of the PRC Corporate Governance Code in their efforts to improve corporate governance.[284] It stipulates the rights and responsibilities of shareholders,[285] directors and board of directors,[286] supervisors and board of supervisors,[287] stakeholders[288] and generally the management.[289]

Information disclosure is crucial and remains an ongoing responsibility of all listed companies. Further, all their shareholders shall have equal rights to receive accurate, complete, truthful and timely information.[290] Every listed company should ensure timely disclosure of its controlling shareholders' interests.[291] The PRC

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280 Rajagopalan and Zhang, above n 231, at 58.

281 OECD Asia Roundtable on Corporate Governance "Corporate Governance in Asia" (2011): www.oecd.org, at 1- 4.

282 Note that the OECD CG Principles were revised in 2004. OECD "OECD Principles of Corporate Governance" (2004): www.oced.org [**2004 OECD CG Principles**].

283 Ibid, at 17-25. See also Section F of this Chapter III below.

284 PRC Corporate Governance Code, above n 209, at The Preface.

285 Ibid, arts 1 to 11 and 15 to 21.

286 Ibid, arts 28 to 58, and 71 to 72.

287 Ibid, arts 59 to 68.

288 Ibid, arts 81 to 86.

289 Ibid, arts 69 to 70, and 73 to 80.

290 Ibid, art 87.

291 Ibid, arts 92 to 94.

Corporate Governance Code also introduces a system of independent directors[292] and tightens the supervision of corporate management.

The PRC Corporate Governance Code strengthens the rights of shareholders, mandating that minority shareholders should possess equal status with other shareholders[293] and highlighting shareholders' right to protect their interests by way of civil litigation and other legal actions.[294] At the same time, the PRC Corporate Governance Code gives controlling shareholders more weight in the decision-making process (for instance, the nomination of directors and supervisors)[295] and attempts to strengthen the roles of the board of directors and board of supervisors. Rather importantly, it requires all listed companies to abide by the following governance rules:

(i) Standardised and transparent procedures have to be established for the election of directors.[296]

(ii) Independent directors have to be introduced to the board of directors which independent directors must be independent from the employing company and its majority shareholders, with duties including the protection of the company's interests and those of the minority shareholders.[297]

(iii) Corporate governance-related information (for instance, composition, performance and evaluation of the board of directors, the board of supervisors and the independent directors, attendance records of board of directors' meetings, their opinions on related party transactions, appointment and removal of management personnel, composition and work of board of directors' specialised committee, the company's corporate governance compliance status, reasons for non-compliance (if any) and specific plans and measures to improve corporate governance) must be disclosed.[298]

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292 PRC Corporate Governance Code, above n 209, arts 49 to 51.
293 Ibid, art 2.
294 Ibid, art 4.
295 Ibid, art 20.
296 Ibid, art 28.
297 Ibid, arts 49 to 50.
298 Ibid, art 91.

(iv) Members of the board of supervisors shall be given access to information regarding the listed company's operational status and be allowed to hire independent intermediary agencies for professional consultation.[299]

(v) Specialised (for instance, audit, corporate strategy, nomination and remuneration) committees of the board of directors must be established, with each being hosted by a majority of independent directors and being entitled to engage intermediary institutions for professional consultation at the expense of the listed company. [300]

(vi) Detailed information on the controlling shareholders must be promptly disclosed, whilst the controlling shareholders must honour the independence of the listed company especially in terms of its personnel, assets and financial affairs and avoid interfering or directly competing with the listed company.[301]

(vii) Matters relating to the signing, amendment, termination and execution of agreements as well as the basis for pricing for related-party transactions shall be disclosed and no financial guarantees shall be provided for its shareholders or their affiliates.[302]

In September 2015, G20 (the grouping of 20 major international economies) and the OECD jointly published the G20/OECD Principles of Corporate Governance (**2015 G20/OECD CG Principles**). The 2015 G20/OECD CG Principles were originally developed from the 2004 OECD CG Principles following global consultations and a review process conducted by the OECD Corporate Governance Committee between 2014 and 2015 with all G20 countries invited to participate in the review in conjunction with the OECD member countries. The exercise was a strategic response to the various corporate governance challenges resulting from the 2008-2009 Global Financial Crisis. The perceived challenges include, in particular, the increased complexity of the investment chain, the changing role of stock markets with the arrival of new investors, investment strategies and business practices.[303]

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299 PRC Corporate Governance Code, above n 209, art 60.

300 Ibid, arts 52 to 58.

301 Ibid, arts 22 and 27.

302 Ibid, arts 12 to 14.

303 OECD, "G20/OECD Principles of Corporate governance" (2015): http://www.oecd.org/daf/ca/Corporate-Governance-Principles-ENG.pdf, at 4 to 6 and 9 to 11.

Like the 2004 OECD CG Principles, the 2015 G20/OECD CG Principles also comprise six substantially similar themes but with different emphases. To illustrate, the 2015 G20/OECD CG Principles highlight the symbiosis between stock markets and corporate governance, the quality of listing rules and criteria, and the importance of independent supervision, especially because stock markets are increasingly operated by companies that are themselves listed.[304] Significant additions are the inclusion of extensive and stricter rules on related-party transactions and say-on-pay (requiring shareholders' approval for equity-based remuneration schemes (vis-à-vis general policies and individual grants) and material changes for board members and key executives).[305] Needless to say, the 2015 G20/OECD CG Principles, which represent a broader spectrum of countries, stand a better chance of adoption in various economies and jurisdictions. They build on lessons drawn from the issues that contributed to the massive corporate collapses in the United States and Europe during the 2008-2009 Global Financial Crisis.

As a G20 member country, China is expected to direct its policymakers and regulators to the 2015 G20/OECD CG Principles for adaptation and guidance when they prepare for a revision of the PRC Corporate Governance Code in the future.[306] The issue became more urgent in August 2015 with the plunge of China's stock market by the biggest margin since its largest one-day loss on 27 February 2007,[307] which occurred around the same time as the adoption of the 2015 G20/OECD CG Principles by the OECD Council in July 2015 and their endorsement by the G20 countries in September 2015.

The direct legal transplants of the 2004 OECD CG Principles into China through the PRC Corporate Governance Code and CRSC's self-assessment of China's

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304 OECD, above n 303, at 13 to 17.

305 Ibid, at 19 to 29.

306 CSRC "CSRC Hosts Corporate Governance Seminar 01-09-2016" (2016): CSRC and the China Association for Public Companies jointly hosted an international corporate governance conference from 31 August to 1 September 2016 to discuss the revision of the PRC Corporate Governance Code with experts from around the globe. Available at: www.csrc.gov.cn/pub/csrc_en/about/newsfacts/PressConference/201609/t20160901_302902.html.

307 Dong Tongjian and Yu Bing "China's stock market suffers biggest one-day fall since 2007" (The New Zealand Herald, 24 August 2015): www.nzherald.co.nz/business/news/article.cfm?c_id=3&objectid=11502226.

corporate governance systems will be discussed in Section F below. The question is whether transplants from other jurisdictions will be carried out in form but not in substance, as has often been the case in the past. Not surprisingly, China will find its own way of employing the same tools for promoting its political and/or economic agendas. For instance, reforms aligned to international standards will likely be introduced to win public support and maintain the sustainability and stability of its stock market and economy, and in turn the one-party rule.

4 Independent Directors Guidelines

Since the rise of takeover activities undertaken by the developed economies in the 1980s, policymakers in the West have turned to independent directors as an important element of legal and policy reform in the corporate governance arena.[308] In the United States, although the New York Stock Exchange (**NYSE**) has only required a majority of independent directors on the board of directors of listed companies since 2004, insider-dominated boards have been rare for years.[309] As at 2001, around 75% of the NYSE-listed companies had already attained such majorities.[310]

In the wake of Enron and other corporate scandals, listed companies were mandated under the Sarbanes-Oxley Act 2002[311] to establish audit committees comprised of independent directors, of which at least one member must be a financial expert.[312] Similarly, the United Kingdom's own spate of corporate scandals led to efforts to step up the role of the outside and non-executive directors under the Combined Code on Corporate Governance 2003.[313] The Combined Code on Corporate Governance 2003 embraced insights from earlier reports and studies on the subject through the 1990s and early 2000s.

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308 Donald Clarke, above n 90, at 127.

309 Sanjai Bhagat and Bernard Black "The Uncertain Relationship Between Board Composition and Firm Performance" (1999) 54 Bus Law 921, at 921

310 Donald Clarke, above n 90, at 128.

311 Sarbanes-Oxley Act 2002, Pub L107-204, 116 Stat 745.

312 John Armour and Joseph A McCahery "Introduction" in John Armour and Joseph A McCahery *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Hart Publishing, 2006), at 2.

313 Ibid, at 3. See also Donald Clarke, above n 90, at 128.

The scandal-driven focus in the United States and Europe on the outside and independent directors did not go unnoticed by the Chinese policymakers. As a matter of fact, they were half a step ahead having the Independent Directors Guidelines promulgated in August 2001, possibly due to the fact that they were troubled by similar corporate scandals to those described above.

The Independent Directors Guidelines aimed to eliminate the dominant managerial powers of the boards of directors in Chinese listed companies and required at least one-third of the boards of these listed companies to be independent directors by 30 June 2003. Not only did the Independent Directors Guidelines represent a rather decisive measure taken by the CSRC to regulate internal corporate governance through the institution of independent directors, the guidelines were also portrayed as a borrowing or a legal transplant from the United States its corporate governance law and practice.[314] However, if China did borrow or transplant this institution of independent directors from the United States, it is no more than a term only (and hence, a notion in form but not in substance again), because independent directors appear to be as new an institution in the United States as they are in China.[315]

The following section E will present an overview of China's stock market and its development and discuss the lingering issues with China's corporate governance regime from the lens of Western commentators. Section F below will then present an overview of the Chinese Government's argument at great lengths in an attempt to rebut the western commentators' contentions by asserting that China's corporate governance system is aligning with international "good" (if not the best) practices that the OECD has been advocating and promoting since 2004.

E Overview of China's Stock Market and Corporate Governance Regime

1 China's Stock Market

China's stock market became operative in late 1990. There are two stock exchanges: the Shanghai Stock Exchange (**SHSE**) and the Shenzhen Stock Exchange (**SZSE**), both established in 1990. Like the NYSE, China's two stock exchanges are, to a certain extent, self-regulatory organisations. The CRSC was

314 Donald Clarke, above n 90, at 129.

315 Donald Clarke, above n 248, at 14.

established in October 1992 with authority from the State Council to regulate and supervise the stock market in China. Headquartered in Beijing, the CSRC comprises 21 functional departments and four specialised units. It also has 38 regional offices across the country and supervises 19 affiliated institutions.[316]

In terms of market growth, there were 1,088[317] companies listed on its two stock exchanges in 2000 with a total market capitalisation of over RMB 4.8 trillion. This was a huge increase from 14 listed companies in 1991[318]. By 2014, the number of listed companies in China has risen to 2,613 and market capitalisation has soared to around RMB¥37.25 trillion, ranking second globally behind the United States.[319]

Despite this rapid growth, the Chinese stock market has a number of unique institutional features that are different from its counterparts in the West. This can be construed as another example of its institutional transplants being in form rather than in substance.[320] In order to preserve the socialist structure in the Chinese economy, the SOEs, for instance, issued a significant proportion of shares to the State when they went public. The shares held by the government and/or government agencies were respectively called state and legal person shares. Before 2005, none of these two types of shares were tradable in the stock market. Thus, the shares of listed companies in China started off from being divided into two categories, namely tradable and non-tradable shares, because the State intended to maintain control of most of the listed companies. [321]

Tradable shares are divided into several categories – namely, A-shares, B-shares, H-shares and N-shares. A-shares are traded in RMB on both SHSE and SZSE and were only available to domestic investors until 23 May 2003 when A-shares were made available to Qualified Foreign Institutional Investors (**QFII**) so as to enhance the strength of institutional investors in the market and to honour China's commitments made under the WTO entry agreement. Thereafter, UBS and

316 CSRC "China Securities Regulatory Commission Annual Report 2014" (2014) [**CSRC Annual Report 2014**]: www.csrc.gov.cn.

317 CSRC Annual Report 2012, above n 270, at 151.

318 Tam, above n 195, at 306.

319 CSRC Annual Report 2014, above n 316, at 11 (English version).

320 Young and others, above n 252, at 199.

321 Cheung and others, above n 189, at 100.

Nomura Securities became the first two QFIIs to trade in China's A-share market.[322]

B-shares are traded in US dollars on the SHSE and in Hong Kong dollars on the SZSE. Prior to 20 February 2001, B-shares were only available to non-residents or investors from outside mainland China. Since then, domestic investors have been allowed to invest in B-shares. [323] H-shares refer to the shares of mainland Chinese companies listed on the Hong Kong Stock Exchange (**HKSE**). N-shares are the shares of mainland Chinese companies listed on the US stock market in the form of American Depository Receipts (**ADRs**).[324] Accordingly, further crossed listed shares are known as S-shares (if listed in Singapore) and L-shares (London).

Prior to the non-tradable share reform in April 2005, state shares could only be transferred privately to other government agencies, legal entities or foreign investing firms, subject to State approval. In reality, non-tradable shares were often transferred through private negotiations and sales (without enlisting proper and professional valuation). Large or controlling shareholders holding non-tradable shares were able to divert funds and wealth from the listed companies.

The trends worked to the detriment of the stock market because it created a split-stock structure in the market and led to discrepancies in the pricing mechanism which in turn adversely affected the stock market's price discovery process and restricted mergers and acquisitions activities in the market. In order to curb these problems and protect the stock market, the government began the non-tradable share reform in April 2005. The CSRC introduced a compensation scheme to substantially slow down the transfer of non-tradable shares and restrict the number of such shares to be transferred at different 12 to 24-month intervals.[325]

As non-tradable shares are gradually becoming tradable, it was anticipated that this should result in improvement of corporate governance of listed companies and capital liquidity. These would, in turn, bring along positive returns for the stock market in the long run. Non-tradable shares have been called ‘restricted shares’ since 2005 in anticipation of their eventually becoming tradable shares. By the end

322 Jingjing Yang, Jing Chi and Martin Young “A review of corporate governance in China” (2011) 25(1) Asian-Pacific Economic Literature 15, at 16.

323 Ibid.

324 Cheung and others, above n 189, at 100.

325 Yang, Chi and Young, above n 322, at 17-18.

of 2007, it was reported that more than half of the listed SOEs had put in place a set plan and timetable to gradually convert all non-tradable shares to tradable shares. By 2012, the majority of shares are tradable in more than half of those listed firms.[326] It is hence imperative for China to continue with, and actively enhance, its law reforms to promote an orderly stock market by introducing and improving mechanisms which hold listed companies' controllers and managers accountable.

2 Issues with China's Corporate Governance

An overview of China's corporate governance system through the development of its legal framework and stock market demonstrates that China has taken a top-down legalistic approach to develop its corporate governance out of necessity to facilitate its economic reforms by way of a piecemeal transplantation of basic structures from its Western counterparts.[327] The trajectory of economic development in China appears to suggest growth first, which is followed by law reforms to plug loopholes that are impeding growth and then there is further growth.

In sum, China's reform style is one of "gradualism" or "trial-and-error". It appears to have adopted a relatively prudent approach to transform a centrally-planned economy into a market economy which is an unprecedented project.[328] The course of its development has been "growth→reform→law→further-growth→further-reform→further-law".

Chinese policymakers and regulators also appear to be eager to learn from, and introduce, proven foreign experience. However, they are unsure which system(s) would suit them well, hence, brought about numerous "in-form-not-in-substance" transplants to suit the Chinese context. In other words, one may argue that those legal transplants are strictly speaking adapted and implanted with Chinese characteristics to suit the Chinese context. The development of a corporate

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326 Fuxiu Jiang and Kenneth A Kim "Corporate governance in China: A modern perspective" (2015) 32 Journal of Corporate Finance 190-216.

327 Tam, above n 181, at 53.

328 Peter Nolan and Robert F Ash, "China's Economy on the Eve of Reform" (1995) 144 The China Quarterly 980, at 997-998, in which Nolan and Ash concluded that China's success stemmed from its refusal to adopt Russia's 'transition orthodoxy' policies of political reform and 'shock therapy' for subsequent economic change, thereby allowing gradual development of market forces and facilitating fiscal stability for China.

governance regime suitable to the Chinese situation therefore remains to be further refined.[329]

From the discussions above, it can be noted that various researchers and scholars who have critiqued China's corporate governance regime and come to almost always "convergent" conclusions that China's corporate governance system does not work as effectively as its western counterparts. In other words, the legal transplants do not take root or implant well in China's corporate governance systems. Major issues adversely affecting China's stock market and corporate governance during the first two decades following the opening of China's stock market in late 1990 may be summarised as follows: (1) concentrated ownership structure, (2) shareholders' issues, (3) undesirable related-party transactions, (4) weak board independence, and (5) ineffective board of supervisors.

(1) Concentrated ownership structure

China has been having great difficulties in attaining separation of government and enterprise.[330] Despite the on-going reforms and the efforts made to transplant the OECD practices by way of introduction of various laws, rules and regulations as discussed in Sections D above, majority government ownership of enterprises with concentrated ownership still dominate. The State continues to control the majority of SOE listed companies, directly or indirectly. It is often uncertain who represents the State as a shareholder in the listed companies. This has led to problems such as insider control in listed companies. Although the Chinese securities regulators have attempted to overhaul insider-controlled boards by requiring listed companies to have independent directors taking up at least one third of the positions in the board, majority power remains extremely concentrated.[331]

To add to the woes, enforcement under such a concentrated ownership regime is adversely affected by the state influence. The CSRC as the major enforcement agency for the State Council is susceptible to political influence, local protectionism and other forms of undue influence. As the major or controlling shareholder of most listed companies, the government is reluctant to enforce the law or impose

329 Idea inspired by Shan and Round, above n 228, at 1331.

330 Peter Hugh Nolan "China and the Global Business Revolution" (2002) 26(1) Cambridge Journal of Economics 119.

331 Feinerman, above n 229, at 593-594.

penalties lest such measures and sanctions will lead to adverse impact on the company's performance.[332] There is thus a serious misalignment of interests in that there is a direct conflict of interest between the State as the major shareholder on one part and the minority shareholder on the other. The former's interest lies in maintaining social stability and state assets as well as other self-interest, while the latter is concerned about their economic welfare.[333]

Jurisdictions in the West recognise a duty of fair dealing by majority shareholders in relation to minority shareholders. In fact, it is one of the six themes of good corporate governance principles stipulated by the OECD.[334] Fiduciary duties of controlling shareholders are nowhere to be seen in the relevant Chinese law, and their liabilities for losses incurred or suffered by minority shareholders are not obvious.[335] A duty of diligence (*qinmian*) owed to the company is added to Article 148 of the Company Law 2005 (now Article 147 under the Company Law following the enactment of the 2013 revision), however, there is no mention whether and how this can be enforced. Also, no duty of care can be found in the entire piece of legislation.[336] Until regulations are introduced in China to spell out the liabilities, penalties and procedures for invoking them as well as the authorities of the courts to deal with such cases, undesirable dealings such as abuses by controlling shareholders, exploitation of listed companies as guarantors for bank loans and sale of assets at unfair prices without proper appraisal by professional assessors or evaluators will continue to happen.[337]

Comparison of the Chinese market with the developed and mature markets elsewhere will point to the need for more reform of the state asset management system to broaden ownership structures and transform the enterprise techniques employed by the government from administrative fiat to contract. Introduction of easier prospects for the listing of non-state-controlled enterprises and better and

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332 Mabel Tsui “Corporate governance in China” (2010): www.epublications.bond.edu.au.

333 Noelle Trifiro "China's Financial Reporting Standards: Will Corporate Governance Induce Compliance in Listed Companies?" (2007) 16 Tulane Journal of International and Comparative Law 271, at 288.

334 2004 OECD CG Principles, above n 282, at 20.

335 Feinerman, above n 229, at 597.

336 Donald Clarke, above n 248, at 16-17.

337 Feinerman, above n 229, at 597-598.

clearer regulations to facilitate mergers and acquisitions will prove to be a good move.[338]

(2) Shareholders' issues

The Company Law provides the shareholders with the following powers at the shareholders assembly: (1) to decide on the company's operational policies and investment plans; (2) to elect or replace directors and supervisors and to determine their remuneration; (3) to examine and approve the board of directors' reports; (4) to examine and approve the board of supervisors' reports; (5) to examine and approve the company's annual financial budget plan and final accounts plan; (6) to examine and approve the company's plans for profit distribution and for making up losses; (7) to adopt resolutions on the increase or reduction of the company's registered capital; (8) to adopt resolutions on corporate bonds issuance; (9) to adopt resolutions on the company's merger, division, dissolution, liquidation or transformation; (10) to amend the company's articles of association.[339] This is another example of an "in-form-not-in-substance" corporate governance transplant in that the shareholders' powers – a concept borrowed from the West – have been modified with unique Chinese governance characteristics when implanted into Chinese corporate law.

In the United States, some of these powers, for instance, the powers to approve the company's profit distribution plans and to decide on the directors' remuneration are reserved for the board of directors rather than for the shareholders.[340] On the other side of the Pacific, in New Zealand,[341] all the powers of management of a company, public or private, are vested with the board of directors.[342] Only the powers to (a) adopt, alter or revoke the company's constitution; (b) approve a major

338 Feinerman, above n 229, at 597.

339 Company Law 2005, above n 184, arts 38 (for companies with limited liability) and 100 (for companies limited by shares) (Author's note: that is, arts 37 (for companies with limited liability) and 99 (for companies limited by shares)).

340 Schipani and Liu, above n 189, at 34.

341 New Zealand is ranked first of 190 economies by the World Bank in its "Doing Business Report 2019" for ease of doing business for the third year in a row: https://www.companiesoffice.govt.nz/insights-and-articles/nz-takes-top-spot-for-ease-of-doing-business/ [accessed 8 December 2018].

342 Companies Act 1993 (NZ), s 128.

transaction, or an amalgamation, of the company; and (c) put the company into liquidation are reserved to the shareholders.[343]

The rationale behind this institutional arrangement in China is that the shareholders are considered to be the ultimate source of authority. This means the powers enjoyed by the board of directors and board of supervisors are derived from the shareholders rather than from the legislature. This corporate governance philosophy resembles the political governance philosophy expressed by the Chinese Constitution.[344] The National People's Congress (NPC), China's highest ruling body, is an example. The NPC is the supreme power centre in the Chinese political arena and all other state bodies derive their powers from the NPC under the Constitution.[345] Given the similarities between the governance structures in the political states and those in the business enterprises, it was understandable for the Chinese legislature to extend the rationale of the political governance regime into corporate governance, hence the comparison between the shareholders' assemblies to the NPC.[346] This is another significant example of China's *modus operandi* of taking form over substance vis-à-vis its treatment of corporate governance transplants from the West.

The question remains whether certain powers, in particular, the substantial managerial powers, should be transferred to the board of directors as it may be sensible to consider the corporate governance arrangements in other legal systems and perhaps reduce some of the powers currently enjoyed or possessed

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343 Companies Act 1993 (NZ), s 106.

344 The Constitution of the People's Republic of China (adopted at the Fifth Session of the Fifth National People's Congress and promulgated for implementation by the Announcement of the National People's Congress on 4 December 1982, amended in accordance with the Amendments to the Constitution of the People's Republic of China adopted respectively at the First Session of the Seventh National People's Congress on 12 April 1988, the First Session of the Eighth National People's Congress on 29 March 1993, the Second Session of the Ninth National People's Congress on March 15, 1999, the Second Session of the Tenth National People's Congress on 14 March 2004, and the First Session of the Thirteenth National People's Congress on 11 March 2018) [**Constitution**]: http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=311950.

345 Ibid, art 57.

346 Schipani and Liu, above n 189, at 35.

by the shareholders so as to harmonise the Chinese corporate governance system with the global investment requirements.[347]

The Company Law requires every company with limited liability to hold regular meetings on schedule as specified by the company's articles of association and companies limited by shares to convene the shareholders' annual general assembly once a year.[348] While every shareholder is entitled to attend a regular meeting, due to the concentrated ownership structure, most attendees are state representatives or representatives of legal persons related or affiliated to the State.[349] A lot of the minority shareholders will simply opt not to turn up for such meetings. Consequently, large shareholders are able to completely control the meetings. The overall quality of these meetings can be rather unsatisfactory as the minority shareholders are probably unable to really exercise their statutory powers at such shareholders' assemblies. The Company Law confers specific functions to the shareholders assembly, however, important decisions such as the determination of the directors' compensation and mergers and acquisitions, are delegated by the large-state-owned-or-controlled-shareholders to the hands of the board of directors or the board chairman. This leads to impairment of the decision-making rights of the minority shareholders.[350]

Another weakness in the shareholder protection regime is the fact that the Supreme People's Court allows the people's courts to hear only a very limited class of securities-related claims as class actions.[351] The remedy the Company Law provides to minority shareholders is the right to bring a lawsuit to a people's court to curb the continuation of unlawful conduct by directors, supervisors or senior

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347 Schipani and Liu, above n 189, at 35.

348 Company Law 2005, above n 184, arts 40 (for companies with limited liability) and 101 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 39 (for companies with limited liability) and 100 (for companies limited by shares)).

349 Feinerman, above n 229, at 599.

350 Gang Wei and Mingzhai Geng "Ownership structure and corporate governance in China: some current issues" (2008) 34(12) Managerial Finance 934, at 942-943.

351 Binglan Xu "Securities legislation protects investors" *China Daily* (Beijing, 28 February 2005). According to Xu, the Supreme People's Court promulgated a set of guidelines in 1993 on class actions which restricted local courts to only accepting cases regarding fabricated statements, and virtually ruled out investors' chances of taking listed companies to court for other misdemeanours.

management personnel.[352] However, there do not appear to be any relevant regulations or implementation rules to spell out the liabilities, penalties or procedures should the shareholder choose to invoke such a right and pursue the parties concerned. The Securities Law is not specific as to whether and when investors or shareholders may take civil action against directors and officers for false or negligent disclosures which give rise to losses being suffered by the companies they serve.[353] Hence, such a remedy is simply a "lame duck" and unable to render the minority shareholders much assistance. This is mainly because supporting regulations are yet to be promulgated to specify the relevant penalties or liabilities under the Company Law. Such lapses have been common in China.

The dilemma in Chinese company law, as in corporate law across the world, is that a majority shareholder or a majority of the shareholders have the power to control a company. Corporate law has long recognised the need to counter this right so that majority shareholders may not exercise their control to gain disproportionate benefits at the expense of the company or non-controlling shareholders.[354] By the same token, opportunistic behaviour by the minority shareholders may have to be contained or monitored as well. It then boils down to the need for corporate law to strike a sensible balance between the control rights of majority shareholders and the protection of minority shareholders from abuse.[355]

As discussed in Section D 1 above, the 2005 revision of the Company Law (or Company Law 2005) has made some good progress in this direction, however, still falls short of protecting minority shareholders in certain crucial respects. This is partly the result of a relatively brief corporate history: companies have only been established following the promulgation of the first Company Law in 1993; most listed companies' shares are highly concentrated and have controlling shareholder(s) directly or indirectly related to the State; the board of directors is controlled by the majority shareholder(s); and market constraints on controlling shareholders are either non-existent or weak.

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352 Company Law 2005, above n 184, arts 151 and 152.

353 Feinerman, above n 229, at 599.

354 James Cox, Thomas Hazen and F Hodge O'Neal *Corporations* (Aspen Law & Business, New York, 1997), at 250-258.

355 Bernard Black and Reinier Kraakman "A self-enforcing model of corporate law" (1996) 109(8) Harvard Law Review 1911.

More importantly, the managers, directors and controlling shareholders remain sheltered with the power of the State as in most cases these companies are corporatised SOEs.[356] These features will have to change if reformers want corporate governance law to have some 'teeth' to solve existing problems and produce a transformational effect in China.

As discussed in Sections D 1 above, the Company Law 2005 does provide improved provisions for shareholders' meetings (including entitlement of shareholder(s) holding 10% or more voting rights to convene or preside over an interim meeting should the board of directors and the board of supervisors fail to do so),[357] regulation of related-party transactions, remedies for minority shareholders if abused, provision of minority shareholders' rights to information, reinforcement of powers of board of supervisors or other supervisory authorities. As an interim meeting convened by other shareholders may adversely affect the majority shareholders, articles 41 and 102 of the Company Law serve as a "demand provision" for the board of directors (quite likely to be one that has most of its members chosen by the majority shareholders in the first instance) to convene shareholders' meetings or else face the prospect that others might do so in their stead.

(3) Undesirable related-party transactions

Majority shareholders are typically powerful in a Chinese company whilst individual minority shareholders are terribly weak to the extent that they are incapable of countering the majority or controlling shareholders' influence. Related-party transactions between the controlling shareholders and the listed company do usually work to the detriment of the minority shareholders. China's corporate governance is potentially relatively ineffective in its protection of minority shareholders' rights.[358]

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356 Feinerman, above n 229, at 600.

357 Company Law 2005, above n 184, arts 41 (for companies with limited liability) and 102 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 40 (for companies with limited liability) and 101 (for companies limited by shares)).

358 Schipani and Liu, above n 189, at 15, and Tam, above n 181; see also Shenshi Mei "The Corporate Governance of Listed Companies in China: Some Problems and Solutions" (2005) Corporate governance: challenges for China 422, and Laura Cha "The future of China's capital markets and the role of corporate governance" (Speech delivered at the China Business Summit, Beijing,18 April 2001).

Evidence has been gathered by some scholars that increasing number of Chinese listed companies have been defrauded by their controlling shareholders directly or indirectly as a result of shoddy related-party transactions and expropriations, affecting the interests of minority shareholders. The absence of strong regulations mandating compulsory disclosure of related-party transactions in China has given many listed companies and their controlling shareholders incentives to engage in potentially damaging practices, for example, tunnelling, loan guarantees and /or earning management.[359]

The way to protect minority shareholders' rights will have to be the implementation of rules regarding information disclosure of related-party transactions. Whilst good corporate governance will demand close support by the board of directors and board of supervisors vis-à-vis disclosure of related-party transactions by the company, such disclosure may prove to be sensitive to those board members who have directly or indirectly entered into such transactions and relationships with the company.[360] In other words, a balance has to be tilted when executing good corporate governance practice to ensure protection of shareholders' rights by way of appropriate information disclosure on one hand and defending directors' and/or shareholders' rights to confidentiality on the other.

The PRC Corporate Governance Code provides three requirements regarding related-party transactions. First, written agreements shall be entered into for related-party transactions between a listed company and its connected parties. Such agreements shall observe the principles of equality, voluntariness and provision of fair value of compensation.[361] Second, efficient measures shall be adopted by a listed company to prevent its connected parties from interfering with the company's operation and/or damaging the company's interests by way of monopolising the sale and purchase channels. The company shall thus fully disclose the basis for pricing for the related-party transactions.[362] Third, the company shall adopt effective measures to prevent its shareholders and their

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359 Yuan G Shan and Dennis W Taylor “Related-Party Disclosures in the Two-Tier Board System in China: Influences of Ownership Structure and Board Composition” (2008) 4(1) Corporate Board: Role, Duties and Composition 37; see also Mei, above n 358.

360 Ibid, Shan and Taylor.

361 PRC Corporate Governance Code, above n 209, art 12.

362 Ibid, art 13.

affiliates from misappropriating or transferring the capital, assets or other resources of the company through various means.[363]

That said, the PRC Corporate Governance Code is merely a guideline for good corporate governance practice. There is no provision under the PRC Corporate Governance Code which sets out the consequences and ramifications for breach of any of the provisions therein nor are the requirements therein being strict enough to require achievement of a high level of disclosure such as a "full and frank" disclosure that some of China's Western counterparts may have to achieve.

Given the contents of the company's articles of association are normally determined by the controlling shareholders (which can be influenced by the officials of their supervising state agencies which may have a vested interest in so doing), it is possible that the companies may 'opt out'[364] or restrict the extent of information disclosure regarding the related-party transactions, so that the majority shareholders can veto a decision in favour of certain disclosure requirements that they may not like or arrangements that they consider inappropriate or too sensitive for them to even embark on considering disclosure lest there may be adverse impact on the market or otherwise on the state assets.

(4) Weak board independence

China's corporate governance is affected by the weak independent board of directors in listed companies. The major problems of independence lie with the directors and managers of listed companies. Chinese directors are normally insulated from responsibility for their company's economic performance. Their remuneration is not linked to the company's performance, nor can they be dismissed prior to the expiry of their terms of office without "cause", albeit what constitutes "cause" in this context is not defined. The Company Law and other laws and regulations do not define nor explicitly set out the concepts of directors' duties of care and good faith and generally fiduciary duties or create any enforcement mechanisms.[365] Clarke opines that "fiduciary duties" are not norms that exist in China. There is no dynamic equivalent in Chinese to this concept which is largely an Anglo-American norm or institution practised in the common law jurisdictions.

363 PRC Corporate Governance Code, above n 209, art 14.

364 Idea borrowed from or inspired by Feinerman, above n 229, at 604.

365 Ibid, at 598.

Hence, no such borrowing had occurred when the Chinese lawmakers drafted the Company Law.[366]

Compared with practices in other markets, the Chinese boards of directors have less decision-making power within the current legal framework, whereas the Chinese government ministries, commissions and regulatory authorities, such as the CSRC and the like, have ample decision-making power. As a matter of fact, the range of decisions which must be made by the shareholders' assembly is exceptionally huge by comparison with the corporate laws of China's Anglo-American counterparts. Consequently, the Chinese board of directors is completely overshadowed by the shareholders assembly. The discretion left to the board of directors is substantially diminished.[367] Another note-worthy point is the Company Law does not stipulate any disclosure obligation on the part of the directors nor will they have to bear any liabilities for failing to perform their obligations.

As discussed in Section D 4 above, the CSRC promulgated the Independent Directors Guidelines in August 2001 which require one-third of the board directors to be independent. Following the enactment of the Independent Directors Guidelines, the CSRC has promulgated a series of provisions to confer independent directors with special powers to convene shareholders' assembly, invite independent auditors, recruit or dismiss accounting firms, offer independent financial reports, review proposed related-party transactions reports before submission to the board of directors for discussions. All these measures are designed to assist independent directors in executing their duties and responsibilities in a more effective manner so as to achieve greater accountability, transparency and fairness for the company.[368]

Despite all the efforts on the part of the CSRC, the reality is most listed companies only fulfil the minimum regulatory requirements. Most of them have no or inadequate systems for the installation of board committees, nor would they plan to establish them. Those companies that do not have board committees may have an investment or finance committee, an audit committee, a financial management committee or a strategy committee. After all, board committees do not appear to

366 Donald Clarke, above n 248, at 14-16.

367 Schipani and Liu, above n 189, at 33-35, and Feinerman, above n 229, at 598.

368 Shan and Round, above n 228, at 1337-1338.

be on anyone's priority list. Moreover, most listed companies have yet to develop a habit of disclosing information that are not mandatorily required to be disclosed by law. For instance, a few will be willing to open their books to the public at large in terms of their directors' nomination procedures or otherwise their corporate governance conditions. The development of independent committees hosted by independent directors with supervisory and auditing functions is still in its infancy.[369] Hence, it may be difficult to imagine that the Independent Directors Guidelines will bring along significant impact on the way Chinese listed companies are run[370] or otherwise give rise to any other significant effect on China's corporate governance system in the near future.

(5) Ineffective board of supervisors

As discussed in Section D 4 above, a board of supervisors is officially conferred with powers which are supervisory and independent under the Company Law. A Chinese board of supervisors is, however, often described as having a "symbolic rather than practical function".[371] Unlike its German counterpart, which has powers to appoint and dismiss (subject to conditions) members of the management board,[372] Chinese boards of supervisors play no effective governance role. Their effectiveness is undermined by their composition. A board of supervisors in China is small in size and is usually comprised of members from labour unions, local party members (possibly, government political officials), non-functional trade union members or leaders, friends of board members elected by the shareholders and the like.

Although the Chinese boards of supervisors have investigative powers and may request for correction or rectification from the directors should they find any errors, the Company Law does not provide the board of supervisors with any powers or

369 Feinerman, above n 229, at 598.

370 Donald Clarke, above n 90, at 216-217.

371 Angus Young "Conceptualising a Chinese corporate governance framework: tensions between tradition, ideologies and modernity" (2009) 20(7) International Company and Commercial Law Review 235, at 239.

372 German Stock Corporation Act 1965, above n 249: a German board of supervisors has power to revoke its appointment of a management board member if it is shown or proven that he is in breach of his duties, unable to manage the company or where there has been a vote of no confidence by the shareholders.

rights to impose any sanctions or penalties or otherwise take any action against board members or managers should serious abnormalities in terms of the company's operation be found or where any board members or company managers refuse to cooperate or rectify a wrongful act. [373]

The key problems of the board of supervisors in China can be summarised as follows: first, the management not only appoints the supervisors, but also determine their remuneration. Thus, there is not even an ounce of independence from the management. Second, the supervisors are not involved in the selection or election of the directors or the managers, nor have they been given any means to discipline them. Third, given the comparatively dominant roles that the board of directors and the senior managers play in the company, members of the board of supervisors are normally treated as a 'rubber stamp' or 'censored watchdog' who should only be singing the praises of the management installed by the controlling shareholders or other government agencies depending on the company's ownership structure. Fourth, the board of supervisors has usually limited access to corporate information, hence, it is virtually impossible for it to make any informed proposals or recommendations. Fifth, most of the supervisors are insiders as opposed to outsiders as far as the management is concerned because they either work directly for, or have close connections with, the company, directors, managers or shareholders. Consequently, it is hardly surprising to find that there is a fundamental want of independence.[374]

In sum, it would be fair to say that the board of supervisors in China is not an office which will give rise to any impact even though it was supposed to be designed to improve corporate governance in China.

The following section discusses China's self-assessment of their transplants and adaptations of the OECD CG principles into the PRC Corporate Governance Code and the relevant corporate governance law and practices.

373 Tsui, above n 332, at 11.

374 Shan and Round, above n 228, at 1334-1336.

F OECD-China Policy Dialogue on Corporate Governance – Self-Assessment by China's CSRC

1 Introduction

In December 2010, China launched a report entitled "Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission"[375] (**CSRC Report**) at the OECD Asia Roundtable on Corporate Governance hosted by the China Securities Regulatory Commission (**CSRC**) and the Shanghai and Shenzhen Stock Exchanges in Shanghai to mark the 20th anniversary of the establishment of the Chinese capital market and the continuous bilateral cooperation and collaboration between China and the OECD on the OECD-China Policy Dialogue on Corporate Governance which began in 2004.[376] The CSRC Report looks at the institutional framework of corporate governance in China through the prism of the 2004 OECD Principles of Corporate Governance and is hailed as a milestone of the ongoing collaboration between the OECD and China under the precinct of the OECD-China Policy Dialogue on Corporate Governance. This report assesses a multitude of laws, rules and regulations and sheds light on the improvement of Chinese corporate governance since the installation of the Chinese stock market in 1990 and China's ambition vis-à-vis its future reform efforts. It is the product of the efforts made by the CSRC and other relevant PRC ministries and agencies, following a significant process of extensive consultation and inter-agency preparation in conjunction with the OECD Secretariat and the national representatives of the OECD Corporate Governance Committee through workshops and policy discussions. The OECD is of the view that the CSRC Report shows China's commitment and readiness to continue the modernisation and improvement of its capital markets and corporate governance practices. It is impressed with the breadth and depth of the legal and regulatory framework in the area of corporate governance that China has established.[377]

That said, potential conflict of interest between majority and minority shareholders remains a core corporate governance issue due to China's concentrated ownership structure in its SOEs. As the corporate governance framework in China is still

375 CSRC Report (OECD publication), above n 96.

376 Ibid, at 11.

377 Ibid, at 3.

developing and adapting to the process of its own SOEs' reforms, private enterprises' growth and economic transformation, formal legal and regulatory framework and other informal institutions should continue to play an essential role for building a competitive, sustainable and efficient capital market.

The CSRC Report addresses China's corporate governance issues under its corporate governance system established based on the *2004 OECD Principles of Corporate Governance* as the same has been, as discussed in Sections C 3 and D 3 above, a direct legal transplant (albeit tweaked with Chinese characteristics in practice, where appropriate) from the OECD into China and adopted by the CSRC and the National Economic and Trade Commission as the Code of Corporate Governance for Listed Companies in China in early 2002. It looks at issues of equitable treatment of shareholders, mechanisms for shareholders' redress and prevention of abusive related party transactions, improvement of information disclosure and market transparency, dual board system, and composition, duties and selection process of board of directors, supervisory board and senior management.[378]

From China's perspective, its stock market started from scratch and experienced an exponential and unprecedented growth, playing an important role in its political economy development. From the OECD's perspective, China's self-assessment concluded in December 2010, was an essential and timely exercise to ensure China's corporate governance laws and regulations will be developing and are transplanted and implanted in China into good corporate practice.[379] It is noted from comments from both parties in the CSRC Report that the policy dialogue between China, the OECD Corporate Governance Committee and its member countries will continue as a long-term commitment by the parties concerned. After all, any laws and regulations on paper must be effectively executed and implemented in practice in order to serve their real purposes and make a difference.

Like all other countries across the globe, China faces the continuous challenges of its corporate governance laws and regulations being transplanted and translated into good corporate practice in order to enable sustainability of an ever-growing economy. It is expected from China's perspective that a sustainable economy will

[378] CSRC Report (OECD publication), above n 96, at 3 and 4.

[379] Ibid, at 4.

in turn maintain a huge political machinery, irrespective of whether China treats legal transplants of western corporate governance institutions and systems as a means for the achievement of other agendas which will be discussed in Chapter IV below as a focal point of this thesis.

The OECD CG Principles comprise six themes: (I) promoting transparent and efficient markets which are consistent with the rule of law and the division of responsibilities among different supervisory, regulatory and enforcement authorities; (II) protecting and facilitating exercise of shareholders' rights; (III) ensuring equitable treatment of all shareholders, canvassing both minority and foreign shareholders; (IV) recognising the rights of stakeholders as established by law; (V) ensuring timely and accurate disclosure of all material matters regarding the company; and (VI) ensuring effective monitoring of management by the board of directors, with board accountability to the company and the shareholders.[380]

The following sections examine China's self-assessment of its corporate governance system following closely the six themes of good corporate governance set out in the 2004 OECD CG Principles, namely (i) shareholders' rights; (ii) equitable treatment of shareholders; (iii) stakeholders' rights and corporate social responsibility; (iv) information disclosure; and (v) board and supervisory board's responsibility and supervision. Where applicable, the following sections also look beyond what the CRSC has covered in its report with a view to capture the more recent developments and transplantations. The examination of China's corporate governance system through its own lens should hopefully enable a better understanding of China's approach to legal transplantation and implantation of western corporate governance systems into its own corporate system and their impacts on company and investor behaviour.

2 Shareholders' Rights

China's company law theorists consider that there are two aspects of shareholders rights which are manifested in the Company Law – "self-benefit rights" and "co-benefit rights". "Self-benefit" rights refer to shareholders' rights to acquire economic benefits, for instance, right to distribution of dividends and residual assets, rights to share transfers and purchases. "Co-benefit" rights refer to shareholders' rights

[380] 2004 OECD CG Principles, above n 282.

to partake in a company's governance, decision-making, operation, management, supervision and control. As far as the Company Law is concerned, in China, shareholders' self-benefit rights include the rights to distribution of dividends and residual assets, to shares transfers and purchases. Shareholders' co-benefit rights include rights to (cumulative) vote, rights to shareholders' representative actions, convene shareholders' general meetings, proposal, enquiry and inspection rights, and to revoke or annul shareholders' and directors' decisions.[381]

Chinese companies which are overseas and domestically listed may issue "both-domestic-and-foreign-currency-denominated" shares respectively in mainland China and overseas. The Prerequisites Clauses of the Articles of Association of Companies Seeking a Listing outside the PRC (**Overseas Listing Prerequisite Clauses**) permits shareholders who hold shares in both overseas and domestically listed Chinese companies to be treated as shareholders of different categories.[382] The PRC Corporate Governance Code provides that a listed company must use its best endeavours (including employment of modern technology) to maximise shareholders' attendance of shareholders' meetings.[383] Indeed, the CSRC reported that they started promoting a network voting system as early as 2004.[384]

The CSRC Report confirms that the Company Law 2005 bestows considerable powers for shareholders (also discussed in Section E 2 (2) above) to vote on (a) amendments to its company's articles of association,[385] (b) authorisation of

381 CSRC Report (OECD publication), above n 96, at 29; and Company Law 2005, above n 184, arts 38 (for companies with limited liability) and 100 (for companies limited by shares) (Author's note: this is, Company Law 2013, arts 37 (for companies with limited liability) and 99 (for companies limited by shares).

382 The Prerequisite Clauses of the Articles of Association of Companies Seeking a Listing outside the People's Republic of China (issued by the Securities Office of the State Council and the State Economic Restructuring Commission on 19 September 1994) [**Overseas Listing Prerequisite Clauses**], art 85.

383 PRC Corporate Governance Code, above n 209 art 8.

384 CSRC Report (OECD publication), above n 96, at 32.

385 Company Law 2005, above n 184, art 104 (Author's note: that is, Company Law 2013, art 103): changes to the articles of association have to be adopted by a two-thirds majority at a general shareholders' meeting.

changes in capital,[386] (c) major transactions,[387] and (d) mergers, divisions, dissolution and changes to corporate form.[388] These were, according to CSRC, put in place to ensure that shareholders have rights to participate in, and be informed of, decisions concerning fundamental corporate changes[389] as required in Principle II of the 2004 OECD CG Principles

The Listing Rules of the Shanghai and Shenzhen Stock Exchanges require their listed companies to make available information necessary for shareholders to make reasonable judgments on matters to be discussed on designated websites. The CSRC reported that in practice, Chinese listed companies usually announce such information regarding their general shareholders' meetings in the media, including the internet.[390]

Articles 22 (right of action), 98 (enquiry right), 103 (right to propose resolutions) and 151 (right to require presence of directors, supervisors and executives at general shareholders' meetings) were included in the Company Law 2005[391] to address the requirements of shareholders' rights to ask the board questions as set out in Principle II of the 2004 OECD CG Principles. Article 29 of the Rules for the General Meetings of Shareholders of Listed Companies further provides that directors, supervisors and executives are obliged to provide explanations and clarifications to shareholders' enquiries at the shareholders' general meetings.[392] According to the CSRC, rules and procedures governing the acquisition of corporate control in listed companies have been set up in the

386 The Measures for the Administration of the Issuance of Securities by Listed Companies, art 41: sets out the scope of approval by the general shareholders' meeting regarding shares issue by listed companies.

387 Company Law 2005, above n 184, art 122 (Author's note: that is, Company Law 2013, art 121): acquisition and disposal of major assets within a year or provision of security exceeding 30% of a listed company's total assets have to be approved by a two-thirds majority at a general shareholders' meeting.

388 Ibid, arts 38 (for companies with limited liability) and 100 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 37 (for companies with limited liability) and 99 (for companies limited by shares)): these provisions confer the shareholders with all of the powers, amongst others, necessary to vote on matters set out in (a) to (d) which are required to be approved by a two-thirds majority at a general shareholders' meeting.

389 Ibid, art 103 (Author's note: that is, Company Law 2013, art 102).

390 CSRC Report (OECD publication), above n 96, at 34 and 35.

391 Author's note: that is, Company Law 2013, above n 184, arts 21, 97, 102 and 150 respectively.

392 CSRC Report (OECD publication), above n 96, at 35.

Securities Law and the relevant administrative measures to ensure corporate control in capital markets in China will function in an efficient and transparent manner as set out in Principle II of the 2004 OECD CG Principles.[393]

For instance, the Securities Law provides that an investor may purchase a listed company by tender, agreement or other lawful means.[394] Where an investor, individually or jointly with others, possesses 5% or more shares in a listed company through trading on the stock exchange must, within three days, submit a written report to the CSRC and the relevant stock exchange and notify the listed company and make a public announcement. The investor is not allowed to buy or sell the listed company's shares within the said 3-day period. Any investor who holds 5% or more shares singularly or jointly must report and make a public announcement for each 5% increase or decrease in his shareholding through securities purchase or sale at the stock exchange. The said investor may not purchase or sell any more shares in the listed company during the reporting period and within two days after the relevant report and announcement have been made.[395]

When an investor, through trading on the stock exchange, holds, individually or jointly with others, through an agreement or other arrangement(s), 30% or more of the shares issued by a listed company and plans to acquire more shares, this investor must make a tender offer to all shareholders for all or part of the company's shares as is required by law. The offer to purchase part of the shares must include an agreement to provide that where the amount of shares the shareholders commit to sell exceeds the offered amount to be purchased, the acquisition will be made by the purchaser proportionately.[396]

The Measures for the Administration of the Takeover of Listed Companies, promulgated by the CSRC in May 2006 (**Takeover Measures**),[397] include detailed procedures and information disclosure requirements for the tender offer. The

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393 CSRC Report (OECD publication), above n 96, at 36 to 38.

394 Securities Law, above n 185, art 85.

395 Ibid, art 86.

396 Ibid, art 88.

397 The Measures for the Administration of the Takeover of Listed Companies (deliberated and adopted at the 180th Chairmen's Executive Meeting of China Securities Regulatory Commission (CSRC) on 17 May 2006; promulgated on 31 July 2006 and took effect as of 1 September 2006) [**Takeover Measures**]: http://www.fdi.gov.cn/1800000121_39_4237_0_7.html.

Takeover Measures also provide for exemptions to facilitate the acquisition of a listed company. The acquiring party may apply for an exemption to the CSRC on making a tender offer if his acquisition conditions are in compliance or consistent with Article 62 (which sets out the circumstances in which the purchaser may apply to the CSRC for exemption from not increasing shares by means of a tender offer) and Article 63 (which sets out the circumstances in which the party concerned may apply to the CSRC for exemption from sending out a tender offer by summary procedures) of the Takeover Measures.[398]

The Administration Measures for Significant Asset Restructuring of Listed Companies (**Significant Asset Restructuring Measures**) [399] provides for mechanisms for information management, disclosure and trading suspension in cases of significant asset restructurings of listed companies.[400]

In sum, the shareholders or actual controllers of the listed company and relevant institutions and persons participating in the planning, negotiating and decision-making of a significant asset restructuring must make a timely and accurate report on the relevant information to the listed company to assist the listed company in making a disclosure in a timely, accurate and comprehensive manner. When the listed company becomes aware of price-sensitive information, it must apply to the stock exchange for trading suspension and information disclosure in a timely manner.[401]

The listed company or the relevant information disclosure obligors who fail to comply with disclosure obligations vis-à-vis a significant asset restructuring will be subject to orders for rectification or penalties pursuant to Article 193 of the Securities Law.[402]

The board directors, supervisors and senior management officers of listed companies who fail to perform their obligations of being honest, faithful, prudent

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398 Takeover Measures, above n 397, arts 62 and 63.

399 The Administration Measures for Significant Asset Restructuring of Listed Companies (adopted at the 224th Chairman's Meeting of the China Securities Regulatory Commission (CSRC) on 24 March 2008; promulgated on 16 April 2008 and became effective as of 18 May 2008 [**Significant Asset Restructuring Measures**]: http://www.csrc.gov.cn/pub/csrc_en/laws/overRule/Decrees/200910/t20091028_166904.html.

400 Ibid, arts 37 to 40.

401 Ibid, art 38.

402 Ibid, art 51.

and diligent[403] in a significant asset restructuring resulting in damages suffered by the listed companies out of the restructuring will be subject to orders for rectification and such regulatory measures as regulatory interview and caution. Warnings and/or fines will be carried out and criminal liabilities will be pursued in serious cases.[404]

The Listing Rules of the stock exchanges in Shanghai and Shenzhen have similar provisions on information management and disclosure in relation to acquisition and significant asset restructuring of companies listed in China.[405]

The Takeover Measures also address the management and board accountability issues vis-à-vis anti-takeover devices stipulated by Principle II of the 2004 OECD CG Principles. For instance, directors, supervisors and senior managers of the company under a takeover or an acquisition (**Target Company**) are required to assume the obligations of devotion and diligence[406] and treat the potential purchasers equally and fairly. The decisions and measures taken by the board of directors of the Target Company have to be conducive to maintaining the interests of the Target Company and its shareholders. The board must not abuse its authority by setting unnecessary or improper barriers to the takeover or acquisition, nor should it use the Target Company's resources to provide financial assistance in any form to the potential purchasers or damage the lawful rights and interests of the Target Company or its shareholders.[407]

The CSRC confirms that institutional investors in China mainly include securities investment funds, social security funds (administered by the National Council for the Social Security Fund), qualified foreign institutional investors, securities firms and insurance companies.[408] The CSRC has reported on statistics provided by

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403 Such obligations are akin to directors' and officers' duties to act with due diligence and in good faith to protect the corporate investors and stakeholders' interests under the common law jurisdictions in the West, however, as it is well recognised that there is no such concept or dynamic equivalent in Chinese, the author therefore refrains from jumping to conclude that they are equivalent concepts and from adopting the same terminologies.

404 Significant Asset Restructuring Measures, above n 399, art 52.

405 CSRC Report (OECD publication), above n 96, at 37.

406 See author's comment regarding directors' and officers' obligations, above n 403.

407 Takeover Measures, above n 397, art 8.

408 CSRC Report (OECD publication), above n 96, at 38 to 39.

Win.d[409] which indicate that the institutional investors held over 45% of the total market value of the freely floated A shares in the Chinese market as at the end of 2009. This shows the importance of institutional investors and the role they play in the Chinese market.

The PRC Corporate Governance Code does in fact specifically provide that institutional investors will play a role in the appointment of company directors, the compensation and supervision of management and the major decision-making processes.[410] According to the CSRC, securities institutional investors in China have been proactive in directly or indirectly partaking in the governance of listed companies in the following ways vis-à-vis their exercise of shareholders' rights:[411]

(a) Indirect participation of institutional investors is manifested by way of their provision of recommendations and opinions on board decisions regarding corporate management. The CRSC's findings show that institutional investors tend to solicit support from other major shareholders to rally on corporate management reforms so as to increase company values and avoid disputes over management.

(b) Institutional investors may opt for direct participation by way of their involvement in board reorganisations and operational management through their exercise of voting rights at the general shareholders' meetings.

(c) The CSRC finds, on the other hand, that qualified foreign institutional investors (**QFIIs**) do not usually participate directly in voting at the general shareholders' meetings as it appears that QFIIs would often entrust the boards of the listed companies in which they have invested to vote on their behalf via their custodian banks.

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409 Win.d is the leading Chinese financial information database provider founded in 1994, three years after China's installation of its first stock market. To date, according to statements made on its website, Win.d serves more than 90% of the financial institutions in China including hedge funds, asset management firms, securities companies, insurance companies, banks, research institutions, and government regulatory bodies. Overseas, Win.d serves 70% of the Qualified Foreign Institutional Investors (QFII): http://www.wind.com.cn/en/about.html [accessed 6 May 2018].

410 PRC Corporate Governance Code, above n 209, art 11.

411 CSRC Report (OECD publication), above n 96, at 38 to 39.

The Company Law also provides that the shareholders of a limited liability company, or shareholders of a company limited by shares, who have, individually or jointly, held 1% or more of the total shares, may request in writing that the board of supervisors or the supervisors of a limited liability company without a board of supervisors instigate proceedings with the people's court.[412] Shareholders holding 3% or more of the total shares may put forward extraordinary resolutions in writing prior to the convening of the general shareholders' meeting;[413] while shareholders holding 10% or more of the total shares jointly or individually may convene a general shareholders' meeting.[414]

The right to solicit voting rights is another way to uphold shareholders' rights through consultation or solicitation with each other. The PRC Corporate Governance Code provides that the board of directors, independent directors and qualified shareholders of a listed company may solicit the shareholders' rights to vote in a shareholders' meeting. However, no payments may be made to the shareholders for such solicitation, and adequate information must be provided to persons whose voting rights are being solicited.[415]

In sum, the CSRC confirms that numerous borrowed institutions involving Principle II of the 2004 OECD CG Principles have been "implanted" into China's corporate governance systems in the name of compliance with this OECD theme of ensuring protection of shareholders' rights. As discussed in Section E 2(2) in this Chapter III above, the result of these enactments has turned out to be the conferring of a high concentration of rights and powers to the shareholders (including managerial powers which are usually the prerogative of the board of directors in the West – "shareholder centralism" as termed by scholars like Wang.)[416] This appears to support the argument in this thesis that China has adopted these rules to show the world that it is prepared to be compliant but is at the same time mindful to fulfil other agendas, for instance, protection of state control in the corporate systems in order to achieve economic growth and in turn the one-party rule. In a way, it may

412 Company Law 2005, above n 184, art 152 (Author's note: that is, Company Law 2013, art 151).

413 Ibid, art 103 (Author's note: that is, Company Law 2013, art 102).

414 Ibid, art 102 (Author's note: that is, Company Law 2013, art 101).

415 PRC Corporate Governance Code, above n 209, art 10.

416 Jiangyu Wang "Corporate Governance in China - The law and its political logic" in Roman Tomasic (ed) *Routledge Handbook of Corporate Law* (Routledge, 2016), at 190.

also be consistent with Siems's "overfitting legal transplants" theory[417] as one may argue that the "purposely-modified-transplants-with-Chinese-characteristics" may prove to work better in China as it needed shareholder-centralism at the time the Company Law was overhauled in 2005 to sustain social, economic and legal control and growth.

3 Equitable Treatment of Shareholders

As discussed in Chapter II above and in this Chapter III, China was hounded by a number of massive corporate scandals like the Ying Guang Xia case involving serious fraud and false disclosure by various high-profile listed companies at the turn of this twenty-first century. Hence, corporate governance has been placed at the very top of the government's agenda as a good governance system for China's enterprises was of critical importance to China in terms of its ability to deliver continuous economic growth which will in turn support the sustainability of its one-party rule. As PRC corporate law specialist Jiangyu Wang has appropriately quoted in his seminal book a Standard & Poor's report in 2003 which reads: "the mandate to improve corporate governance is a top priority amongst all sectors, including government bodies, regulators, intermediaries, corporations, and investors"[418] in China, this thesis elucidates that it is obvious that the improvement of China's corporate governance is the means to achieve its important goal or agenda of attaining continuous economic growth in order to sustain its one-party rule.

The CSRC Report explicates that there are two types of conflict of interest in corporate governance, one between majority and minority shareholders and the other between management and shareholders. The CRSC observes that in the case of China where the ownership of enterprises, in particular, their SOEs, is relatively concentrated, the conflict of interest between majority and minority shareholders becomes comparatively more prominent.[419]

The CRSC also acknowledges that although the level of ownership concentration decreased after the 2005 non-tradable share reform (as discussed in Section E 1 above), when Chinese listed SOEs are compared with those companies listed in

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417 Siems, above n 56.

418 Jiangyu Wang, above n 230, at 151, in which Wang quoted the Standards & Poor's report: Standard & Poor's *Corporate Governance in China* (2003), at 1.

419 CSRC Report (OECD publication), above n 96, at 41.

the United Kingdom and the United States, they have concentrated ownership structures. Consequently, the Chinese government finds that the conflicts of interest between majority and minority shareholders is a fundamental corporate governance issue in China. They have to ensure that shareholders are treated in an equitable manner.[420]

The CSRC identifies three aspects to China's institutional framework for equitable treatment of shareholders as follows:[421]

(1) To ensure shareholders' equitable participation in corporate governance, institutions have to be put in place to include shareholders' equal voting power, low-cost participation in corporate governance, inspection and enquiry rights, cumulative voting rights and rights to make proposals.

(2) Mechanisms to regulate or restrain related-party transactions involving majority shareholders are contemplated to ensure appropriate inclusion of withdrawal of voting rights from shareholders in a related-party guarantee, prohibition of loans to related parties, and compensation duties where damages are caused in related-party transactions.

(3) Mechanisms are in place to ensure operative indemnities and remedies which include their rights to declare that the resolutions passed at general shareholders' meetings and board meetings are null and void and thereby revoke them in the event of impingement of minority shareholders' rights. They should also have rights to claim damages caused by controlling shareholders, directors and/or executives and rights to bring lawsuits against those who have damaged the company's interest.

420 CSRC Report (OECD publication), above n 96, at 41.

421 Ibid.

The CSRC Report points out that the Company Law only provides for common shares and does not include preferred,[422] deferred[423] or golden shares.[424] Therefore, in practice, there are no specific meetings for certain classes of shareholders. The Company Law provides for one-share-one-vote.[425] However, for companies listed not only on the Mainland China but also in Hong Kong, the United States, or elsewhere, shareholders may simultaneously hold A shares and H shares or A shares and N shares. In such event, these companies need to hold shareholders' meetings for investors holding different shares such as A, H or N for resolutions to be passed respectively.[426]

The Overseas Listing Prerequisite Clauses[427] provide that a Company which intends to change or abrogate the rights of shareholders of different categories may do so only if such change or abrogation has been approved by way of a special

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422 A preferred stock is a class of ownership in a company that has a higher claim on its assets and earnings than a common share. Preferred shares generally carry a dividend that must be paid out before dividends to common shareholders, and the shares usually do not carry voting rights. Preferred stock combines features of debt, in that it pays fixed dividends, and equity, in that it has the potential to appreciate in price: https://www.investopedia.com/terms/p/preferredstock.asp.

423 A deferred share is a share that does not have any rights to the assets of a company undergoing bankruptcy until all common and preferred shareholders are paid. Deferred shares, if serves as a method of stock payment to a company's directors and executives, are deposited into a locked account. The value of these shares fluctuates with the market and cannot be accessed by the beneficiary for the purpose of liquidation until they are no longer employees of the company or a particular date has past and the employee is considered fully vested with the company. A deferred share may also be a share that is issued to company founders that restricts their receipt of dividends until dividends have been distributed to all other classes of shareholders: https://www.investopedia.com/terms/d/deferredshare.asp.

424 A golden share gives its shareholder veto power over changes to the company's constitution. A golden share holds special voting rights, giving its holder the ability to block another shareholder from taking more than a ratio of ordinary shares. These shares were most popular during the 1980s with governments who wanted to maintain control over privatised companies. Golden shares are used mainly in the United Kingdom. In the European Union, however, golden shares have been deemed illegal by the government: https://www.investopedia.com/terms/g/goldenshare.asp.

425 Company Law 2005, above n 184, art 104 (Author's note: that is, Company Law 2013, art 103).

426 CSRC Report (OECD publication), above n 96, at 42.

427 Overseas Listing Prerequisite Clauses, above n 382, art 79. See also Guanghua Yu *Comparative Corporate Governance in China: political economy and legal infrastructure* (Routledge, Oxon, 2007), at 79.

resolution of the general shareholders' meeting and by a separate shareholders' meeting convened by the affected shareholders of the relevant categories.[428]

The CSRC confirms that mechanisms have been put in place to ensure that shareholders exercise their rights and powers by virtue of their voting rights at general shareholders' meetings. Hence, to ensure minority shareholders are protected from abusive actions, powers that entitle them to convene a general shareholders' meeting and then exercise their voting rights at the meeting would be imperative to render them effective protection of their rights.[429] Also, the Company Law provides that where the board of directors or board of supervisors is unable or does not perform its duty to convene a general shareholders' meeting, shareholders individually or jointly holding 10% of the company's shares for 90 consecutive days or more may convene and chair a general shareholders' meeting.[430]

The Company Law provides that a cumulative voting system may be adopted in the event of election of directors or supervisors by the shareholders at a general shareholders' meeting pursuant to the company's articles of association or the resolutions passed at the general shareholders' meeting. For the purposes of the Company Law, a "cumulative voting system" provides that the number of voting rights attached to each share will be the same as the number of directors or supervisors to be elected at the general shareholders' meeting and that the voting rights held by a shareholder or shareholders may be exercised collectively.[431] The CSRC also notes that certain Chinese listed companies have already included the cumulative voting system in their articles of association.[432]

It is worth noting that Article 32 of the Rules on Shareholders' General Meetings of Listed Companies (2016 Revision)[433] and Article 82 of the Guidelines for Articles

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428 Guanghua Yu, above n 427, at 79.

429 Ibid, at 42.

430 Company Law 2005, above n 184, art 102 (Author's note: that is, Company Law 2013, art 101).

431 Ibid, art 106 (Author's note: that is, Company Law 2013, art 105).

432 CSRC Report (OECD publication), above n 96, at 43.

433 The Rules on Shareholders' General Meetings of Listed Companies (2016 Revision) (first promulgated by the China Securities Regulatory Commission on 16 March 2006 and took effect on the same date, revised in 2014 pursuant to China Securities Regulatory Commission Announcement [2014] No. 46 [**2014 Revision**], and recently further revised pursuant to the China Securities Regulatory Commission Announcement [2016] No. 22 issued on 30

of Association of Listed Companies (2016 Revision) (**Articles of Association Guidelines**)[434] resonate with the above cumulative voting system and voting rights stipulated by the Company Law. The Articles of Association Guidelines have also required that (a) the list of candidates for directors and supervisors, their curricula vitae be tabled to facilitate voting by the shareholders; and (b) the companies include provisions in their articles of association canvassing the methods and procedures for the nomination and appointment of the directors and supervisors and the specifics relating to their cumulative voting systems.[435]

The Company Law affirms that minority shareholders' rights are protected by virtue of provisions which allow shareholders (holding individually and jointly at least 3% of the company's shares) to make prior written proposals to the board of directors for deliberation at a shareholders' general meeting[436] and shareholders to vote by proxy present at a shareholders' general meeting.[437]

The Company Law provides that shareholders present at a shareholders' meeting are entitled to one vote for each share held. The company itself has no voting rights for shares it holds. Save for certain major matters, resolutions generally require to be passed by a simple majority of the shareholders present at a shareholders' general meeting. Major matters include amendments to the articles of association, an increase or reduction of the registered capital, a merger, division or dissolution of the company or change in the form of the company[438] as well as any acquisition or sale of major assets, or provision of a security, within one year, in an amount in

September 2016 which repealed the 2014 Revision and took effect on the same date): http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/DepartmentRules/201804/P020180427332503070146.pdf .

434 The Guidelines for Articles of Association of Listed Companies (2016 Revision) (first promulgated by the China Securities Regulatory Commission on 16 March 2006 and took effect on the same date, revised in 2014 pursuant to China Securities Regulatory Commission Announcement [2014] No. 47 [**2014 Revision**], and recently further revised pursuant to the China Securities Regulatory Commission Announcement [2016] No. 23 on 30 September 2016 which repealed the 2014 Revision and took effect on the same date): http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/DepartmentRules/201804/P020180427331974952658.pdf.

435 Ibid, art 82.

436 Company Law 2005, above n 184, art 103 (Author's note: that is, Company Law 2013, art 102).

437 Ibid, art 107 (Author's note: that is, Company Law 2013, art 106).

438 Ibid, art 104 (Author's note: that is, Company Law 2013, art 103).

excess of 30% of the total assets of a listed company,[439] all of which may only be approved by a two-thirds majority of those shareholders with voting rights who are present at a shareholders' general meeting.[440]

The Securities Law contains provisions to require mandatory tender offers. These requirements arise where, through transactions on a stock exchange, an investor's holding, or by virtue of an agreement or other arrangement, its joint holding with another of the issued shares of a listed company, reaches 30%, and where the investor plans to continue to acquire more shares. When these conditions exist, the investor must, in accordance with the law, issue to all of the listed company's shareholders a takeover offer for all or part of the listed company's shares, unless otherwise exempted from so doing by the CSRC.[441] These provisions protects minority shareholders from discriminative treatment in the process. The Takeover Measures stress that if the acquirer makes a partial offer, the shares of shareholders who accept the offer must be acquired proportionately.[442]

The Securities Law provides that upon the expiration of a tender offer, if the spread of equity of the target company fails or ceases to satisfy the listing conditions, the listing and trading of the said listed company's shares will be terminated by the stock exchange according to law. The remaining shareholders who still hold the shares of the target company have the right to sell their shares on equal terms as stipulated in the relevant tender offer to the tenderer, who will acquire the shares accordingly. If the target company no longer meets the requirements of a company limited by shares upon completion of the takeover, it will have to transform into another form of enterprise in accordance with the law.[443]

The Company Law looks after repurchase request rights of dissenting shareholders – if the shareholders of the company oppose the decision of merger or division of the company made at a general shareholders' meeting, they may request the company to purchase the shares they hold. The shares purchased by the company shall be cancelled within six months.[444] The Company Law also

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439 Company Law 2005, above n 184, art 122 (Author's note: that is, Company Law 2013, art 121).

440 Ibid, arts 104 and 122 (Author's note: that is, Company Law 2013, arts 103 and 121 respectively).

441 Securities Law, above n 185, arts 88 and 96.

442 Takeover Measures, above n 397, Chapter III arts 23 to 46.

443 Securities Law, above n 185, art 87.

444 Company Law 2005, above n 184, art 143 (Author's note: that is, Company Law 2013, art 142).

includes a shareholder voting avoidance system in security provision to related parties. The resolutions for the provision of security by a company to its shareholders or actual controllers have to be approved by the board of directors or shareholders or the company's general shareholders' meeting (as the case may be) pursuant to the company's articles of association. The shareholders or actual or de facto controllers to whom the security is to be provided shall not participate in the voting process on the relevant matters. Resolutions on such matters shall be adopted by more than half of all the other shareholders attending the meeting.[445]

The Company Law specifically provides that if a director, supervisor or senior manager violates any laws, administrative regulations or the company's articles of association in the course of performance of his duties for the company and as a result of which causes the company to suffer losses, he will be liable for compensation.[446] Provisions have thus been included in the Company Law to enable lawsuits to be filed by shareholder representatives in the event of occurrences as specified in Article 150.[447] In short, where a director or senior manager causes losses to the company as specified in Article 150 of the Company Law 2005, the shareholders of a company with limited liability, or the shareholders of a company limited by shares individually or jointly holding at least 1% of the company's total shares for at least 180 consecutive days, may make a written request to the board of supervisors (or the supervisor(s) of the company with limited liability where there is no such board) to bring a lawsuit before a People's Court.

Where a supervisor is involved in the circumstances described in Article 150 of the Company Law 2005, the aforesaid shareholders may also make a written request to the board of directors (or the executive director of a company with limited liability where there is no such board) to file a lawsuit before a People's Court.

Where the board of supervisors (or the supervisor(s) of the company with limited liability where there is no such board), or the board of directors (or the executive director of a company with limited liability where there is no such board) refuses to take legal proceedings after receipt of the written request mentioned above, or

445 Company Law 2005, above n 184, art 16 (Author's note: that is, the same provision under Company Law 2013).

446 Ibid, art 150 (Author's note: that is, Company Law 2013, art 149).

447 Ibid, art 152 (Author's note: that is, Company Law 2013, art 151).

does not, or fails to, file a lawsuit within 30 days of receipt of the same, or under emergency situations, failure to take legal proceedings immediately would result in irreparable damages to the company, then the shareholders may, in the interest of the company and in their own names, directly bring a lawsuit before a People's Court.

Where the company's legal rights and interests are violated by others thereby resulting in losses suffered by the company, the shareholders defined above may file a lawsuit before a People's Court accordingly. That said, as discussed in Section E 2(2) above, there do not appear to be any corresponding regulations or implementation rules which cover the procedures, liabilities, or reliefs to be pursued should the shareholder choose to invoke such rights. Again, it appears that these are merely "in-form-not-in-substance" transplants to show the world that China has such systems and institutions in place.

The Company Law provides that the shareholders of a company shall exercise their shareholders' rights in compliance with laws, administrative rules and regulations and the articles of association of the company. However, the shareholders shall not abuse their rights to harm the interests of the company or other shareholders. Where the abuse of shareholders' rights gives rise to any losses to the company or other shareholders, the shareholder who causes the loss(es) shall be liable for compensation pursuant to the law. If a shareholder of a company abuses the independent status of the company as a legal person or the limited liability of the shareholders, evades debts and thus seriously damages the interests of the company, the shareholder shall assume joint and several liabilities for the debts of the company.[448]

In sum, it can be inferred that although the Company Law does not expressly impose a fiduciary duty (which is supposed to be a legal transplant from the common law jurisdictions in the West) on the controlling shareholders or actual controllers towards minority shareholders to prevent them from abusing their shareholders' rights, concepts which are akin to a fiduciary duty and the mechanism for the piercing of the corporate veil have apparently been introduced albeit "with Chinese characteristics".[449]

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448 Company Law 2005, above n 184, art 20 (Author's note: the same provision under Company Law 2013).

449 See also discussions in Section D 1 of this Chapter III above.

Article 5 of the Guidance for the Controlling Shareholder and de Facto Controller of Companies Listed on SME Board issued by the Shenzhen Stock Exchange provides that the controlling shareholder and de facto controller shall shoulder loyalty and diligence obligations towards the listed company and minority shareholders. If their own interest is in conflict with that of the listed company or the minority shareholders, the interests of the latter should be placed above their own.[450]

The CSRC points out that the Company Law contains provisions that a shareholder may attend a general shareholders' meeting by proxy. The proxy holder has to present the proxy statement issued by the shareholder to the company and exercise the voting rights to the extent authorised by the proxy.[451]

The PRC Corporate Governance Code further provides that shareholders may either be present at the general shareholders' meetings in person or appoint a proxy to vote on their behalf. Both means of voting have the same legal effect.[452]

The CSRC confirms that the following institutions have been put in place to provide shareholders with rights to (1) be informed of the convening of general shareholders' meetings, (2) make written proposals, and (3) online voting.[453]

The Company Law provides for all shareholders the rights to be informed about the convening of a general shareholders' meeting.[454] The Company Law does not require a shareholder to hold a particular number of shares to be eligible to attend a general shareholder meeting. Shareholders present at a general meeting are entitled to one vote for each share held.[455]

The Company Law also provides that shareholders individually or jointly holding 3% of the shares of the company may, ten days prior to the general shareholders' meeting, submit provisional written proposals to the board of directors. The board of directors is required to notify the other shareholders of such proposals within two

450 CSRC Report (OECD publication), above n 96, at 45.
451 Company Law 2005, above n 184, art 107 (Author's note: that is, Company Law 2013, art 106).
452 PRC Corporate Governance Code, above n 209, art 9.
453 CSRC Report (OECD publication), above n 96, at 45-46.
454 Company Law 2005, above n 184, art 103 (Author's note: that is, Company Law 2013, art 102).
455 Ibid, art 104 (Author's note: that is, Company Law 2013, art 103).

days from the date of receipt of the proposals and then table them at the shareholders general meeting for deliberation.[456]

In order to protect the legitimate rights and interest of public shareholders, the CSRC promulgated the Regulations on Safeguarding Public Investors' Interests in December 2004. These regulations require listed companies to provide an online voting platform for its shareholders when the general shareholders' meeting discusses the following matters.[457]

The CSRC also confirms that the following institutions have been installed to ensure insider trading is deterred and prohibited. As discussed in Section C 3 above, prohibition of insider trading forms one of the basic principles of the Securities Law.[458] Articles 74 and 75 of the Securities Law set out the definitions and scopes of insiders and insider information. Article 76 specifically prohibits insider trading. Where any insider trading gives rise to losses to investors, the traders responsible shall be liable for losses and damages pursuant to the law.[459]

The Criminal Law provides that any insider who possesses insider information and engages in any relevant stock exchange transactions shall, if the circumstances are serious, be sentenced to a fixed-term imprisonment of no more than five years or criminal detention, and shall also, or shall only, be fined no less than one time but no more than five times the illegal gains. If the circumstances are particularly serious, the insider shall be sentenced to a fixed-term imprisonment of between five and ten years and will be fined no less than one time but no more than five times the illegal gains.[460]

The Securities Law provides that if an insider who has access to insider information and engages in insider trading shall be ordered to dispose of or divest his illegally held securities pursuant to the law. His illegal gains will be confiscated, and he will be fined no less than one time but no more than five times the illegal gains. If there are no illegal gains or the illegal gains are less than RMB¥30,000, he will be fined no less than RMB¥30,000 but no more than RMB¥600,000. If an entity is involved in any insider trading, the person directly in charge and any other persons directly

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456 Company Law 2005, above n 184, art 103 (Author's note: that is, Company Law 2013, art 102).

457 CSRC Report (OECD publication), above n 96, at 46.

458 Securities Law, above n 185, arts 5 and 73.

459 Ibid, arts 74 to 76.

460 Criminal Law, above n 215, art 180.

responsible will be given a warning as well as a fine of no less than RMB¥30,000 but no more than RMB¥300,000 each. Any official from a securities regulatory body who engages in any insider trading will be given a heavier punishment.[461]

Regarding the regulation of related-party transactions, the CSRC confirms that the following institutions are in place. For example, the Company Law has included a shareholder voting avoidance system which provides that where a company intends to provide guarantees to one of its shareholders or actual controllers, the matter will be subject to approval by a simple majority of the shareholders who have the relevant voting rights present at a shareholders' meeting or shareholders' general meeting. The shareholder or the shareholder controlled by the actual controller in question must not participate in voting on the matter.[462]

The Company Law also includes provisions which disallow lending to related parties. It specifically provides that a company must not provide loans, directly or through its subsidiaries, to its directors, supervisors or senior managers.[463]

The Company Law provides that the remuneration of the directors, supervisors and senior managers of a company shall be determined by general shareholders' meetings.[464] The Company Law further provides that a company limited by shares shall disclose the remuneration of its directors, supervisors and senior managers on a regular basis.[465]

The Company Law includes a director voting avoidance system. Specific provision is in place to require that a director of a listed company who is affiliated to an enterprise involved in the matters to be discussed and voted on by the listed company's board of directors must not exercise his own voting rights or represent other directors to exercise voting rights on such matters. The meeting of the board of directors may be held when more than half of the unrelated directors are present. The resolution made by the board must be adopted by more than half of all such

461 Securities Law, above n 185, art 202.

462 Company Law 2005, above n 184, art 16 (Author's note: the same provision under Company Law 2013).

463 Ibid, art 116 (Author's note: that is, Company Law 2013, art 115).

464 Ibid, arts 38 (for limited liability companies) and 100 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 37 (for limited liability companies) and 99 (for companies limited by shares)).

465 Ibid, art 117 (Author's note: that is, Company Law 2013, art 116).

directors. Where there are not more than three unrelated directors, the relevant matters will be forwarded to the general meeting of shareholders for deliberation.[466]

The Company Law has also stipulated a series of general prohibition of related-party transactions by directors and senior managers.[467] It also specifically provides that a director or senior manager may not execute any contract or engage in the conduct of any transaction with the company in violation of the provisions of the articles of association or without the consent of the general shareholders' meeting.[468]

The Company Law provides for certain damage compensation liability. It clearly requires that the proprietary or controlling shareholders, actual controllers, directors, supervisors and senior managers of a company must not take advantage of their affiliated relations in an attempt to harm the company's interests and where any losses to the company are incurred in related violation, those responsible will be held liable for compensation.[469]

The Amendment VI to the Criminal Law provides that where any director, supervisor or senior manager of a listed company, failing his duty of loyalty to the company and taking advantage of his position, manipulates the company in gratis, unfair, unjustifiable or inequitable related-party transactions resulting in the listed company suffering serious losses, he will be sentenced to a fixed-term imprisonment of no more than three years or criminal detention, and/or will be fined. If the listed company suffers from especially heavy or extremely serious losses, the offending director, supervisor or senior manager will be sentenced to a fixed-term imprisonment of no fewer than three years but no more than seven years and will be fined.[470]

The Administrative Measures on Information Disclosure by Listed Companies[471] provide that the directors, supervisors, senior managers, shareholders whose

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466 Company Law 2005, above n 184, art 125 (Author's note: that is, Company Law 2013, art 124).

467 Ibid, art 149 (Author's note: that is, Company Law 2013, art 148).

468 Ibid, art 149(4) (Author's note: that is, Company Law 2013, art 148(4)).

469 Ibid, art 21 (Author's note: that is, the same provision in the Company Law 2013).

470 Amendment VI to the Criminal Law, above n 216, art 9.

471 The Administrative Measures for the Disclosure of Information of Listed Companies (deliberated and adopted at the Executive Meeting of the 196th Chairmen's Meeting of China Securities Regulatory Commission on 13 December 2006, and promulgated and came into force on 30 January 2007 [**Disclosure of Information Measures**] [accessed 10 June 2018]:

shareholding constitutes 5% or more, and those persons acting in concert with such shareholders as well as the de facto or actual controllers of a listed company shall submit to the board of directors of the listed company a list of the listed company's interested or affiliated parties and an explanation of the interested-party relationships or affiliations. The listed company shall comply with the procedures established for the deliberation of affiliated or interested-party transactions and strictly fulfil the rules on the exclusion or abstention of the involved shareholders in voting on the respective affiliated or interested-party transactions. None of the parties to such transactions may circumvent the process of deliberation of affiliated or interested-party transactions and the process of information disclosure obligations either by concealing the affiliated or interested-party relationship or by adopting any other means.[472]

Most of the above examples raised by the CSRC to demonstrate China's compliance with or convergence towards the "text-book-or-best-practice-Anglo-American-corporate-governance-model" do in fact point to the pathway of shareholder-centralism taken by China as a result of its implantation of "wittingly-modified-western-corporate-governance-institutions-with-Chinese-characteristics". After all, it appears China's mode of "compliance" or "convergence" is in name or in form only. These transplants may in fact be used as an instrument to serve some of its objectives, for instance, (a) fulfilment of other agendas to attain sustainability of economic reforms and growth, (b) maintenance of its memberships in the WTO and other international economic pacts (albeit that there might be other underlying factors relating to China's role in the global economy and in turn its continued memberships which lie beyond the scope of this research), and (c) maintenance of its sustainability and competitiveness vis-à-vis inbound and outbound foreign direct investment as discussed in Section B 1 in Chapter II above.

4 Stakeholders' Rights and Corporate Social Responsibility

The Company Law provides that "when engaging business activities, a company must comply with the laws and administrative regulations, observe social morality

http://www.sipf.com.cn/NewEN/lawsandregulations/otherlawsandregulations/08/5084.shtml; or http://en.pkulaw.cn/Display.aspx?lib=law&Cgid=83590.

472 Disclosure of Information Measures, above n 471, art 48.

and business ethics, act in good faith, accept the supervision of the government and the general public, and bear social responsibilities".[473]

The PRC Corporate Governance Code stipulates that listed companies must respect the legal rights of such stakeholders as banks, creditors, employees, consumers, suppliers, communities and others; actively cooperate with their stakeholders in the advancement of the companies sustainability and development; provide necessary means for the maintenance of stakeholders' rights and interests and channels for redress of infringement of their rights; and tilt a balance between maximisation of shareholders' and stakeholders' rights and fulfilment of their social responsibilities.[474]

The CSRC has also reported that they have made special efforts to supervise and ensure that the Shanghai and Shenzhen Stock Exchanges make it easier for listed companies to protect stakeholder interests and fulfil their social responsibilities. The issuance of the Guidelines on Social Responsibilities of Companies Listed at the Shenzhen Stock Exchange by the Shenzhen Stock Exchange in 2006 and the Notice on Enhancing CSR Requirements for Listed Companies by the Shanghai Stock Exchange in 2008 are some of the examples of such efforts. They are designed to give the public a better picture of the real value that businesses can create for their shareholders, employees, clients, creditors, communities, and society as a whole.[475]

The CSRC reports that China has installed a compensation mechanism for creditors with damaged interests through the following transplantations from the West. First, as discussed in Section D 1 in Chapter III above,[476] the Company Law provides for circumstances in which the piercing of a company's corporate veil is permitted. Such circumstances include where a shareholder of a company evades the payment of its debts by abusing the independent status of legal personality or the shareholder's limited liabilities, thereby causing seriously damages the

473 Company Law 2005, above n 184, art 5 (Author's note: the same provision in the Company Law 2013).

474 PRC Corporate Governance Code, above n 209, arts 81 to 86.

475 CSRC Report (OECD publication), above n 96, at 99.

476 Section D 1, Chapter III, at 59 to 69.

interests of any creditor, it will bear joint and several liabilities for the company's debts.[477]

Second, the Guarantee Law empowers creditors through the introduction of rights of guarantee. Under the Guarantee Law, creditors may establish a guarantee by way of surety, mortgage, pledge, lien or deposit to ensure the creditors' claims are honoured in economic activities such as loans, sale and purchase of commodities, transportation of goods, contract for possessing of materials.[478]

Third, the Contract Law, which was promulgated in 1999 as the first contract law for the PRC and another legal transplant from the West, provides that creditors may exercise subrogation rights. Under the Contract Law, if the debtor delays in exercising its matured creditor's rights, thereby causing losses to the creditor, the creditor may apply to the People's Court to subrogate the debtor's creditor's rights and exercise them in the creditor's name, save for the creditor's rights exclusively belonging to the debtor. The necessary expenses required by the creditor's subrogation will be borne by the debtor.[479]

Fourth, the Contract Law also provides that where the debtor waives its due creditor's right against a third party or assigns its property without reward, thereby causing losses to the creditor, the creditor may apply to the People's Court for the rescission of the debtor's action. Where the debtor transfers its property at a low price which is evidently unreasonable, thereby harming the creditor's interests, and the transferee is aware of the situation, the creditor may also apply to the People's

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477 Company Law 2005, above n 184, art 20 (Author's note: the same provision under Company Law 2013).

478 The Guarantee Law of the People's Republic of China (adopted at the 14th Meeting of the Standing Committee of the Eighth National People's Congress on 30 June 1995 and promulgated by Order No. 50 of the President of the People's Republic of China on 30 June 1995), art 2: http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383719.htm [**Guarantee Law**]. Author's note: this appears to be another legal transplant from the West into China as guarantee was not a legal institution in China prior to the adoption of the Guarantee Law.

479 The Contract Law of the People's Republic of China (adopted at the Second Session of the Ninth National People's Congress on 15 March 1999, promulgated by Order No. 15 of the President of the People's Republic of China on 15 March 1999 and took effect on 1 October 1999), art 73: http://www.npc.gov.cn/englishnpc/Law/2007-12/11/content_1383564.htm [**Contract Law**].

Court for rescission of the debtor's action. The expenses required by the creditor in exercising its right of rescission will be borne by the debtor.[480]

The CSRC confirms that employees in China are afforded various means of participation in corporate governance and can access the management and operation of their companies in different ways. They may be democratically elected into the board of directors[481] or the board of supervisors.[482] The board of supervisors must have a minimum of one-third of employee representatives.[483] Employees are entitled to a range of rights such as examining the company's financial situation, supervising the behaviours of directors and senior management in delivering their duties, and raising proposals at the shareholders' meetings.[484]

The CSRC also confirms that a multitude of laws, regulations and self-disciplinary rules such as the Securities Law, Administrative Measures on Information Disclosure of Listed Companies and the Listing Rules of the Stock Exchange have stipulated strict requirements on information disclosure by listed companies. Regular and ad hoc reports released by listed companies are published on websites designated by the CSRC as well as the nationwide securities newspapers as free public resources. All stakeholders can access such information free of charge. The CSRC estimated in 2010 that 162 listed companies in Shenzhen and 290 in Shanghai disclosed their social responsibility reports together with their annual reports in 2008.[485]

Corporate internal control in the West usually provides its stakeholders with opportunities to file complaints with the competent institutions within the companies regarding rampant unethical or unlawful practices in companies. The CSRC has also transplanted this common institution for internal audit into Chinese "soil" by requiring listed companies to set up audit committees which are directly

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480 Contract Law, above n 479, art 74.

481 Company Law 2005, above n 184, arts 45 (for companies with limited liability) and 109 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 44 and 108 respectively).

482 Ibid, arts 52 (for companies with limited liability) and 118 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 51 and 117 respectively).

483 Ibid.

484 Ibid, arts 54 (for companies with limited liability) and 119 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 53 and 118 respectively).

485 CSRC Report (OECD publication), above n 96, at 102.

accountable to their boards of directors. The CRSC also requires a company's application for IPO to be accompanied by a report confirming the validity of the internal control prepared by certified accountants. The accountants should verify that the company's internal control system is sound, efficiently executed and capable of maintaining reliability of its financial statements, legitimacy of the company's operations and manufacturing activities as well as their efficiency and effects.[486]

The Guidance on Internal Control of Companies Listed on the SME Board requires companies which are listed on the small business board to submit a self-assessment report on internal control on an annual basis and an accounting firm which deals with the company's financial affairs to present a verification report on the validity of the report every other year.[487]

The CSRC confirms that the Company Law[488] and the Enterprise Bankruptcy Law of the People's Republic of China (**Enterprise Bankruptcy Law**)[489] constitute the 'backbone' of China's legal regime for corporate insolvency. The Enterprise Bankruptcy Law is enacted with a view to regulating the procedure for enterprise bankruptcy, fairly settling claims and debts, safeguarding the lawful rights and interests of creditors and debtors, and maintaining the order of the socialist market economy.[490] It provides for the procedures for the application, reorganisation, compromise and bankruptcy liquidation should a company become insolvent, and safeguards the repayment of property and the creditors' rights and committee. The Enterprise Bankruptcy Law also introduces a bankruptcy managers' system and standardises the procedures of restructuring and settlement, which in turn ensures transparency and efficiency and minimises the effects of corporate insolvency. Under the Company Law and Enterprise Bankruptcy Law, creditors are entitled to

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486 CSRC Report (OECD publication), above n 96, at 103.

487 Ibid, at 104.

488 Company Law, above n 184, arts 181 to 191 (provisions for dissolution and liquidation of companies) (Author's note: that is, Company Law 2013, arts 180 to 190).

489 The Enterprise Bankruptcy Law of the People's Republic of China (adopted at the 23rd Meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China and promulgated by the Order of the president of the People's Republic of China on 27 August 2006; and took effect as of 1 June 2007) [**Enterprise Bankruptcy Law**]: http://www.npc.gov.cn/englishnpc/Law/2008-01/02/content_1388019.htm.

490 Enterprise Bankruptcy Law, above n 489, art 1.

participate in bankruptcy liquidation procedures and mechanisms which actively protect their own legal rights and interests.[491]5 Information Disclosure

The CSRC confirms that in the course of development of China's capital market and corporate governance reform, all the Chinese legislative bodies and government agencies have placed emphasis on corporate information disclosure. They have, as far as the CSRC is concerned, actively promoted the improvement of information disclosure in terms of its quality and transparency. The CSRC reports that it is satisfied that their regulations are consistent with international practices regarding normative principles, operational specifications, and disclosure methods and contents. Overall, the CSRC has found that information disclosure by listed companies has improved in terms of the accuracy, scope, and depth of the disclosed information, and use of information by the investors and intermediaries over the years.[492]

The CRSC takes the view that information disclosure is not only a legal obligation for listed companies but also the key channel for investors to keep track of them and for regulatory authorities to supervise them. Listed companies must be responsible for the accuracy, authenticity, completeness of the disclosed information. Also, the disclosure must be made in a timeless and fair manner. In this respect, the Securities Law provides that information disclosed by an issuer or a listed company pursuant to law must be truthful, accurate and complete and free from any false entries, misleading statements or major omissions.[493]

The Administrative Measures on Information Disclosure by Listed Companies provide that in addition to the periodic reports (which include annual reports, half-yearly reports and quarterly reports) that listed companies must disclose on a regular basis,[494] if the occurrence of a significant event is likely to have significant impact on the trading prices of a company's securities and derivatives, and the investors have yet to be informed, the listed company must make a timely disclosure to declare the cause, the current status and the likely effect of the event.[495] In other words, information disclosure does not only refer to the reports

491 CSRC Report (OECD publication), above n 96, at 104.
492 Ibid, at 51.
493 Securities Law, above n 185, art 63.
494 Disclosure of Information Measures, above n 471, art 19.
495 Ibid, art 30.

that limited companies must disclose regularly in accordance with the law, but also information on those transactions which will materially affect the companies' securities and derivatives' trading prices. Such information may include important documents such as prospectuses, regular annual, semi-annual, quarterly and ad hoc reports, public security offering statements, public bond offering statements, private stock offering plans, outcome reports, major asset reorganisation reports, listing particulars, related-party transactions and acquisition disclosure reports.[496]

In addition to the above, the CSRC reports that both Shenzhen and Shanghai Stock Exchanges have issued the "Guidance on Internal Control of Listed Companies". This Guidance includes a chapter dedicated to information disclosure regarding internal control. It provides that a listed company should report to its board of directors on a timely basis when encountering or identifying any major flaws or risks in internal control during its inspection or supervision process. Issues should be reported to the relevant Stock Exchange by the board of directors on a timely basis. Upon confirmation by the Stock Exchange, the board of directors should issue a public notice, setting out the relevant flaw or risk in internal control, its consequence, accountability and proposed remedies.[497]

The CSRC also confirms that the Shanghai and Shenzhen Stock Exchanges have been receiving annual reports submitted by listed companies through the eXtensible Business Reporting Language (XBRL) since December 2008. The Shanghai Stock Exchange can even receive half-yearly reports and quarterly reports through XBRL. At the Shenzhen Stock Exchange, the XBRL service platform provides search and information display functions. Customers can download the XBRL documents with regular reports of all listed companies.[498]

In December 2012, the XBRL International (XII) announced that the General Purpose Taxonomy of the Chinese Accounting Standards (CAS) has been granted "acknowledged" status by its Taxonomy Recognition Task Force, recognising its compliance with the XBRL specifications. This taxonomy defines the XBRL elements and requirements for preparing the XBRL financial reporting based on the CAS which were first applied in 2011. It is currently used in China by numerous financial institutions, state-owned enterprises (SOEs) and large-scale administered

496 CSRC Report (OECD publication), above n 96, at 52 to 55.

497 Ibid, at 55.

498 Ibid.

(or more commonly known as central) SOEs.[499] This supports China's continuous efforts to improve its systems to be consistent with international practices, however, one cannot jump to the conclusion that this means outright convergence as one will have to look at its other moves to determine the motive or agenda behind such institutions.

The CRSC confirms that relevant institutions which are consistent with Principle V of the 2004 OECD CG Principles have been put in place in China to ensure listed companies observe their information disclosure obligations. For instance, institutions consistent with Principle V are implanted in the Company Law and other regulations, measures and guidelines stipulated by the CSRC. They provide that a company must prepare its financial reports at the end of each fiscal year and financial reports must be audited by an accounting firm in accordance with the law.[500] Chinese listed companies are required to observe the General Regulations on Financial Reports issued by the CSRC when disclosing their annual reports. The Disclosure of Information Measures provide that besides publishing annual reports within four months from the end of the corresponding fiscal year, mid-term reports must be prepared and disclosed within two months from the end of the first half of each corresponding fiscal year; and quarterly reports must be completed and disclosed within one month from the end of each of the third and ninth months of the corresponding fiscal year.[501]

Prior to going public, a company limited by shares must lodge an application for approval of its IPO and disclose the relevant information regarding such an offer in its prospectus pursuant to the Securities Law and the relevant CSRC regulations.[502] Thereafter, the listed company is subject to a continuous obligation to disclose information at regular intervals as required by the CSRC and the relevant stock exchange under the Securities Law and the relevant CSRC regulations by way of annual, periodic and temporary reports. The required information for such disclosure should include the financial statements, business, management, operation and material events of the company, and shareholding information of the company's top ten shareholders, shareholders holding 5% or

499 IASPlus "Chinese XBRL taxonomy achieves 'acknowledged' status" (2012) https://www.iasplus.com/en/othernews/china/cas-xbrl.

500 Company Law, above n 184, art 165 (Author's note: that is, Company Law 2013, art 164).

501 Disclosure of Information Measures, above n 471, art 20.

502 Securities Law, above n 185, arts 12, 14 and 21.

more of the company's shares, controlling shareholders and de facto controllers, and major equity changes within the reporting periods.[503] Listed companies are also required to put in place disclosure management rules and procedures. Their directors, supervisors and senior managers are expected to act diligently and dutifully in terms of the execution and fulfilment of such rules and procedures.[504]

The CRSC reports that the requirements of Principle V are included into the standards on contents and formats for annual reports stipulated by the CSRC (Information Disclosure Standards).[505] The Information Disclosure Standards require all listed companies to disclose information on directors, supervisors and senior managers. For instance, their personal details, qualifications, positions (including other directorships), terms of office, shareholdings and changes (where applicable) during the reporting periods.[506]

The Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies (**Independent Directors Guidelines**) provide that independent directors should have the qualifications required to perform their duties according to laws and regulations and that they must meet the "independence" test.[507] Neither the Independent Directors Guidelines nor the PRC Corporate Governance Code set out the professional qualification requirements of an independent director. In other words, this was another "in-form-not-in-substance-transplant". The PRC Corporate Governance Code simply provides that the relevant laws and regulations shall be complied with for matters such as the qualifications, procedures for the election and replacement, and the duties, of independent directors.[508] Interestingly, although the PRC Corporate Governance and the Independent Directors Guidelines were both promulgated in 2001, it took the CRSC over five years to stipulate the Measures for the Supervision and

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503 Securities Law, above n 185, arts 63 to 72; see also the Disclosure of Information Measures, above n 471, arts 19 to 36.

504 Ibid, Disclosure of Information Measures, arts 37 to 56.

505 The Standards for the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No. 2 – Contents and Formats of Annual Reports (2017 Revision – issued by the CSRC on 26 December 2017; took effect on the same date and repealed the earlier versions which were stipulated in the first decade of this century): http://en.pkulaw.cn/display.aspx?cgid=307656&lib=law.

506 CSRC Report (OECD publication), above n 96, at 58.

507 Independent Directors Guidelines, above n 228, ss II and III.

508 PRC Corporate Governance Code, above n 209, art 51.

Administration of the Professional Qualifications of Directors, Supervisors and Senior Managers of Securities Companies to regulate the supervision and administration of the professional qualifications of directors, supervisors, senior managers and persons in charge of securities companies.[509] This again manifests China's *modus operandi* that reforms to attain economic growth go first, legal transplants (mostly 'in-form-but-not-in-substance') will follow in order facilitate the reform for economic growth. Thereafter, modifications and adaptations of transplants from the West (Principle V of the 2004 OECD CG Principles in the present case) with reference to domestic characteristics will finally kick in or be implanted into the Chinese system should there be needs to attain and maintain sustainability of economic development and growth.

The Company Law provides that a company must periodically disclose to its shareholders the payment received by its directors, supervisors and senior managers.[510] The PRC Corporate Governance Code stipulates that the board of directors of a listed company may establish a corporate strategy committee, an audit committee, a nomination committee, a remuneration and appraisal committee in accordance with the resolutions of the shareholders' meetings. All committees must be composed solely of directors. The audit committee, the nomination committee and the remuneration and appraisal committee must be chaired by an independent director, and independent directors must constitute the majority of the committees.[511]

The main duties of the remuneration and appraisal committee are to (i) study the appraisal standard for directors and management personnel, conduct an appraisal and make recommendations, and (ii) study and review the remuneration policies

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509 The Measures for the Supervision and Administration of the Professional Qualifications of Directors, Supervisors and Senior Managers of Securities Companies (deliberated and adopted at the 192nd Chairman's Executive Meeting of the China Securities Regulatory Commission on 20 October 2006, and revised in accordance with the Decision of the China Securities Regulatory Commission on Amending the Measures for the Supervision and Administration of the Professional Qualifications of Directors, Supervisors and Senior Managers of Securities Companies on 19 October 2012), arts 7 to 19: http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/DepartmentRules/201212/t20121204_217601.html.

510 Company Law, above n 184, art 117 (Author's note: that is, Company Law 2013, art 116).

511 PRC Corporate Governance Code, above n 209, art 52.

and schemes for directors and senior managers.[512] The main duties of the nomination committee are to (i) formulate standards and procedures for the election of directors and make recommendations; (ii) extensively seek qualified candidates for directorship and management; and (iii) review the candidates for directorship and management and make recommendations.[513]

The Company Law provides that the board of directors will decide on the employment or dismissal of the manager and his remuneration, as well as the employment or dismissal of the deputy manager(s) and person(s) in charge of the company's financial affairs and on their remuneration based on the recommendations put forward by the manager.[514]

The PRC Corporate governance Code requires all listed company to disclose information regarding its corporate governance in accordance with laws, regulations and other relevant rules, including but not limited to: (i) the members and structure of the board of directors and the supervisory board; (ii) the performance and evaluation of the respective boards of directors and supervisors; (iii) the performance and evaluation of the independent directors, including their attendance at board of directors' meetings, their issuance of independent opinions and their opinions regarding related party transactions and appointment and removal of directors and senior management personnel; (iv) the composition and work of the specialised committees of the board of directors; (v) the actual state of corporate governance of the company, the gap between the company's corporate governance and the PRC Corporate Governance Code, and the reasons for the gap; and (vi) specific plans and measures to improve corporate governance.[515]

The OECD finds from experience in most OECD countries with large and active equity markets that corporate information disclosure, both mandatory and voluntary, is an effective and powerful tool for influencing companies' behaviour and protecting investors' interests. Having a strong information disclosure regime will certainly assist in attracting domestic and foreign capital and maintaining

512 PRC Corporate Governance Code, above n 209, art 56.

513 Ibid, art 55.

514 Company Law 2005, above n 184, arts 47 (for companies with limited liability) and 109 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 46 (for companies with limited liability) and 108 (for companies limited by shares)).

515 PRC Corporate Governance Code, above n 209, art 91.

confidence in their capital markets.[516] China obviously appreciates that a corporate governance framework canvassing timely and accurate corporate information disclosure for listed companies in its growing capital market is pivotal to its success in attaining continuous economic growth. CSRC certainly demonstrates through its 2011 report that China has been actively improving its law-making capability and installing rules and regulations which are consistent with international practices.

Transplantation of the 2004 OECD Principles on disclosure and transparency (Principle V),[517] albeit being in form but not in substance as this thesis argues, is definitely a good start as the CSRC has reported that there are improvements year by year in terms of the scope, breadth and depth of the disclosed information by listed companies and its use by investors and intermediaries in the market.[518] The Securities Law provides that the information disclosed by an issuer or a listed company pursuant to law must be truthful, accurate and complete and must not contain any false entries, misleading statements or major omissions.[519] The directors, supervisors and senior managers of the listed company are required to ensure the truthfulness, accuracy and completeness of the information disclosed by the company.[520] Also, the information which must be disclosed pursuant to law must be released through the media designated by the CSRC and placed simultaneously at the domicile of the company and stock exchange for public information.[521]

In addition to its annual reports, a listed company must disclose all the major events that may have a significant impact on its share trading price by submitting provisional reports about the situations of such events to the CSRC and the stock exchange and release the same, explaining the causes, current statuses and possible legal consequences of such events.[522]

The Company Law requires that a listed company has a secretary to the board of directors. The board secretary will be in charge of matters such as the preparation of the general meetings and the meetings of the board of directors of the company,

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516 Principle V (Disclosure and Transparency), 2004 OECD CG Principles, above n 282, at 49.

517 Ibid, at 49 to 57.

518 Idea inspired by and borrowed from CSRC Report (OECD publication), above n 96, at 51.

519 Securities Law, above n 185, art 63.

520 Ibid, art 68.

521 Ibid, art 70.

522 Ibid, art 67.

the safekeeping of documents as well as the administration of the shareholders' information of the company and the handling of information disclosure. The board secretary is a senior manager of the company specialises in dealing with information disclosure to ensure continuous and timely information disclosure.[523]

6 Board and Supervisory Board's Responsibility and Supervision

Principle VI of the 2004 OECD CG Principles has been implanted into the Company Law. It provides that the directors, supervisors and senior managers of a company must observe the laws and administrative regulations and the company's articles of association. They are required to assume the duties of loyalty and diligence to the company. The Company Law also clearly states that directors, supervisors and senior managers must not take advantage of their functions and powers to accept bribes or collect other illicit earnings, nor can they take illegal possession of the property of the company.[524]

Directors are required to comply with the duty of loyalty to the company. They must not (i) divert, misappropriate or lend the company's capital, (ii) enter into contracts or conduct transactions in violation of the company's articles of association or without the consent of the shareholders' meeting or the board of directors, (iii) divulge the company's secrets without authorisation or commit other acts which are inconsistent with their duty of loyalty to the company.[525]

The Company Law is the recipient of common law concepts through the legal transfer of Principle VI of the 2004 OECD CG Principles which require directors, supervisors and senior managers to exercise their duty of care and act diligently in the best interest of the company. The Company Law further provides that they will be liable should they breach the relevant laws and regulations and cause damage to the company in the course of performing their duties on behalf of the company.[526]

As discussed above, the Company Law requires that directors should diligently and carefully carry out their duties prescribed by the relevant laws and regulations as well as the articles of association of the company. They should also ensure that the company abides by its articles, treat all the shareholders fairly and respect the

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523 Company Law 2005, above n 184, art 124 (Author's note: that is, Company Law 2013, art 123).

524 Ibid, art 148 (Author's note: that is, Company Law 2013, art 147).

525 Ibid, art 149 (Author's note: that is, Company Law 2013, art 148).

526 Ibid, arts 148, 150 and 151 (Author's note: that is, Company Law 2013, arts 147, 149 and 150).

interests of other stakeholders.[527] By the same token, directors are prohibited from voting in their own rights or on behalf of others in the case of related-party transactions. Board meetings may be held only if more than half of the directors having no related-party relationship attend the meetings.[528]

Again, the Company Law, having considered Principle VI of the 2004 OECD CG Principles, provides that both engaged directors and supervisors should play their roles in safeguarding and maintaining the rights and interests of such stakeholders as the employees. The board may include staff and worker members which to a certain extent represent their interests in the company's decision-making process.[529] Likewise, provisions have been installed in the Company Law to include staff and worker representatives who would be democratically elected to the supervisory board.[530]

As discussed in Section F 4 above, the PRC Corporate Governance Code, which has been adopted by the CSRC closely following the 2004 OECD CG Principles, requires listed companies to respect the legal rights of their stakeholders, including banks and other creditors, employees, customers, suppliers, and the community.[531] They are also expected to provide the necessary means to ensure the legal rights of their stakeholders, who will be entitled to the opportunities and channels for redress of any infringement upon their rights.[532]

China has basically transplanted Principles VI into the Company Law which clearly sets out the functions and powers exercisable by the board of directors essentially consistent with Principles VI. These functions and powers are applicable to both companies with limited liability and companies limited by shares.[533]

The PRC Corporate Governance Code provides for a listed company to establish an incentive mechanism linking the managerial personnel's remuneration with the

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527 Company Law 2005, above n 184, arts 113 and 148 (Author's note: that is, Company Law 2013, arts 112 and 147).

528 Ibid, art 125 (Author's note: that is, Company Law 2013, art 124).

529 Ibid, art 109 (Author's note: that is, Company Law 2013, art 108).

530 Ibid, art 118 (Author's note: that is, Company Law 2013, art 117).

531 PRC Corporate Governance Code, above n 209, art 81.

532 Ibid, art 83.

533 Company Law 2005, above n 184, arts 47 (for companies with limited liability) and 109 (for companies limited by shares) (Author's note: that is, Company Law 2013, arts 46 (for companies with limited liability) and 108 (for companies limited by shares)).

company's and the individual's respective performance. The performance assessment of management personnel will hence become a basis for determining the compensation and other rewarding arrangements for the managerial personnel who are the subject of assessment. If the management personnel violate any laws or regulations, or the company's articles of association, and cause damages to the company, its board of directors will actively investigate and pursue such personnel's legal liabilities.[534]

As mentioned in Section F 5 above, the PRC Corporate Governance Code stipulates that the audit committee is responsible for the accuracy of the corporate financial information for the purposes of corporate information disclosure.[535] Timely and adequate information must be rendered to the directors and supervisors to enable them to perform their duties.[536]

In sum, numerous references can be taken to support CSRC's argument that China's corporate governance system is aligning and converging with international "good" (if not the best) practices that the OECD has been advocating and promoting since 2004. It can be seen that China has made a great deal of effort to implant such foreign practices and institutions into its laws, rules, regulations and measures in order to create a similar corporate governance system (at least in form not necessarily be in substance as discussed throughout this thesis) in China. However, it remains puzzling to find researchers and scholars who have critiqued China's corporate governance regime coming to almost always "convergent" conclusions that China's corporate governance system does not work as effectively as its western counterparts. In other words, the legal transplants do not take root or implant well in the Chinese corporate governance "soil". This thesis argues that China's corporate governance regime is neither convergent nor divergent, it is rather misunderstood or "lost in translation" to Sino-Capitalism because it serves a different purpose to simply the protection of corporate shareholders and stakeholders. Its purpose is the State's agenda to attain and maintain sustainability of its economic growth which in turn upholds the continuous one-party rule.

In order to examine this puzzle more closely, Chapter IV will present a contextual review of legal transplants and their evolutions in China with a view to uncover the

534 PRC Corporate Governance Code, above n 209, arts 77 to 80.

535 Ibid, arts 52 and 54.

536 Ibid, arts 46 and 61.

misunderstanding or loss in translation to Sino-Capitalism which forms the vocal point of this thesis.

G Conclusion

This Chapter III has presented an overview of China's development of its corporate governance systems through legal transplants from the West and the adoption of the 2004 OECD CG Principles. Despite the CSRC's assertion by way of its self-assessment at great lengths that China has done its utmost to bring itself up to gear to be at par with its western counterparts, it appears that such transplants which are supposed to be mirroring or converging with those of their western donors are not functioning in the same-or-substantially-similar-way as their western counterparts. This thesis argues that they are simply implanted in form to serve a different agenda to that of its western counterparts, that is, attainment of sustainability of China's economic growth as opposed to advocacy by its western counterparts for the protection of the interests of the shareholders and stakeholders. Hence, one may say that the legal transplants that facilitate China's installation of its corporate governance regime have led to neither convergence nor divergence, but in essence a loss in translation during this "implantation-and-sinonisation-process" to facilitate attainment of China's particular form of prosperity or capitalism. Chapter IV will uncover this pathway by exploring such transplants through the Chinese government's lens in order to gain an insight into the direction to which they are driving in terms of their treatment of legal transplants from the West.

Chapter IV Contextual Review of Corporate Governance Transplants in China

A Introduction

As discussed in the preceding chapters, it can be noted that legal scholars and commentators[537] appear to believe that western-style private ownership presents the right direction for Chinese corporations to take if they are to gain a sustainable presence in the international arena. However, the unique legal culture and concept of law in China seem to favour state ownership[538] and China's own form of capitalism – Sino-Capitalism. Modern scholarship in comparative corporate governance differentiates convergence of form and function. US scholars such as Gilson tend to believe that corporate law may be functionally converging while formal legal rules are diverging.[539] The Chinese case seems to prove the opposite[540], or this thesis will, at the very least, argue that it is a case of legal transplants which are lost in translation or misunderstood to Sino-Capitalism.

The Company Law 1993 can be considered the first piece of corporate governance legislation that has largely been transplanted from the West since China's adoption of its Open-Door Policy in 1978. As discussed in Sections C 1 and C 2 in Chapter III above, after almost four and half decades of having a static and uncompetitive economy (from 1949 to 1992) due to failed reforms, lawmakers would likely have a keen desire to adopt a corporate governance system for Chinese corporations as an essential vehicle for developing a sustainable economy. They advocated for the adoption of Company Law 1993 by way of legal transplants to build western-style corporations in China with private ownership to make it the 'fittest' for survival. They feared being left behind in economic reforms, hence, there was a conscious legislative effort to make Chinese corporations the 'fittest',[541] preferably from the

537 See generally Young and others, above n 252, Tam, above n 181; Shan and Round, above n 228; Nolan, above n 330; Feinerman, above n 229; Tsui, above n 332; Trifiro, above n 333; Donald Clarke, above n 248; Schipani and Liu, above n 189; Shan and Taylor, above n 359; and Mei, above n 358, to name a few.

538 Rui Guo "The Creation of Modern State Ownership: Legal Transplantation and the Rise of Modern State-Owned Big Businesses in China" (2013) 4 Peking UJ Legal Stud 69, at 69.

539 Gilson, above n 136, at 337 to 345.

540 Guo, above n 538, at 70.

541 Idea borrowed from Guo, above n 538, at 71-72.

western perspective. In other words, they meant to achieve "convergence" to the standards and models in the West. However, it appears that this effort did not generate the intended result. Instead, they saw the rise of modern big businesses in the SOEs. In the Chinese context, it seems that the best "fit" for China is not western-style private ownership but is state ownership. This "western-style-private-ownership-based-legal-transplant" has been modified in China to serve state ownership or state capitalism, as preferred by some.[542] However, this thesis will, on balance, prefer to call this unique form of capitalism that China has developed "Sino-Capitalism". Sino-Capitalism will be conceptualised and discussed in Chapter VI, the concluding chapter.

The following section will elucidate the way the legal transplant of the Company Law has nurtured the emergence of the modern big businesses in the SOEs and how it ruled out other alternatives that might have directed China towards the convergence of its corporations to western-style-private-ownership-based-corporations. In the process of transplanting a corporate governance system into China by way of adoption of the Company Law, China purposely- modified the system to create a 'corporatised-but-not-privatised' state ownership instead. This system (i) affirms the state's property rights as the owner of SOEs, (ii) empowers managers of SOEs while stripping the direct control of non- professional state or party bureaucrats, and (iii) steers the multiple incentives of the bureaucrats that supervise SOEs to 'converge' into a profit maximisation incentive.

B Transplantation of Corporate Governance Law

China is the home to the most extensive development for large-scale experimentation with SOEs. As discussed in Sections C 1 and C 2 in Chapter III above, until the 1990s, Chinese SOEs were operated by government authorities or agencies. They were then transformed into business corporations. At the time when most of the western world were undertaking standard privatisation programmes, the Chinese government embraced 'corporatisation, not privatisation'[543] as an integral part of its economic reform strategy. Some might see corporatisation as a first step in the transition towards private control of

[542] Li-Wen Lin and Curtis J Milhaupt "We are the (national) champions: Understanding the mechanisms of state capitalism in China" (2013) 65 Stan L Rev 697-795.

[543] Donald Clarke "Corporatisation, not privatisation" (2003) 7(3) China Economic Quarterly 27-30.

corporations. Despite the introduction of western-style Company Law 1993 by way of legal transplant, the PRC government obviously chose to go for the reverse [544] as its clear goal is to increase state control of business and in turn economic activity through leveraging and reinforcing the state's "grip on key economic sectors".[545]

Over the last three to four decades, corporate governance has matured in the developed economies where competitiveness and sustainability of firms, and in turn the economies generally, have been advanced by how firms are owned and governed. The experience of the 1990s has seen corporate governance arguably even more critical in transition economies that have engaged in marketisation and wholesale property rights reforms. Corporate governance development is recognised as imperative to the successful transition to an efficient market system. China has also engaged in the improvement of corporate governance since its market reforms which were introduced from 1978. What sets China apart is that unlike other transition economies, China's initiatives have been made essentially without full privatisation. The PRC government has strived to improve corporate governance of SOEs almost as a means of avoiding, if not as a substitute for, complete privatisation. The most significant measure has been the clarification of property rights through corporatisation. Corporatisation has in essence become the overarching solution not simply for the improvement of the performance of SOEs, but also for the external financing of corporations via a capital market which is growing at an exponential rate.[546]

In their seminal book *The Chinese Miracle: Development Strategy and Economic Reform* published in 1994, Chinese economists Justin Yifu Lin, Fang Cai and Zhou Li analysed the inefficiency of Chinese SOEs. They opined that such inefficiency accounted for the backwardness of the Chinese economy and that it stemmed from their policy burden. This policy burden contributed to an improper development strategy – China first set up SOEs in industries that were doomed to fail. This is because such SOEs were unable to stand on their own feet nor did they possess comparative advantages as the government continually subsidised them. The SOEs were also obliged to maintain redundant workers and provide them with pensions and other social benefits such as childcare, education and general

544 Cyril Lin "Corporatisation and corporate governance in China's economic transition" (2001) 34(1) Economics of Planning 5, at 6.

545 Donald Clarke, above n 543, at 27. See also Lin and Milhaupt, above n 542, at 699-703.

546 C Lin, above n 544, at 6.

medical care. They argued that if China's policy burden problem could be resolved, its SOEs would develop.[547]

According to Lin, Cai and Li, China's policy burden also defined the corporate governance problem of Chinese SOEs, the solution to which held the key to better economic performance. They elucidated that only when China's corporate governance problem was solved could Chinese SOEs develop into large profit-making businesses.[548]

Lin, Cai and Li's analysis does not appear at first glance to deviate too much from that of the western scholars. For example, Donald Clarke sees the reason behind China's dilemma in its corporate governance to be the fundamental incompatibility between the State's goals of maintaining controlling ownership of the SOEs on the one hand and running them along the commercial lines of profit maximisation on the other. Such incompatibility permitted the managers to impinge upon the private minority shareholders' rights. He therefore attributed the inefficiency of the SOEs to the state ownership and control and the state's politically-appointed-and-motivated managers' deviation from the goal of profit maximisation.[549]

Clarke argues that the Company Law, which was supposed to be a transplant from the West to embody a set of modern corporate governance rules to enable enterprises to operate more efficiently, was twisted instead to suit the special circumstances and needs of the Chinese SOEs. He however points out that some commentators' idea that the legal transplant of the Company Law as 'a kind of creeping privatisation' in China was misconceived.[550] As discussed in Section D 1 in Chapter III above, the Company Law replaced the organisational structure of a traditional SOE, which was administratively subordinate to the relevant government ministries, departments or agencies, with one of the three corporate forms introduced under the Company Law – limited liability company, wholly state-

547 Justin Yifu Lin, Fang Cai and Zhou Li *Zhong Guo De Qi Ji: Fa Zhan Lue Yu Jing Ji Gai Ge (Translation: The Chinese Miracle: Development Strategy and Economic Reform*) (Shanghai Sanlian Press and Shanghai People's Press, Shanghai 1994) [**The Chinese Miracle**]; see also Guo above n 538, at 73-74.

548 Ibid, Lin, Cai and Li.

549 Donald Clarke, above n 543, at 27.

550 Ibid, at 27 and 30.

owned limited liability company or company limited by shares.[551] Many of the corporatized SOEs have since been listed on domestic or foreign stock exchanges.

To Clarke's mind, the PRC government's corporatisation policy for their SOEs has many aims. They include:[552]

(i) Capital raising for SOEs following their conversion to the permitted corporate form under the Company Law;[553]
(ii) Expansion of state control in certain strategically important sectors through leverage. Such sectors include national security related industries, natural monopolies, sectors providing important goods and services to the public, and pillar industries and advanced technology; and
(iii) Improvement of state asset management by way of the implementation of a new organisational form (that is, the installation of the State-owned Assets Supervision and Administration Commission (SASAC) in 2003).

Clarke believes that the Company Law (which canvasses the PRC corporate governance reform) was not about privatisation. It was installed to restructure SOEs and make them more efficient by eliminating three major problems in traditional management of SOEs, namely:[554]

(i) Bureaucratic interference arising from the state acting as both the owner and the manager of the SOE;
(ii) Confusion arising from multiple state entities having overlapping authority over the SOE; and
(iii) Accountability deficiency arising from the absence of a clear single or dominant owner to whom the managers are supposed to report.

However, it appears to Clarke that corporatisation 'misanalyses' the problems and hence delivers 'flawed' solutions. Clarke argues that as long as the Company Law is employed as an SOE restructuring device and state involvement as a majority or controlling shareholder continues, it is virtually impossible for the Chinese corporate governance law and policy to achieve prohibition of exploitation of minority shareholder by dominant or controlling shareholders. The result, to Clarke's mind, is "a hijacking of the entire Company Law" – instead of the SOEs

551 Company Law 1993, above n 184, arts 2, 23-35, and 64-70.
552 Donald Clarke, above n 543, at 27-28.
553 Company Law 1993, above n 184, arts 64, 75 and 151.
554 Donald Clarke, above n 543, at 29.

being made more efficient by having to follow the rules for private-sector enterprises, potential private sector enterprises incorporated under the Company Law are "hamstrung" by having to follow rules that make sense only in a state-run economy.[555] In sum, this supports the argument put forward in this thesis that the legal transplant of the Company Law has been 'twisted' or 'tweaked' to suit the special circumstances and needs of continued state ownership and control of SOEs in China.

Lin, Cai and Li's suggested solution for solving China's policy burden problem is profoundly different from Clarke's although both sides have identified the same problem. Clarke implies that China's better bet is to be rid of state ownership through privatisation and adoption of private property rights. Lin, Cai and Li advocate for the Chinese government to remove from its SOEs the policy burden.[556]

It appears that the core of this difference lies with their different stances towards the concept of state ownership. Whilst western scholars like Clarke view state ownership as the ultimate root of the problem, Lin, Cai and Li do not seem to be bothered by it. In a report that Lin, Cai and Li presented to the World Bank in 1994,[557] the same year of publication of their book *The Chinese Miracle*, Lin, Cai and Li pointed out that the economic problems in China and other former socialist economies included the low level of incentives to workers and the misallocation of resources among sectors – the policy burden that they elucidate in their book, which was a rather common phenomenon in other former socialist economies as well.[558]

According to Lin, Cai and Li, China's national economy has enjoyed continuous growth throughout its reform process because China's approach was drastically different from the 'rapid eclectic privatisation' approach undertaken in other former socialist economies such as those in Eastern Europe and the former Soviet Union.[559] They argue that the key to China's success is the 'gradual, organic or

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555 Donald Clarke, above n 543, at 30.

556 Lin, Cai and Li, above n 547.

557 Justin Yifu Lin, Fang Cai and Zhou Li *China's Economic Reforms: Pointers for Other Economies in Transition?* (Policy Research working Paper 1310, The World Bank, 1994).

558 Ibid, at 5.

559 David Lipton and Jeffrey Sachs *Privatization in Eastern Europe: The Case of Poland* (Brookings Papers on Economic Activity, World Institute for Development Economics

evolutionary' approach that China has been undertaking during its reform process. This approach is partial, incremental, sequential and often experimental. It does not pursue large-scale privatisation.[560] Just as Clarke observes, "[p]rivatisation may be an occasional side-effect of this process but it is scarcely a major goal."[561]

One important point to note is – state ownership or privatisation does not form part of Lin, Cai and Li's debate – they do not appear to be bordered by who is the owner. To their mind, as long as the policy burden is removed, SOEs can do just as well as privately-owned enterprises. As Guo puts it, a significant reason for their difference lies in a restriction set by the government of the Communist Party of China on scholars' research work. The government only wanted leading Chinese economists like Lin, Cai and Li and their other fellow scholars to advise on how to preserve state ownership as an ideological pillar for China's socialist regime, rather than how to replace state ownership with privatisation, as those prominent western scholars like Clarke would naturally advocate.[562]

The difference can be better understood by examining Lin, Cai and Li's policy suggestions. Working under the mandate to preserve state ownership, Lin, Cai and Li maintain that China's SOE problem is caused by two sources. First, SOEs are rooted in the socialist economic system in which there are no well-defined property rights – in theory, SOEs belong to all the people, but in reality, they cannot be operated or managed by all the people. Consequently, granting more autonomy to SOEs would result in the creation of ample opportunities for managers and workers who are not SOE owners to foster 'insider control'[563] and in turn 'steal' from the SOEs. Second, the government tends to compensate the losses of the SOEs, irrespective of whether such losses are the result of 'stealing' by their managers and workers. Lin and the others thus suggest that the government should (i) maintain the SOEs without privatisation but by way of better definition of property rights in those SOEs, and (ii) eliminate policy burden on SOEs through the

Research, United Nations University, Helsinki, 1990), at 296-299, and 332-334. See also Guo, above n 538, at 74.

560 Lin, Cai and Li, above n 557, at 3-7.

561 Donald Clarke, above n 543, at 27.

562 Guo, above n 538, at 74-75.

563 Shuguang Zhang "Kong Zhi Nei Bu Ren Kong Zhi" (Translation: Control Insider Control) (1996) 6 Jing Ji Yan Jiu (Translation: Economic Research).

implementation of tight fiscal and financial reforms to reduce the value of policy burden for the government.[564]

It appears from development in the following decade, from the 1990s to the 2000s, that the government did adopt and implement those economists' policy suggestions. The government gradually strengthened the state's property rights over SOEs and reduced its imposition of policy burdens on SOEs. Without policy burdens, SOEs grew rapidly. Large SOE businesses incorporated during the said period attained double digit increase in profitability.[565] Through various initial public offers (IPOs), Chinese SOEs managed to maintain state ownership whilst enlarging their asset pools. Classic examples cited by Clarke are China Telecom Corporation Limited (CTCL) and Guangzhou Light Industrial Group (GLIG). CTCL is listed on the Hong Kong and New York stock exchanges. CTCL is almost 80% owned by China Telecom Group Company (CTGC), a traditional SOE which issues no shares and is directly held by the Chinese government with less than 12% of its equity that was offered to the public. The transplant of the Company Law to China enables the creation of a controlled subsidiary in the form of a company limited by shares and the offer of a relatively small portion of its shares to the public. CTGC, CTCL's parent company (the holding SOE), could in essence increase the value of its assets without parting with state control. Another extreme example can be seen in GLIG in which a mere 6% of equity stake allows a 94% control of the "social capital" in GLIG, which is thus categorised as a "state-controlled" enterprise.[566]

The creation of a modern state ownership of big businesses has accelerated when China joined the WTO at the end of 2001. The Chinese government was deeply concerned if their SOEs would survive competition with much larger multinational corporations in the international arena. Hence, further economic reform to enable enlargement of the size of their SOEs became imperative and a matter of urgency. By 2009 China reported 43 Chinese conglomerates attaining Fortune Global 500 ranking.[567] With such phenomenal achievements under its belt, it was hardly

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564 Guo, above n 538, at 77.

565 Rongrong Li, *Guan Yu Guo You Qi Ye Gai Ge Fa Zhan De Bao Gao (Translation: A report on the reform and development of state-owned enterprises)*, Xue Xi Shi Bao (Translation: Learning Times) 22 April 2008.

566 Donald Clarke, above n 543, at 28.

567 CCTV "43 Chinese firms on Fortune Global 500 ranking" in Yan Liu (ed) (CCTV.com, Beijing, 9 July 2009): http://www.cctv.com/program/bizchina/20090709/105718.shtml.

surprising to see Rongrong Li, the then Chairman of the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council proudly declaring that China's modern state-owned big businesses had proved that state ownership did not necessarily mean low efficiency.[568] This year marks the 40th anniversary of China's adoption of its "Open Door Policy" – 120 Chinese big businesses have made it to the Fortune Global 500 List 2018, up from the 109 companies in 2017.[569]

C Emergence of Modern State Ownership

The transition from the traditional Chinese-style socialist SOEs to modern state-owned conglomerates canvasses a vast amount of legal changes. The most important legal change involves the transformation from traditional state ownership to modern state ownership. Traditional state ownership means the system with state-delegated prerogative to central and local authorities and agencies to decide on (i) the assignment and removal of managers and workers who enjoy *de facto* life-long employment benefits, welfare and insurance (that is, the "iron rice bowl" discussed in Section C 1 in Chapter III above), (ii) the outputs of the SOEs, and (iii) the allocation and submission (back to the state) of the revenues of the SOEs.[570] During this transitional period as discussed in Sections C 1 and C 2 in Chapter III above, China's enterprise reform canvasses the so-called "power-delegating-and-profit-sharing" (*fang quan fen li*) approach which encapsulates the separation of ownership of the state and managerial rights of the enterprises. However, this reform did not change the basic respective institutional frameworks of state ownership and SOEs which in turn led to chaotic relationships of property rights and serious maladies of unchecked insider control. The delegation of managerial and decision-making powers to factory managers who became the legal representatives of such SOEs without installing any corporate governance mechanism like a board of directors would essentially mean the grant of *de facto* partial ownership to them. Consequently, this *de facto* partial ownership became the impetus for many SOE legal representatives to attempt to turn the *de facto*

568 Rongrong Li, above n 565.

569 Jie Zhang "Global 500: Chinese companies race ahead" *China Daily* (Beijing, 20 July 2018).

570 Guo, above n 538, at 78.

partial ownership into *de jure* complete ownership, which gave rise to a series of corruption cases involving such SOE legal representatives.[571]

Modern state ownership can be described as the refitting or reconditioning of both the SOEs and their supervisory authorities and agencies. Following such refitting and reconditioning, the State holds clearly designated property rights which means that the State will no longer determine the outputs or revenues for its SOEs nor will it be concerned with other matters than those related to profit maximisation.[572] This refitting and reconditioning is the result of the corporatisation of the Chinese SOEs through legal transplants in the Company Law to ensure implantation into the Chinese corporate regime. This also sheds light on an alternative theoretical perspective – economic development in the 20th century has been characterised by such economic historians as Chandler, Amatori and Hikino as the result of the rise of big businesses that re-defined the size and pace of economic development in various nations.[573]

In the recent years, international organisations like the United Nations, economists and politicians have advocated for such big businesses to be developed in the developing parts of the world to further and better economic development.[574] From China's perspective, its economic development is highlighted by the growth of big businesses. It can be said that the success of its economy rests on the construction of a modern enterprise system and the rise of Chinese "big businesses". If big businesses have prompted economic development and if legal changes are necessary to build big businesses, as in the case of China, then legal changes through legal transplants from the West that have facilitated the building of such big businesses have contributed to China's corporate performance. These two assumptions will certainly need to be tested. And assuming that these assumptions are correct, the lawmakers' original intent to foster western-style private

571 Jinglian Wu, "Understanding and Interpreting Chinese Economic Reform", (2005) Thomson/South-Western, at 148-153.

572 Guo, above n 538, at 90.

573 See generally Alfred D Chandler Jr, Franco Amatori and Takashi Hikino, "Historical and Comparative Contours of Big Business", in AD Chandler Jr, F Amatori and T Hikino (eds) *Big Business and the Wealth of Nations* (Cambridge University Press, Cambridge, 1997), at 5-6, and 11-13.

574 William Lazonick, "Entrepreneurial Ventures and the Developmental State" (Paper prepared for UNU-WIDER, Helsinki, 2007): www.wider.unu.edu/stc/repec/pdfs/rp2008/dp2008-01.pdf.

corporations and the outcome of such transplant which predominately benefits state ownership are quite different and are, as this thesis argues, misunderstood or lost in translation. Just as Harvard historian William Kirby has observed: transplanted corporate law ending up benefitting state ownership is not rare in Chinese history. According to Kirby, the history of economic development in China since the introduction of *Gongsilü*[575] in 1904 proves the case that (i) corporate law is a useful means to define limits to foreign economic activity in China, and (ii) the Chinese state is the prime beneficiary of the adoption of the regulated corporate form of business activity. However, after examining legal discourse and development over the course of the 20th century (including the first Company Law of the People's Republic of China – the Company Law 1993),[576] Kirby concludes that the lawmakers would be rather mistaken to assume that the modern corporate law which fosters the anonymous private corporation on a western model would be the essential vehicle for "*private* Chinese economic development" or the essential means to "facilitate commerce and help industries" in modern China.[577]

In order to appropriately capture the legal changes that define state ownership in China, a legal realism approach will have to be taken as black-letter law may not always be efficacious in terms of resolving concrete legal issues in China. Procedural and administrative influences will not simply disappear because a new law has been enacted. Formal legislation such as the promulgation of the Company Law 1993 certainly plays a crucial ground-breaking role which has, together with the substantively revised Company Law 2005, led to the formation of Chinese big businesses. And the corporatisation of SOEs was formally implemented through the legislation of the Company Law 1993. By the same token, policies and decisions rolled out from time to time by the central and local governments should be considered as they often adjust, limit or revise formal or national laws. Hence, the picture should be painted to include the local corporatisation experiments prior to the formal legislation of the Company Law 1993.[578]

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575 *Gongsilü* was China's first Company Law which was issued on 21 January 1904 by the then Ministry of Commerce (*Shangbu*) under the Qing government – almost 90 years before the promulgation of the Company Law 1993 by the PRC government on 29 December 1993.

576 Company Law 1993, above n 184.

577 William C Kirby, "China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China", (1995) 54(1) The Journal of Asian Studies 43, at 44 and 58-59.

578 Guo, above n 538, at 79.

China's corporatisation experiments took place as early as the 1980s in various special economic zones along the coast, such as Shenzhen (in Southern China), Shanghai (Eastern China) and Shenyang (Northern China). Provincial and municipal governments would issue local regulations with the objective of transforming local SOEs into corporate form. These local regulations permit SOEs to form corporations under a rather fluid legal framework: (i) through their articles of association, SOEs may form corporations and enlist private investors; (ii) such newly formed corporations would be granted independence in terms of rights to making decisions on their daily operations, employing managers from outside the bureaucratic systems, and installing remuneration arrangements for their managers and workers; and (iii) ownership structures that canvassed both the state and employees' interests could be set up by such SOEs. These arrangements not only facilitated problem-solving options especially for struggling SOEs, but also fostered willingness of SOE managers to break away from traditional SOEs' business style in order to pursue objectives that were designed to achieve profit maximisation.[579]

Such experiments became prevalent all over China. For instance, even the local Sichuan provincial authorities (in the far western China) stipulated local rules to regulate the conversion (possibly without state scrutiny) of portions of its local SOEs' profits respectively into (a) taxes for submission to the state and (b) capital for reversion to the enterprises.[580] The central government eventually found such experiments unsatisfactory in that there was a want of firm state control which might jeopardise social stability. In 1993, the "Decision of the Central Committee of the Communist Party of China on Some Issues Regarding the Establishment of a Socialist Market Economic System" (**1993 Decision**)[581] was issued by the state to adjust the central government's strategy for SOE reforms. The 1993 Decision explicitly provided for an emphasis on the "institutional innovation of enterprise reforms" by way of establishment of a "modern enterprise system" by the government which would have "clearly defined property rights".[582] In other words,

579 Liufang Fang "China's Corporatization Experiment" (1995) 5 Duke J Comp & Int'l L 149-269, at 151-153.

580 Ibid, at 156-157.

581 1993 Decision, above n 183.

582 Ibid.

the 1993 Decision were designed for the state to put in place concrete measures to standardise corporatisation of SOEs.

The Company Law 1993 and the legislative actions and governmental policies which were rolled out throughout the 1990s to adjust, refine and re-shape such experiments and reforms have collectively contributed to the rise of China's modern state ownership. Amongst these legislative actions and governmental policies, it can be identified that three conditions were set for this modern state ownership. First, they redefined the state as the ultimate owner of the SOEs and reorganised the control structure. Second, they debilitated the control of the non-professional governmental or party bureaucrats and empowered the managers in the SOEs. Third, they restrained the multiple agendas of the bureaucrats who supervised the SOEs to profit maximisation.[583]

The first condition was met through the transplant of the Company Law 1993 which, albeit modified to suit the Chinese condition, installed a standardised corporate system which was implanted into all SOEs through a government-imposed enforcement campaign. The Company Law 1993, together with other subsequent legislative acts and policies, excluding private actors, achieved the following legal changes: (i) capital requirement was installed to prevent corporatisation of those SOEs or private parties who were not approved by the central government; and (ii) a new corporate governance system was set up with shareholders' meeting being raised as the most powerful authority as discussed in Sections D 1 and E 2 (2) in Chapter III above. These changes set themselves apart from the corporate governance practices under the Anglo-American models, which were supposed to be the subject of the transplants incorporated in the Company Law 1993. They deviate from such western practices in that there is normally no capital requirement for private corporations set up in the West nor is their shareholders' meeting conferred with most of the controlling powers – a direct transplant would mean the adoption of the boards of directors being the highest governing body in western-style corporations, as discussed in Section D 1 in Chapter III above. These are obvious examples of the Company Law being adapted with Chinese characteristics to suit the State's agenda and strategy for economic development.

The Company Law 1993 did not bestow workers with rights to elect managers, as a traditional SOE entailed. Instead, it provided that managers should only be

583 Guo, above n 538, at 80-81.

accountable to the shareholders' meeting, which is controlled by the State, whether directly or indirectly. Those traditional agencies under the old SOE regime, for instance, party committees, labour unions, and worker-delegates' meetings, were stripped of their powers as central government closed those avenues that might allow such agencies to influence corporate management. For example, the State decided to temporarily suspend the issuance of internal employee shares to SOE employees in 1994 and has not reverted this measure ever since. This measure put a stop to the convenient way for workers to be involved in decision-making and profit-sharing of the SOEs.[584] As both private actors and workers were excluded, the State, being the controlling shareholder in most cases, secured the power to appoint the legal representatives of the SOEs (who are normally the Chairman of the board or the CEO) who held virtually all managerial powers and had the effective control of the corporations.

The Company Law 1993 also assisted in fulfilling the second condition. The direct control system of SOEs by non-professional, government or party bureaucrats was put in place in the 1950s, following the establishment of the PRC. Traditionally, SOEs managers had no power to run the SOEs. They were "puppets" who were controlled by various bureaucrats from their supervisory administrative authorities or agencies (*xing zheng zhu guan bu men*). The Company Law 1993 specifically provided that unless otherwise stipulated by other laws or administrative regulations, registration of companies would not require the prior approval of any administrative agency.[585] This provision was important because it severed the once exclusive power enjoyed by the supervisory authorities. Even though the provision might have still left certain room for administrative approval, bureaucratic interference of SOEs' management could be inhibited by the implied *ultra vires* principle canvassed under this provision. This is because such administrative or supervisory authorities' power could only derive from laws promulgated by the NPC and the interim provisions and regulations stipulated by the State Council, any act that went beyond their delegated authority would be deemed void (which is akin to the implied *ultra vires* principle under a common law system).[586]

584 Fang, above n 579, at 156-157.

585 Company Law 1993, above n 184, art 8.

586 Fang, above n 579, at 175-178, and 254. See also Company Law 1993, above n 184, art 8.

Governmental policies played an important role in eradicating non-professional government or party bureaucrats' direct control and conferring managers with operational and managerial powers. In fact, these policies started making their marks since the government-initiated separation of the state from enterprises and enhanced enterprise autonomy in the late 1970s. For instance, the State Council enacted several provisions expanding the autonomous managerial powers enjoyed by SOEs in 1979, provisional regulations on SOEs in 1983, and several provisions on deepening enterprise reforms and increasing enterprise vigour in 1986.[587] In the mid-1980s, the government enacted the 1984 Decision[588] which offered a lengthy explanation why traditional SOEs should become legal persons with enhanced autonomy and managerial powers in order to make them competitive.[589] Phrases like "legal person", "enterprise" and "corporation" became popular phrases associated with the SOE reform in China. By the time when the government expanded corporatisation to all SOEs in the 1990s, administrative interferences with corporate affairs decreased despite the tightening of bureaucratic control.[590]

The third condition was fulfilled through the government's big leap to reorganise its administrative structure – the installation of the State-Owned Assets Supervision and Administration Commission (**SASAC**) in 2003. This initiative was first contemplated in 1988 when the World Bank suggested that the ownership of SOEs might be held by one designated administrative agency instead of many.[591] The State Council took on this suggestion and established the Stat-owned Assets Administration Bureau (**SAAB**) which assembled controlling power in SOEs. In 2003, the State Council established the SASAC by way of an administrative act. This act clarified SASAC's controlling rights by explicitly separating central, provincial and municipal SOEs and allocating control over the SOEs to the respective SASAC's offices at the corresponding administrative levels.[592] The

587 Schipani and Liu, above n 189, at 8.

588 1984 Decision, above n 194.

589 Schipani and Liu, above n 189, at 6-7.

590 Wu, above n 571; and Guo, above n 538, at 82-83.

591 Guo, above n 538, at 83.

592 Interim Regulations on the Supervision and Management of State-owned Assets of Enterprises (adopted at the Eighth Executive Meeting of the State Council on 13 May 2003, and promulgated by the Premier of the People's Republic of China to take effect on 27 May 2003): http://en.sasac.gov.cn/n1408035/c1477199/content.html [**SASAC Regulations**].

SASAC is legally tasked with such functions as assuming the rights and responsibilities as the owner to carry out reforms and reorganisations of SOEs; appointing boards of supervisors to monitor SOEs; appointing and dismissing enterprise managers; auditing state assets; and such other functions as may be allocated to them by the respective government authorities.[593]

Besides the above functions, the SASAC may formulate rules and systems on the supervision and administration of the state-owned assets of all SOEs. This ensures the removal of the control of the SOEs from various governmental agencies and bureaucrats and confirms the unitary supervision of all SOEs by the SASAC.

By fulfilment of these conditions, the government managed to set up China's modern state ownership (or sometimes termed by other scholars like Lin, Milhaupt, Bremmer and Stewart as "state capitalism", noting that the concept of China's own form of capitalism – "Sino-Capitalism" – has been developed as a result of this research).[594] This modern state ownership enables the building of big businesses without the policy burden problem discussed above. Under the modern state ownership, managers – led by a legal representative who is usually assigned by the SASAC to focus on steering the SOE to profitability – could execute reform measures to maximise profitability with less interference. For example, the reform to "break the iron rice bowl" entitled managers to lay off unqualified, unsuitable or redundant workers, whilst the government would be refrained from interfering given that autonomy was granted to the modern SOE big businesses to implement measures to bring the businesses to profitability.[595]

Having installed the legal infrastructure of modern state ownership, the government managed to gradually convert failing or struggling SOEs into big businesses. Many of them have become global players recognised on the Fortune Global 500 list in the recent years. Other than those enterprises which produce strategically important or special products and military industrial enterprises, SOEs have been transformed into modern businesses with managerial independence. Through various SASAC offices at different administrative levels, the state holds a

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593 SASAC Regulations, above n 592, art 13.

594 Lin and Milhaupt, above n 542; and see also Ian Bremmer and Devin T Stewart "China's state capitalism poses ethical challenges" *(Asia Times Online* 17 August 2010). Sino-Capitalism will be discussed in Chapter VI below.

595 Guo, above n 538, at 84.

controlling ownership in "pillar industries", "key enterprises in the basic industries" and for those "general enterprises where non-state-owned capital will be absorbed as much as possible", the state maintains equity participation.[596]

D Legal Transplantation and State Ownership

At first glance, the Company Law 1993 appeared to be a magnificent legal transplant which embraced in many formal respects the western-style governance institutions. This law granted corporations legal personality and limited liability. It confirmed that corporations would have shared ownership by equity investors. It constituted delegated management under a two-tier board structure. It provided that shares should be transferable in principle, albeit non-transferable shares such as state shares and legal person shares continued to exist.[597] However, in reality, this transplanted law did not function as western scholars would have expected. Fang commented that the transplantation inevitably imposed more burdensome bureaucratic approvals and expensive procedures on Chinese corporations. He noted that certain transplants were implanted without sufficient consideration of "the necessity, feasibility, and compatibility of such transplantation."[598] The Company Law presented more transitional problems than other legislation because the legislators included provisions aiming at changing the *status quo ante* by imposing varying degrees of limitations on administrative agencies' powers as opposed to attempting to adapt the new law to the existing rules and regulations.[599] His assessment was countered by policymakers such as Xiping Gao, the then Chief Counsel and Director of Public Offerings of the China Securities Regulatory Commission, the regulator of the capital market in China. Gao published a paper in response to Fang's 1995 article,[600] arguing that the transplanted rules were indispensable to "ensure the continued and successful development" of Chinese corporations. That said, Gao did concur with Fang that the current corporate and securities regulatory framework "allows too many forces to play, making it a

596 Guo, above n 538, at 84.
597 Fang, above n 579, at 200.
598 Ibid, at 254.
599 Ibid, at 253.
600 Xiqing Gao "The Perceived Unreasonable Man - A Response to Fang Liufang" (1995) 5 Duke J Comp & Int'l L 271-288.

cumbersome, inefficient, and frequently confusing system".[601] He however saw its potential to promote western-style corporate governance towards which Chinese corporations were moving even though this transplantation and in turn transformation was a process which would take time. He and other like-minded legal scholars believed that the "inherent severe political restrictions" could not prevent the Company Law 1993 from promoting western-style corporate governance.[602]

What Gao (and perhaps more so in Gao's case) did not anticipate was that the Chinese government did not stop its reform simply at the promulgation of the Company Law 1993. As discussed in Section D 1 in Chapter III above, the Company Law 1993 was almost re-written twelve years later and the Securities Law was promulgated in 1998 and likewise substantially revised in 2005 as attempts on the part of the Chinese lawmakers to draw closer treatments between the state-owned and private sectors, and strengthen corporate governance for the protection of creditors, minority shareholders, stakeholders and employees.

More than two decades have passed since Fang and Gao's debate. That the Company Law would assist in improving China's corporate performance has been demonstrated. However, even Gao must have been surprised that the improved performance was not achieved through the simple transplantation of the western-style corporate governance regime. The transplanted corporate law which has been adjusted with Chinese characteristics along the process of China's economic reform has helped establish China's modern state ownership that has facilitated the transformation of traditionally underperformed SOEs to modern state-owned big businesses.[603]

Modern state ownership has improved China's corporate performance by facilitating the increase in corporate scale and guaranteeing structural stability. With the installation of the SASAC, both central and local governments become profit-seeking owner-investors. They can then steer the managers to embracing profit-maximisation in a more effective manner which in turn benefits the rest of the ecology – the creditors, minority shareholders, stakeholders and employees. The new incentive structure contributes to the stability of these big businesses which

601 Gao, above n 600, at 279-280.

602 Ibid, at 286-287.

603 Idea borrowed from Guo, above n 538, at 85-86.

fosters unparalleled economic growth. This thus bestows them with productive and expansion opportunities unavailable to other firms.[604]

The nation-wide corporatisation of SOEs in the 1990s essentially ended the locally-based corporatisation experiments in the 1980s. The improved corporate performance did not come without cost, nor was it the only or best way to take the economy forward. For instance, SOE managers who were given ample powers under the new corporatisation regime became frequent delinquents against state property rights – in the 1990s, corruption offences committed by SOEs' legal representative (managers) often made national news. The Chinese media used idioms like "poor temples headed by rich monks" to describe cases where SOEs went into liquidation whereas their legal representatives became millionaires.[605]

It appears that the inevitable debate between these legal elites lies in the way they evaluated transplanted law – their assessment is often based on how the transplanted law adheres to the advanced model from one or more western jurisdictions as opposed to how well it works in China. They usually view the installation of modern corporate law as a goal as it will help the recipient jurisdiction build a good western-style corporate governance system. Most of them did not look into how the transplanted law was used in reality and hence did not anticipate this rise of state ownership through the transplanted law. To date, the question of whether and how legal transplantation contributes to China's economic development still puzzles scholars and policymakers across the globe. Some of them insist that legal transplants in China have largely facilitated economic development. Others question whether China is truly committed to legal transplantation. They consider the Chinese government selectively transplants western laws and institutions to suit its political priorities, however, those critical components which support good governance are often ignored or modified.[606] Consequently, the transplanted laws in China appear to be a "distorted" version of

604 Guo, above n 538, at 86.

605 Liufang Fang, "Guo Qi Fa Ding Di Biao Ren De Fa Lü Di Wei Quan Li He Li Yi Chong Tu" (Translation: The Legal Representatives of State-owned Enterprises: Legal Status, Power and Conflict of Interest), (1999) 3 & 4 Bi Jiao Fa Yan Jiu (Translation: Comparative Law Studies) 419-438.

606 Guo, above n 538, at 88-89.

the western model because it is essentially a selective adaptation.[607] Hence it warrants continued efforts to understand China's participation in international legal regimes through legal transplantation and the role legal transplants play in its economic development.

Contemporary commentators like Allen, Qian and Qian maintain that good corporate law is indispensable for good corporate governance and in turn good corporate performance. China is, however, considered to be a "counter-example".[608] Scholars' general perception is that Chinese corporate governance law is inadequate. For example, Clarke points out Chinese policymakers have directed lawmakers to adjust the transplanted corporate law to suit other purposes such as maintenance of the one-party-state control, urban employment levels, direct control over sensitive industries and politically motivated job placement and retention and so on. This inevitably leads to the conflict of interest between the state as controlling shareholder and other shareholders and the state's tendency to exploit minority shareholders who have no other way to benefit from their investment. He thus comments that the entire Company Law was "hijacked" because this transplanted law has been modified to cater for the organisation under the "modern enterprise system" to fulfil the purposes listed above so that state ownership may continue. This also means that all corporations (public or private) have to be subjected to a new set of governance rules that makes sense only in a heavily state-invested economy.[609]

Liu reported that China appeared on the low-end respectively of 49 economies (ranking 44th) surveyed by the World Economic Forum in 2003 and 60 economies (average rank 41.5) surveyed by the International Institute for Management Development (IMD) in Switzerland in 2004, ten years after the Company Law 1993 became effective. When assessing a country's overall corporate performance, the IMD's emphasis is on the following four aspects: corporate board, shareholder value, insider trading and shareholder right. China ranked 25th on the corporate board category, 40th on shareholder value, 57th on insider trading, and 44th on

607 Pitman B Potter, "China and the international legal system: challenges of participation", (2007) 191 The China Quarterly 699, at 700-703, and 715.

608 Franklin Allen, Jun Qian and Meijun Qian, "Law, finance, and economic growth in China", (2005) 77(1) Journal of financial Economics 57-116, at 57 and 59.

609 Donald C Clarke, "Corporate governance in China: An overview", (2003) 14 China Economic Review 494, at 495.

shareholder right. Not surprisingly, China's overall ranking appeared very low on these lists due to its weak corporate board, low shareholders' value, massive insider trading and unprotected shareholders' rights.[610] That said, it is worth noting from the 2004 IMD survey[611] that China's ranking on corporate board was higher than Japan (50th), Korea (53rd) and Indonesia (56th), and surprisingly even the United States (35th), Sweden (38th) and Germany (44th). It appears that the policies and institutions introduced by the Chinese government to improve corporate board independence through the transplanted laws on independent directors and board of supervisors (as discussed under Section D 4 in Chapter III above) have been acknowledged by the rating agencies, albeit it that they were generally considered to be not terribly effective (as discussed under Section F 2 in Chapter III above).

Interestingly, China's corporate performance seems to be going from strength to strength. Allen, Qian and Qian find that "[d]espite its poor legal and financial systems, China has one of the fastest growing economies in the world".[612] In 2004, China was the second largest economy based on GDP adjusted for PPP. They anticipated that if the current trends would continue, China would overtake the United States and become the largest economy in the world in ten years.[613] They were right indeed – as discussed in Section A of Chapter III above, the IMF predicted in April 2014, and confirmed in October the same year that China surpassed the United States to become the largest economy in the world in terms of GDP adjusted for PPP, putting the United States in the second place for the first time in 142 years.[614]

Economic and legal elites have attempted to explore how China forms such a "counter-example". Some consider the statistics could be problematic, whilst some comment that the economic performance would not last. Others suggest that such other non-legal institutions as reputational sanctions may have worked in the stead of legal institutions. Scholars like Guo comment that statistics have been verified through other means while economic growth has continued. Hence, the first two arguments are not terribly convincing. The third suggestion warrants further

610 Qiao Liu, "Corporate governance in China: Current practices, economic effects and institutional determinants", (2006) 52(2) CESifo Economic Studies 415, at 431-433.

611 Ibid, Table 5 – Panel A: IMD 2004 survey, at 432.

612 Allen, Qian and Qian, above n 608, at 59.

613 Ibid.

614 Bird, and Duncan and Martosko, above n 89.

research and exploration, as this appears to be a novel approach to which little attention has been given as a matter of fact.[615]

Guo elucidates that the difficulty lies in the approach adopted. Guo opines that scholars in the West typically rely on the neoclassical economic theory that economic development is the natural outcome of a self-regulated or free market. Such a market includes private players with divergent interests. He finds that western scholars are generally used to working in a legal system that protects minority shareholders in its corporate law and that their interests can only be reconciled by well-functioning laws, amongst which the important ones are contract and property laws. In reality, the Chinese corporate law may not adequately protect minority shareholders' rights, however, law's function in promoting economic development appears to go beyond such considerations in China. The Company Law that was expected to be transplanted to build western-style private corporations in China has facilitated the formation of its modern state ownership instead.[616] This Chinese modern state ownership has in turn been contributing to the rise of state-owned big businesses which enables centralised management and control of an upward and continuous GDP and economic growth.

Nowadays, China stands second only to the United States in terms of the number of the world's largest companies by revenue on the Fortune Global 500 list. This represents a continuous trajectory of increase from only 10 in 2001,[617] 43 in 2009,[618] to 109 in 2017.[619] A high majority of these 109 gigantic Chinese companies are SOEs controlled by SASAC. Lin finds that when assessing these

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615 Donald Clarke tries to examine the non-state institutions of corporate governance in China because he also believes that very little attention has been paid to the institutions outside the Chinese state regulatory structure in which both formal and informal corporate governance norms are expected to function in China: see generally Donald C Clarke "The role of non-legal institutions in Chinese corporate governance" in Curtis Milhaupt, Kon-Sik Kim and Hideki Kanda (eds) *Transforming Corporate Governance in East Asia* (2008) 168-192.

616 Guo, above n 538, at 90.

617 There are 132 companies from the United States (ranks first) and 109 from China (second and increasing from only 10 in 2001) on the Fortune Global 500 List 2017: https://www.someka.net/checkout/order-received/416461/?key=wc_order_yqTlPSRQRDKd5; https://en.wikipedia.org/wiki/Fortune_Global_500#Fortune_Global_500_list_of_year_2017 and http://fortune.com/global500/list/ [accessed 17 January 2018].

618 CCTV, above n 567.

619 Fortune Global 500 2017 List, above n 617.

SOE big businesses, scholars tend to benchmark the governance attributes of these Chinese corporations against international corporate governance standards and institutions. They would typically concentrate on the corporate boards, independent directors, information disclosure, shareholders' rights protection, and other governance-related institutions commonly adopted by western companies. The conclusions they would normally come up with tend to show that there is a significant want of "internationally-recognised" governance institutions in such SOEs.[620]

These conclusions inexorably present a puzzle of how such a system which is lacking governance institutions that are considered so very important to western companies produces a whole bunch of the world's biggest businesses and what alternative mechanisms are in place to fill that void? This appears to be an enigma that legal scholars and policymakers have yet to begin to comprehend, let alone attempting to decipher it, as US scholar Marshall Meyer quite rightly puts it:[621]

> China's current trajectory is not in the direction of capitalism…Rather, the current trajectory is toward central management. A further suggestion is that having co-opted Western capitalism and mirrored many of its surface features, China today poses an unprecedented and profound challenge to Western capitalism that scholars and policymakers have only begun to grasp.

Meyer's comment above is rather insightful – like Meyer's, the discussion in this thesis thus far also points to the direction that China's current trajectory is going towards central management via state ownership to achieve its economic growth through legal transplants which mirror the façade of Western capitalism and bear the surface features of its governance institutions and norms. Meyer further observes that this "increasingly centralized Chinese economy" is undergoing rapid economic growth and that:[622]

> GDP growth in China is an imperative, a given that is deeply institutionalized and will be maintained at almost any cost…China has had to centralize control of the economy in order to maintain acceptable rates of GDP growth given the parlous state of the global economy.

620 Li-Wen Lin, above n 205, at 1.

621 Marshall W Meyer "Is It Capitalism?" (2011) 7(1) Management and Organization Review 5, at 8.

622 Ibid, at 15.

In order to "crack this nut" to enable a glimpse of the contents of this enigma, it is important to understand CHINA INC for what it is rather than what people wish it to be. The following section uncovers the web of intertwined ecosystems in which groups of China's big businesses are organised, with an analysis of institutionalised mechanisms connecting the business groups with other organs of the one-party state.

E Overview of China's SOE Ecosystems

As discussed in Section F 2 in Chapter III and Section D of this Chapter IV above, China's corporate governance system has been analysed and assessed by way of benchmarking at great lengths the governance attributes of Chinese corporations (typically listed SOEs) against international corporate governance institutions and norms which are usually the subject of transplants by Chinese lawmakers into China. This approach certainly provides insights on how well they fare from the western perspective but invariably places its emphases simply on the shortfalls of the Chinese system. In other words, they critique what the Chinese system lacks, but not its fundamental construction nor how it actually functions. This has blinded them from recognising the correlation between the Chinese nature, local conditions and implantations of such transplanted institutions and norms. An overview of China's SOE corporate ecosystems will assist with the appreciation of the construction of these ecosystems and how they actually function alongside the transplanted institutions and norms from the West.

Chinese SOEs are interconnected by a web of relations with one another and various types of entities and organs in the ecosystems. This network is composed of certain actors and relational ties. These actors include those SOEs, SASAC, various government organs and financial institutions. The relational ties include ownership, strategic alliance, personnel and supervisory connections.[623]

In China, most of the SOE big businesses are structured as business groups (*qiyejituan*).[624] Each business group has a hierarchical ownership structure and governance system. There are often a number of member entities or firms within

[623] Li-Wen Lin, above n 205, at 2.

[624] Tyler M Rooker "Corporate governance or governance by corporates? Testing governmentality in the context of China's national oil and petrochemical business groups" (2014) Asia Pacific Business Review 1, at 2.

each group which are intertwined through equity, personnel and other relationships. These business groups are not isolated networks but carry ubiquitous institutional connections through ownership, personnel, financing, supervision and strategic cooperation as "institutional bridges" which form a wider web of ecosystems that bring the business groups under the umbrella of SASAC.[625] The following sections will illustrate the hierarchical structure of these SOE business groups and the institutional bridges that interconnect such ecosystems.

1 Chinese SOEs as Big Business Groups: Structure and Governance

Modern Chinese big businesses are typically organised as multi-layered business groups serving different functions. Each business group usually include a nucleus company, a finance company, several listed companies and research institutes. The nucleus company is a holding company wholly owned by SASAC. Underneath the nucleus company there are multiple layers of subsidiaries which include listed companies, finance companies, research institutes and numerous companies related to its production chain.[626]

As discussed in Section D in this Chapter IV above, many of the nucleus companies were former government ministries, bureaux or agencies which supervised the relevant SOEs before restructuring pursuant to the Company Law and the SASAC Regulations. The nucleus company sets the development and growth strategies for the group and coordinates the execution and relationships amongst its member companies and subsidiaries. It also plays a bridging role between the State and its group members. It passes down policies and their execution rules received from the State to member companies and then passes up their members' proposals and information to the State.[627] The nucleus company and its business group companies can be undergoing at different stages of restructuring reforms to enable the execution by SASAC of strategic decisions of the Central Party Committee and the State Council to form "an effective and balanced corporate governance structure and a flexible and efficient market

625 Li-Wen Lin, above n 205, at 2.
626 Ibid.
627 Ibid.

mechanism" – State Grid Corporation of China (State Grid) is one of the typical examples to illustrate this point.[628]

State Grid ranks 2nd on the Fortune Global 500 2017 List, immediately after Walmart of the United States which tops the list for the 4th year in a row. State Grid is the world's largest electric utility corporation and holds a monopoly in China. State Grid was founded in 2002, a by-product of China's three-stage power sector reform started in 1986. The reform segregated the former State Power Corporation of China into two grid companies, resulting in the emergence of State Grid. State Grid now owns and manages five regional power grid enterprises and 24 electric enterprises.[629] That being the case, it was only on 30 November 2017 that State Grid (together with its 21 secondary companies and 123 tertiary subsidiaries) marked the completion of corporate restructure from an industrial enterprise owned by the whole people under the old system to an enterprise wholly owned by the state[630] pursuant to the Company Law and SASAC Regulations. It received a new business licence (i.e. the western equivalent of a certificate of incorporation) from SAIC and was renamed State Grid China Company Limited as from 30 November 2017.[631]

The listed companies in such a business group, as opposed to the nucleus company, serve as the group's interface with the outside world and the public in the domestic market. Good examples are Sinopec Group and China National Petroleum Corporation. Not only are these two gigantic business groups the world's 3rd and 4th largest companies by revenue on the Fortune Global 500 2017 List, they also exercise a near duopoly over the wholesale and retail oil and gas industry in China.[632]

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628 State Grid, "State Grid Completed Company Restructure on Time Finishing the Transition from an Industrial Enterprise Owned by the Whole People to an Enterprise Wholly Owned by the State" (State Grid News, issued by State Grid Department of Legal Affairs, 7 December 2017) [accessed 23 January 2018]: http://www.sgcc.com.cn/ywlm/mediacenter/corporatenews/12/344013.shtml.

629 Fortune Global 500 2017 List – State Grid: http://fortune.com/global500/state-grid/ [accessed 23 January 2018].

630 For discussions relating to the transition of, and the differences between, SOEs owned by the whole people and SOEs owned by the state, please refer to Section C 2 in Chapter III above.

631 State Grid, above n 628.

632 Fortune Global 500 2017 List – Sinopec Group: http://fortune.com/global500/sinopec-group/; and China National Petroleum: http://fortune.com/global500/china-national-petroleum/; and

China Petrochemical Corporation (commonly known as Sinopec Group) is Asia's largest oil refining and petrochemical enterprise, the nucleus company owned and administered by SASAC, and the third largest company in the world by revenue. Its major subsidiary, China Petroleum and Chemical Corporation Limited (commonly known as Sinopec or Sinopec Limited in order not to be confused with Sinopec Group, the parent company) was established and listed in Hong Kong and New York in 2000 and then Shanghai in 2001.[633]

China National Petroleum Corporation (CNPC), one of the biggest central SOE nucleus businesses owned and administered by SASAC, ranks 4th (and was apparently overtaken by Sinopec as CNPC was ranked 3rd in 2016) in the 2017 Fortune Global 500. Alongside with Sinopec Group, it is one of the largest integrated energy conglomerates in the world. Its major subsidiary, PetroChina Company Limited (PetroChina), was established as a company limited by shares in 1999 as part of the restructuring of CNPC under the Company Law 1993. In the restructuring, CNPC injected into PetroChina most of CNPC's assets and liabilities in relation to its hydrocarbon exploration and production, refining and marketing, chemicals and natural gas businesses.[634]

PetroChina has been trading on the stock exchanges in New York and Hong Kong since April 2000 and Shanghai since November 2007.[635] PetroChina is 86% owned by CNPC. The remaining 14% is publicly listed on NYSE, HKSE and SHSE. CNPC and PetroChina develop overseas through a joint venture, CNPC Exploration & Development Company (CEDC), which is 50% owned by PetroChina. Although PetroChina is the most profitable company in Asia, its success may be the result of corporate management, it can also be attributed to the near duopoly on the oil and gas industry it shares with Sinopec in China.[636] From the above examples of big central SOE groups like Sinopec and CNPC, which are independent structure-

see also PetroChina website: http://www.petrochina.com.cn/ptr/gsjj/gsjs_common.shtml [accessed on 27 January 2018].

633 China Petroleum & Chemical Corporation website: http://english.sinopec.com/about_sinopec/our_company/20100328/8532.shtml.

634 Fortune Global 500 2018 List – China National Petroleum Corporation (**CNPC**): http://fortune.com/global500/china-national-petroleum/; and PetroChina website, above n 632.

635 PetroChina website, above n 632.

636 Ibid, and CNPC, above n 634; see also PetroChina Canada website – CNPC Family: https://www.petrochinacanada.com/about-us/cnpc-family.html [accessed on 27 January 2018].

wise and yet intertwined or closely related, it is worth noting that these big groups' high quality assets are consolidated from the nucleus company level into their respective overseas and domestically listed companies.

Apart from the listed companies as discussed above, another important group member is the finance companies within these big SOE business groups. These finance companies are non-bank financial institutions in China which can provide an expansive range of financial services for their group members. The finance company enables flexible management of financial resources across member companies in the group. It virtually serves as the hybrid of a commercial bank and an investment bank – it essentially accepts member companies' deposits, provides funding by way of loans and such other services as loan syndication, foreign exchange, financial consultation, underwriting securities for group members, consumer loans related to members' products, and participating in interbank securities market for members and so on.[637]

Research institutes often play an integral part in these big central or national SOE groups in China. A research institute within the group may engage in research which will benefit the group's productivity and products. Intellectual property derived from their research activities is usually vested in the holding company or allocated by way of contracts in joint projects with other external institutes. Some of such institutes even offer degree-awarding programs accredited by the State. For instance, the State Grid Electric Power Research Institute (SGEPRI). SGEPRI was founded in 2008 and is based in Nanjing, China. It has numerous scientific research centres and industrial bases in China. SGEPRI operates as a subsidiary of State Grid, the nucleus company of the group. It offers power system research and development services worldwide. The institute also provides technology and research services, testing and verification, and equipment manufacturing services.[638]

As illustrated above, these central SOE groups and their numerous subsidiaries in their respective industry chains form a vertical hierarchy of ecosystems in which their nucleus companies (usually national or central SOEs) are sitting at the top of

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637 Li-Wen Lin, above n 205, at 3.

638 Bloomberg, "Company Overview of State Grid Electric Power Research Institute" (26 January 2018): https://www.bloomberg.com/research/stocks/private/snapshot.asp?privcapId=117082693.

the corporate hierarchy. This hierarchy facilitates the State's centralised ownership or control through such nucleus companies under the administration of SASAC. It is not surprising to see SASAC being dubbed as "the world's largest controlling shareholder" or "China's Megashareholder".[639] As of December 2017, SASAC oversees 98 central SOEs.[640] SOEs under SASAC's watch have in 2017 a combined revenue of approximately RMB¥52.20 trillion (US$7.91 trillion) and a total owner's equity of RMB¥52 trillion, making it the largest economic entity in the world.[641] As Mancur Olson, one of the most influential American economists in the latter half of the 20th century, put it in his seminal book, *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*:[642]

> If an organization represents, say, a third of the income-producing capacity of a country, its members will, on average, obtain about one-third of the benefit from any effort to make the society more productive. The organization will therefore have an incentive to make sacrifices up to a point for policies and activities that are sufficiently rewarding for the society as a whole. The members of the highly encompassing organization own so much of the society that they have an important incentive to be actively concerned about how productive it is.

It is the very fact that SASAC owns so much of the society on behalf of the state that its primary objective is to ensure the SOEs under its watch achieve sound and continuous corporate performance. Because SASAC, acting as such an "encompassing organisation" for the state, has every incentive to seek "institutionalised GDP growth" which "means production, employment, and ultimately social harmony."[643] The next section examines the intra-and-inter-group relations and correlation with other parts of the ecosystems in terms of collaboration, consolidation and competition, where applicable.

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639 Marcos Aguiar and others "SASAC: China's Megashareholder" (*BCG Perspective* 1 December 2007).

640 SASAC website (in Chinese) (updated 29 December 2017) – List of Central SOEs: http://www.sasac.gov.cn/n2588035/n2641579/n2641645/index.html [accessed 22 January 2018].

641 SASAC website (in English): http://en.sasac.gov.cn/2018/01/23/c_311.htm [updated 23 January 2018].

642 Mancur Olson *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities* (Yale University Press, 1982), at 48.

643 MW Meyer, above n 621, at 14.

2 SOEs' Intra-group Relational Arrangements: Collaboration, Consolidation and Competition

At the turn of this 21st century when China implemented the earlier stage of SOE reforms, the state organised business groups in each of the strategically-important industries, for instance, aerospace, mining, nuclear, oil, steel, telecommunications and transportation. Consequently, there are three national groups in each of the air transportation, oil and telecommunications sectors and five in the power sector. The national groups in each sector compete with each other, albeit that competition in certain industries is limited due to oligopolies.[644]

Despite the domestic competition between business groups in the same industries, the state has been encouraging them to embark on collaboration in overseas projects to enhance their global competitiveness. National business groups in different industries are also urged to collaborate in their global expansion moves. Contractual strategic alliances or joint ventures (**CSAs/CJVs**), equity joint ventures (**EJVs**) and mergers and acquisitions (**M&As**) are the typical avenues for such collaborative relations and/or associations. These relations and/or associations in complementary industries are designed to facilitate technological advancement and such other initiatives as capital pooling, information sharing and marketing for such projects as those capital-intensive ventures. A more popular form of collaboration amongst these big business groups is M&As. When SASAC was established in 2003, there were almost 200 central SOEs. The number has been halved with SASAC reporting 98 central SOEs in late 2017[645] due to execution of ongoing SOE restructuring reforms by way of a litany of M&As brought forward by the state. The Chinese government appears to favour resolving inefficient management issues in SOEs through M&As, which is itself a transplanted institution established under corporate laws from the West – this concept was only transplanted into China just over a decade ago in August 2006.[646]

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644 Li-wen Lin, above n 205, at 3.

645 SASAC website, above n 640 – for the latest number of central SOEs.

646 See generally the Interim Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors, adopted by MOFCOM on 10 August 2006, and took effect on 8 September 2006: http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045825.shtml.

It has been reported that China has been streamlining and modernising its "bloated and debt-ridden state-owned sector" and creating conglomerates capable of competing globally. The government has ordered a series of M&As between central SOEs over a five-year period (roughly 2012-2017), reducing such big businesses to 98 from 117 under SASAC's control by the end of 2017.[647] Examples of relatively recent high-profile M&As include the acquisition by central SOE China Minmetals Corporation of China Metallurgical Group Corporation (MCC), which becomes China Minmetals' subsidiary. The acquisition marked one of the largest in China's metal sector as SASAC looked to overhaul SOEs in the coal, oil and steel sectors.[648]

One point that is worth noting is collaboration by way of M&As, CSAs/CJVs and EJVs may give rise to anti-monopoly or antitrust issues which can be rather prevalent amongst the biggest business groups in the same industry. China has adopted an anti-monopoly law in August 2007 which has become effective since 1 August 2008 (Anti-Monopoly Law).[649] To a large extent, the Anti-Monopoly Law bears the hallmarks of a legal transplant.[650] Just like the antitrust or anti-monopoly laws in most western jurisdictions, the Anti-Monopoly Law contains provisions dealing with restraints or potential restraints on competition in areas that are often

647 Matthew Miller and Fang Cheng "China says framework for state-owned enterprise reform 'basically complete'" *Reuters* (Beijing, 28 September 2017): https://www.reuters.com/article/us-china-soe-reforms/china-says-framework-for-state-owned-enterprise-reform-basically-complete-idUSKCN1C313P.

648 Josephine Mason "Minmetals takes over MCC as Beijing reforms state-run firms" *Reuters* (Beijing, 8 December 2015): https://www.reuters.com/article/us-cn-metallurgical-m-a-china-minmetals/minmetals-takes-over-mcc-as-beijing-reforms-state-run-firms-idUSKBN0TR10M20151208.

649 Anti-Monopoly Law of the People's Republic of China (adopted at the 29th Meeting of the Standing Committee of the Tenth National People's Congress 30 August 2007, took effect 1 August 2008) [**Anti-Monopoly Law**]: http://english.mofcom.gov.cn/article/policyrelease/Businessregulations/201303/20130300045909.shtml.

650 Tay-Cheng Ma "Legal transplant, legal origin, and Antitrust effectiveness" (2013) 9(1) Journal of Competition Law and Economics 65, at 69, in which Ma observes that the antitrust philosophy originates from America and has been introduced to many parts of the world since the 1920s.

described as the "three pillars" of antitrust – agreements in restraint of trade,[651] abuse of dominant market position,[652] and mergers or concentrations.[653]

Specifically, the Anti-Monopoly Law follows the substantive format of the majority of western competition laws, dealing separately with agreements in restraint of trade, monopolies or abuses of dominant market positions, and mergers or concentrations. The language of these provisions borrows heavily from articles 81 and 82 of the Treaty Establishing the European Community. Also, its provisions on mergers or concentrations appear to be drawn from the European Union Merger Regulation.[654] It would appear that having enacted the Anti-Monopoly Law which has heavily borrowed and transplanted foreign institutions and practices (at least in form if not in substance), these intra-or-inter-group collaborations would be subject to anti-monopoly scrutiny. However, given the state is the controlling shareholder, its national business groups appear to have been essentially exempt from anti-monopoly law enforcement,[655] especially and at least at the early stages of interpretation and enforcement of a new law. This thesis does not propose to delve into discussions as to whether and how legal transplants of western antitrust or competition laws work in China as it is beyond the scope of this research. As US scholar John Haley succinctly stated around three to four years prior to the promulgation of the Anti-Monopoly Law, the antitrust models that originated in the United States and Europe "were designed to deal with problems in advanced capitalist states in which the influence of private actors in national and international markets often seemed to outmatch the role of the state."[656] Haley further observed

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651 Anti-Monopoly Law, above n 649, arts 13 and 14: just like its German counterpart, the Anti-Monopoly Law prohibits two separate types of monopoly agreements – vertical and horizontal agreements; see also Xiaoye Wang "Highlights of China's new anti-monopoly law" (2008) 75(1) Antitrust Law Journal 133, at 138-139.

652 Anti-Monopoly Law, above n 649, arts 17-19.

653 Ibid, arts 20-31.

654 Susan Beth Farmer "The Evolution of Chinese Merger Notification Guidelines: A Work in Progress Integrating Global Consensus and Domestic Imperatives" (2009) 18 Tul J Int'l & Comp L 1, at 6 and 9. See also European Union Council Regulation 139/2004 O.J. (L 24) 1-22.

655 Angela Huyue Zhang "Antitrust Regulations of Chinese State-Owned Enterprises" in Benjamin L Liebman and Curtis J Milhaupt (eds) *Regulating the Visible Hand? The Institutional Implications of Chinese State Capitalism* (Oxford University Press, New York, 2016) 85-107.

656 John O Haley "Competition Policy for East Asia" (2004) 3 Wash U Global Stud L Rev 277, at 277.

that none of these models "were concerned with the state power or the need of the state to create conditions for effective market competition."[657]

That said, as China is considered a "counter-example"[658] and will strive to maintain its GDP and economic growth "at almost any cost",[659] the antitrust or competition law transplants from the West will, like other corporate governance law transplants as discussed in Chapter III above, be modified to suit China's conditions and ensure enforcement. And if the situation warrants actions to be taken to uphold its continuous economic growth, the Chinese government, as an "encompassing organization" which "owns so much of the society",[660] will take measures, however unconventional or extraordinary, to maintain the sustainability of the market. This point can be illustrated by China's first national and highest-profile domestic monopoly case against two gigantic SOEs, China Telecom and China Unicom, in November 2011, just over three years after the Anti-Monopoly Law became effective.[661]

On 9 November 2011, Li Qing, the Deputy Director General of the Price Supervision and Anti-Monopoly Bureau of the National Development and Reform Commission (**NDRC**), the authority in charge of price-related breaches of the Anti-Monopoly Law, made a surprise announcement on the China Central Television (**CCTV**), the national television channel. Ms Li disclosed at CCTV's daily midday news program "News in 30 Minutes" that NDRC had been investigating two gigantic SOE telecommunication operators, China Telecom and China Unicom, which together account for 90% of the country's broadband business, for alleged abuse of dominance in the broadband market. It was the first time for China's antitrust enforcement authority to conduct an antitrust investigation on its big SOE businesses.[662]

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657 Haley, above n 656.

658 Allen, Qian and Qian, above n 608, at 57 and 59.

659 MW Meyer, above n 621, at 15.

660 Olson, above n 642, at 48.

661 Loretta Chao "China Telecom, China Unicom Face Monopoly Probe" *The Wall Street Journal* (Beijing, 9 November 2011) [accessed 29 January 2018]: https://www.wsj.com/articles/SB10001424052970204358004577027283900972206.

662 Vikram Subhedar, Charlie Zhu and Chyen Yee Lee "China Unicom, Telecom shares hit on monopoly investigation" *Reuters* (Hong Kong, 9 November 2011): https://www.reuters.com/article/us-chinatelecom/china-unicom-telecom-shares-hit-on-

In this case, NDRC acted as a whistle blower and employed an innovative form of regulatory tactic by embarking on strategic public shaming against China Telecom and China Unicom. NDRC's announcement led to a plunge in the two SOEs' share prices in Hong Kong by more than 3% on the same day.[663] It was later revealed by the Xinhua News, China's national news agency, that the surprise announcement was a deliberate tactic adopted by NDRC in response to the uncooperative attitude of the two SOEs towards NDRC's investigations and strong oppositions from various ministries (e.g. SASAC and the Ministry of Industry and Information Technology (MIIT)) who were concerned about the controversy over the matter.[664]

As NDRC has considerable discretion in deciding whether, when and how to disclose an investigation, it can potentially use this discretion to its advantage. If the listed firm is uncooperative, it could face strategic public disclosure or shaming by NDRC resulting in substantial equity loss. If the firm is cooperative and readily rectifies its breach, NDRC may not disclose its investigation, may delay announcing, or even withhold, its decision, thereby minimising the negative impact on its stock performance.[665]

This case demonstrates that Chinese government agencies like NDRC are incentivised to take actions against SOEs, despite the strong political resistance that they might encounter. The fact that NDRC used the state media to make public announcements of their antitrust investigations is a unique and innovative move that has not been observed or executed in any other major antitrust jurisdictions. While public disclosure of an antitrust investigation is routine for enforcement authorities in other jurisdictions, the Chinese antitrust enforcement agencies use it strategically as a mechanism for reputation sanction. This new form of regulation is not used as an alternative to formal legal sanction, but rather a regulatory tool at

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monopoly-investigation-idUSTRE7A81CS20111109; see also Susan Ning, Yiming Sun and Jia Liu "Earlier Rumor Confirmed: China Telecom and China Unicom under Antitrust Investigation" *China Law Insight - Antitrust & Competition* (King & Wood, Beijing, 14 November 2011): https://www.chinalawinsight.com/2011/11/articles/corporate/antitrust-competition/earlier-rumor-confirmed-china-telecom-and-china-unicom-under-antitrust-investigation/
[both accessed 29 January 2018].

663 Ibid.

664 Angela Huyue Zhang "Strategic Public Shaming: Evidence from Chinese Antitrust" (2017): available at SSRN—2943268, at 9.

665 Ibid, at 18.

NDRC's disposal to facilitate cooperation in its investigation. It helps NDRC overcome the poor governance institutions in China so as to enhance the deterrent effects of the Anti-Monopoly Law and boosts active antitrust enforcement in China. It also rebuts the conventional belief that such enforcement is solely targeting at foreign firms and will never be seriously applied to big SOE business groups.[666]

Research has reviewed that shaming tactics have been effectively applied by Chinese regulators in a wide range of administrative enforcement, for instance, intellectual property law,[667] environmental law,[668] and securities law (and hence corporate governance).[669]

3 SASAC as the Controlling Megashareholder

As discussed above, SASAC leads all the industrial and non-financial national business groups at the top of the hierarchy. Its mission is to consolidate the shareholder control rights which used to be vested with various government ministries, bureaux and agencies. SASAC reports directly to the State Council, the highest authority of the state. However, in practice, SASAC's controlling shareholder status can be handicapped by the government's tenacious power structure. Although SASAC is a ministry-level authority, so are the very important central SOEs under its administration. Not only may SASAC face resistance from the central SOEs that it supervises but also from such other important ministries as the Ministry of Finance which may challenge SASAC's decisions due to their own competing agendas. The clashes between big SOE business groups in the airline industry, the relevant ministries and SASAC in the proposed sale by China Eastern Airlines of 24% stake to Singapore Airlines in 2007 is a classic example to illustrate this point.[670]

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666 A Zhang, above n 664, at 3-4, 8-9 and 19-20.

667 Peter K Yu "From pirates to partners: Protecting intellectual property in China in the twenty-first century" (2000) 50 Am UL Rev 131-243.

668 Judith Shapiro "The Evolving Tactics of China's Green Movement" (2013) 112(755) Current History 224-229.

669 Benjamin L Liebman and Curtis J Milhaupt "Reputational sanctions in China's securities market" (2008) 108 Colum L Rev 929-983.

670 Barry Naughton "SASAC and rising corporate power in China" (2008) 24(2) China Leadership Monitor 1, at 3.

In early September 2007, China Eastern Airlines signed a framework agreement to sell a 24% equity to Singapore Airlines. This transaction almost shook up China's airline industry. At that time, the airline industry was dominated by three central SOEs – Air China, China Southern and China Eastern. Air China and China Southern were both profitable and among the largest airlines in the world. China Eastern, on the other hand, was the comparatively weaker sister. It was marginally profitable and had struggled to develop a successful strategy. That was why they were in talks with Singapore Airlines to seek a sustainable turn-around strategy. At the outset, it was anticipated that the deal should sail through, especially with the support of SASAC, which holds 100% equity in the parent companies of all three national airlines, which in turn hold majority interests in the three airlines. These airlines are listed on the stock exchanges in Hong Kong and Shanghai.[671]

Almost three weeks later, Hong Kong's Cathay Pacific Airlines announced its intention to block the sale in conjunction with Air China by offering a higher price for the China Eastern shares. Cathay Pacific owns 20% of Air China whilst Air China owns 17.5% of Cathay Pacific following a complicated cross-holding deal entered into in June 2006 after a protracted process of negotiations with China's airline officials. This deal saw Cathay Pacific (through Dragonair's (rebranded Cathay Dragon in November 2016) becoming Cathay's wholly owned subsidiary) the only 'foreign' airline licensed to serve numerous (currently 22) destinations within China. Cathay Pacific was understandably not keen on other foreign airlines crashing that hard-earned monopoly privilege. Interestingly, Cathay Pacific aborted this bid two days later without giving any reason, but it was speculated that Cathay Pacific "had been slapped down by Chinese officials"[672]. It was obvious that Chinese authorities could not afford to be seen to be acquiescing to one central SOE airline group colluding with "quasi-foreign" Cathay Pacific in their attempt to stop healthier competition in the airline sector by way of indirect introduction of another truly world-class operator in the market: three strong competitors instead of two should naturally be beneficial to the Chinese economy in the long run. Indeed, it was reported that China Eastern had repeatedly indicated that SASAC had supported its collaboration with Singapore Airlines; and SASAC repeatedly affirmed its support of central SOEs' tie-up with "foreign strategic investors". In the meantime, it gradually became clear that Air China, which already had a substantial

671 Naughton, above n 670, at 3.

672 Ibid, at 4.

holding in China Eastern, was determined to block the deal. As trading in China Eastern's shares resumed following the announcement of Singapore Airlines' offer, China Eastern's share price soared to reach a level double that of Singapore Airlines' offer.[673]

The matter took a sharp turn by the end of December 2007 when Air China's head Li Jiaxing was promoted to be the acting minister of the Civil Aviation Administration of China (CAAC), China's nominal independent airline regulatory commission. The Standing Committee of the Politburo suddenly appeared to prefer Air China's vision (to keep foreign airlines out of their home market) to SASAC's (or China Eastern's) vision (to support entry into strategic alliance with selective foreign investors to foster business or economic growth). Given the price disparity, it simply appeared to be an unpalatable pageant of selling off state-owned assets cheaply to a foreign company. SASAC was hamstrung from arguing the case for China Eastern. SASAC consequently decided that the deal was ultimately a market transaction with which SASAC would not interfere. On 8 January 2008, China Eastern's outside shareholders met in Hong Kong and Shanghai. The deal required an approval of a two-thirds majority of these shareholders (not including China Eastern's parent). With Air China voting against the deal, the outside shareholders also voted it down in Hong Kong and Shanghai. Not surprisingly, SASAC was in essence "rolled" – Air China brought in higher-level patrons to assist it with the protection of its cosy monopolistic position and these political alliances flouted SASAC's authority as the ultimate "owner" of these airlines.[674] SASAC's vision for the development of a more competitive marketplace was set aside, to say the least.

Needless to say, situations like these are always complex, SASAC's mandate is to "own" these SOEs and manage them in the public interest with the ultimate goal of increasing the value of the state-owned assets. When sagas like the Singapore Airlines' acquisition offer are construed as a rivalry between domestic and foreign corporations, public opinion and regulatory outcomes will tend to lean towards the home teams especially when markets and the economy are booming. SASAC will need to tilt the balance between acting as an ally or adversary of these central SOEs from time to time as they are growing to become gigantic, and thus economically and politically influential. SASAC has a shareholder's ostensible legal

673 Naughton, above n 670, at 4 and 9.

674 Ibid, at 5.

rights over the SOEs. In reality, SASAC can only exercise its rights in the shadow of party control. SASAC has both less and more powers than those available to a typical controlling shareholder under corporate law.[675] Understanding the way SASAC exercises its shareholder's rights will also shed some light on the fact that Chinese SOEs' behaviour should not be analysed simply from the individual firm's perspective. They are, as discussed above, intertwined in a multitude of levels of ecosystems.

One of SASAC's powers, like those of the controlling shareholders elsewhere, is the selection, allocation and compensation of senior managers. Again, SASAC has to live with exercising this power in the shadow of party control. Chinese SOEs are structured to operate on two personnel systems running parallelly with each other – the usual corporate management system and the party system. In the corporate management system, positions are similar to those commonly found in corporations elsewhere. They include CEO, deputy-CEO, chief accountant or chief financial officer (CFO), and if the company has a board of directors, a chairman, a vice-chairman, and independent board members. In the party system, there is usually a leadership team which includes the secretary of the Party Committee, several deputy secretaries, and a chief inspector of the Inspector's Office of the central Commission for Discipline Inspection of the Communist Party of China (CPC) (in other words, an anticorruption office), plus other members of the Party Committee. The personnel of the two parallel systems customarily overlap and correspond to each other. For example, the chairman is normally the secretary of the Party Committee. The top executive position holders in the central SOEs typically include the board chairmen, vice-chairmen, CEOs and party secretaries. They are appointed and assessed by the Central Organisation Department of the Communist Party of China. This appointment and assessment practice predate the installation of SASAC and subsists to date. Certain of such positions carry ministerial rankings equivalent to provincial governors and members of the State Council; others may hold deputy ministerial rankings. Deputy positions in those SOEs are usually appointed by the Party Building Bureau of SASAC (*guo zi wei dang jian gong zuo ju*).[676] The first and second bureaux for the Administration of Enterprise Executives are responsible for the installation, delegation, training and

675 Li-wen Lin, above n 205, at 4.

676 Ibid, at 4-5.

administration of SOEs' corporate executives.[677] Further, the ministries that supervise the relevant business operations provide rigorous input in the appointment process and all appointments are subject to the State Council's approval. This process completely bypasses the board of directors that is legally responsible for appointing and assessing top executives or managers.[678]

One unique feature of SASAC's management of SOEs' top executives or managers (*gaoguan*) is the rotation of top or senior corporate and party leaders amongst the central SOE business groups in key industries. It is also an institutionalised practice of the Chinese government to appoint top executives or managers as members of the three national political bodies, namely the National People's Congress (NPC), the National People's Political Consultative Conference (NPPCC) and the National Congress of the Communist Party of China (NCCPC). Membership of such political bodies bestows political or social status rather than any substantive law-making power.[679] For example, China National Offshore Oil Corporation's and China National Petroleum Corporation's chairmen were directed by SASAC to swap positions with each other in March 2015. It was understood that China State Shipbuilding Corporation and China Shipbuilding Industry Corporation did the same thing earlier the same year.[680]

SASAC coordinates and shares with the Organisation Department of the CPC, the Ministry of Human Resources and Ministry of Finance the power of appointment and removal of top or senior corporate and party leaders. The PRC managerial compensation system for SOEs under SASAC's administration canvasses basic salary, performance bonus, and certain mid-to-long-term incentives. The board of directors, which is supposedly the organ responsible for executive compensation considered in a typical stand-alone firm in the Western economies, is again avoided in such a process.[681] Indeed, Lin's research shows that even executive compensation approved by the board and disclosed in the annual reports of the SOE listed companies can be rather misleading or is at least to be "accepted with

677 SASAC website (in Chinese) > Internal Structure: http://www.sasac.gov.cn/n2588020/index.html [accessed 4 February 2018].

678 Li-wen Lin, above n 205, at 5.

679 Li-Wen Lin "Reforming China's State-owned Enterprises: From Structure to People" (2017) 229 The China Quarterly 107, at 116.

680 Li-wen Lin, above n 205, at 5.

681 Ibid, at 5.

caution" because "Chinese public companies and even the government have a notorious reputation of data manipulation" and "[b]ig accounting firms in China have been embroiled in scandals involving accounting frauds."[682] SASAC (not the SOEs' boards) sets the compensation to be received by these executives. Consequently, the reality is their top management compensation practice remains a mystery to the public, as does their corporate governance practice despite adoption of western institutions via legal transplants albeit more in form than substance. As Donald Clarke puts it:[683]

> [T]he reality of corporate governance practices in China remains very different from what appears in the statute books, and indeed is so opaque that it is difficult to measure reliably where it is, let alone to know in what direction it is moving.

Contrary to the state's proactive approach in terms of its exercise of rights over SOEs' executive appointment and assessment, the state appears to be reluctant to exert its financial rights as their owner. Given the financial struggles that the SOEs experienced in the earlier years when the SOE reforms were rolled out, the state had relieved the SOEs from any dividend distribution or profit remittance back to the state for quite a long while. Following SASAC's installation in 2003, SASAC and the Ministry of Finance had worked together on plans to bring state capital management and profit remittance back on the table. SASAC and the Ministry of Finance reached an agreement in principle regarding state capital management budgets and profit remittance by the end of 2004. It was reported that a more detailed program had been fleshed out by the two government agencies in the middle of 2006.[684]

The system of the state capital management budgets was rolled out across the nation in 2008 with SASAC acting as the lead authority for compiling the budgets and the Ministry of Finance the authority for collection of the funds. The full system became effective during 2008. The state capital income budgets prepared by the central SOEs under SASAC's guidance are required to be approved by the Ministry of Finance. Thereafter, these SOEs will remit profits according to the regulations which divided all central SOEs into three groups with remittance rates for after-tax

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682 Li-Wen Lin "Behind the Numbers: State Capitalism and Executive Compensation in China" (2016) 12 U Pa Asian L Rev 140, at 142-143.

683 Donald C Clarke ""Nothing But Wind"? The Past and Future of Comparative Corporate Governance" (2011) 59(1) American Journal of Comparative Law 75, at 101-102.

684 Naughton, above n 670, at 6.

profits set at 0%, 5% and 10% respectively. The remittance rates are set based on broad-brush industrial categories rather than individual firms' performance.[685]

In addition, local governments would be expected to decide on their own formulae for profit remittance and the pace of implementation with a view to gradually follow the lead of central SASAC. With this profit remittance scheme, the Ministry of Finance collects the funds and coordinates with SASAC regarding the use of funds. SASAC will finally have a source of funds to carry out its restructuring projects. It is committed to using the funds in three areas: capital outlays, restructuring outlays and reform costs. In practice, this means that SASAC has money to purchase companies, pay costs which are necessary to restructure particular SOEs or sectors, and buy out workers and social services in bankrupt or struggling enterprises. In other words, the profit remittance is more in form than substance. Funds collected from SOEs are likely to be recycled back to the SOEs for corporate restructuring, technology invention and emergency support for failing enterprises.[686]

The *modus operandi* that the state employs to exercise its shareholder rights shows that the state aims to balance the interests of multiple groups (as well as their ruling elites) in their ecosystems. Their focus is not on wealth maximisation of individual companies and firms. This explains why different emphases have been placed on the governance institutions adopted for these SOEs. For instance, the websites of most Chinese central SOEs include webpages on their development of corporate social responsibility (CSR). This was due to the heavy emphasis placed by the state on CSR through their CSR campaign which is designed to enlist domestic political support for the SOEs and their managerial elites, improve the state's image in the international arena, and other political agendas. This approach may sound enigmatic if examined from the western-style-corporate-wealth-maximisation perspective.[687] As CSR does not form part of the discussion in this thesis, it will not be delved into here apart from using it as an example to illustrate the point made above.

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685 Naughton, above n 670, at 6.

686 Ibid, at 7.

687 See generally Li-Wen Lin "Corporate Social Responsibility in China: Window Dressing or Structural Change" (2010) 28 Berkeley J Int'l L 64-100.

4 SASAC and SOEs: A Bond Beyond Shareholding

SOEs are by definition naturally related to the state through ownership. However, this appears to be an oversimplification of the SASAC-SOE-ecosystem given the different layers of state-controlled networks which are embedded into the system with critical mass. As discussed in Section 3 above, besides the ownership ties, there are regular personnel swaps and exchanges administered by SASAC within the intertwined and densely organised networks at both SOE and party-state levels. This is an institution which is simply beyond the ambit of the western-style shareholders' rights – SASAC is a unique 'Megashareholder'.

Lin's research shows that fifty to sixty SOE top managers are seconded to, and swapped with officials from, SASAC for one-year periods every year. The corporate managers who are seconded to SASAC are fairly experienced from leading central SOEs, whereas the SASAC officials who are seconded to the SOEs in return can be comparatively junior.[688] Obviously, the main reason for this practice is more on building capability for SASAC's officials and promoting cooperation between the SOEs and SASAC rather than monitoring the SOEs.

Within this gigantic ecosystem, there is another institutional link, the China Group Companies Association (CGCA), which was installed to be an intermediary between China's big business groups and the central government. CGCA was founded in 1987 and is a national legal entity registered with the Ministry of Civil Affairs. It is under the administration of SASAC but is also mandated to be guided by the Ministry of Commerce (MOFCOM). In other words, SASAC and MOFCOM jointly oversee CGCA. As of 2013, CGCA has over 200 members, which are mainly central SOEs and most of which are Fortune Global 500 companies. CGCA's board of directors is composed of senior government officials from SASAC, MOFCOM, other economic ministries, and the top managers of China's most important national SOE business groups. CGCA's mission is to (i) serve as a bridge between member corporations and the government, organise economic policy research, provide members with recommendations regarding national economic policies and report corporate concerns; (ii) provide legal services and safeguard corporate legitimate rights; (iii) act as a 'think tank' entrusted by the government and member corporations to conduct project research; (iv) provide training, consultation,

688 Li-wen Lin, above n 205, at 6.

information procurement and research services and exchanges between domestic and foreign enterprises; and (v) promote independent innovation, cross-border operation and better governance for member corporations. CGCA also functions as a vehicle to air issues of concern to member corporations by submitting reports directly to the State Council and other ministries and agencies. As of 2013, CGCA has assisted member corporations with submitting a total of 90 advisory reports to the State Council and other relevant ministries and departments.[689]

Another important institutional link which runs in the above-mentioned Chinese ecosystem is the substantive management and supervisory rights bestowed to the specific ministry to oversee the particular industry in which the SOE business groups operate. This link was established prior to the installation of SASAC and runs parallelly with SASAC following its inception in 2003. For instance, the Ministry of Industry and Information Technology (MIIT) maintains strategic management and supervisory powers over China's tele-communications sector which in turn oversees the three pillars in China's domestic mobile services market, China Mobile (which controls a 70% market share), China Unicom (20%) and China Telecom (10%) as of 2010.[690] Apart from the personnel swaps and exchanges between the top executives and officials amongst SASAC and certain central SOEs, it is equally common for vice-or-deputy ministers from the industry regulators to be swapped or exchanged with the top executives (for example, party secretaries, chairmen or CEOs) of those central SOEs. One classic example was the almost simultaneous move of MIIT's Deputy Minister to be the Party Secretary in charge of China Mobile and the assignment of China Mobile's Vice-CEO to be MIIT's Vice Minister in 2011.[691] Such high-level and bidirectional exchanges underpin a crucial institutional link that binds SASAC, the central SOEs and the industry regulators together in their interconnected ecosystems.

In addition to the above link, the leaders of the national SOE business groups are also assigned positions in a number of elite government and party bodies. This serves as another layer of institutional link between the SOE big business groups

689 Li-wen Lin, above n 205, at 6; see also China Group Companies Association website > English >profile: http://www.cgcpa.org.cn/english/Profile/2013-04-10/2706.html [accessed 10 February 2018].

690 China Mobile website: https://www.chinamobileltd.com/en/about/overview.php [accessed 28 June 2019].

691 Li-wen Lin, above n 205, at 6.

and the government. Amongst them are the National People's Congress, the central government's legislative body; the National People's Political Consultative Conference, an advisory body composed of representatives of various social and political groups; and the National Congress of the Communist Party of China (CPC), CPC's general assembly.[692]

The CPC plays a crucial role in the personnel appointments in the national SOE business groups. Party organisations exist within each level of the hierarchy of the business groups. The CPC has been unwavering in maintaining, strengthening and institutionalising its ties with the SOEs as they are implementing corporate governance reforms. Prior to the commencement of the SOE reforms in the 1980s, the CPC's role in the SOEs was ubiquitous in every respect because there was virtually no separation between the CPC, the SOEs and the government. Those reforms which have been facilitating the corporatisation and modernisation of the SOEs could have jeopardised CPC's encompassing control. However, the unyielding presence of the CPC in the post-reform SOEs through its well-monitored placements of personnel in these SOEs appears to be the *quid pro quo* of CPC's continuous support for reforms that it could have otherwise impeded. As Richard McGregor, the former Beijing bureau chief of the Financial Times, puts it:[693]

> The Party's control over personnel is at the heart of its ability to overhaul state companies, without losing leverage over them at the same time. So important does the Party rate its power to hire and fire government officials that it places it on par with its control over the media and the military.
>
> […]
>
> The Party body with ultimate power over personnel, the Central Organization Department, is without doubt the largest and most powerful human resources body in the world.

It has recently been reported that the CPC is "writing itself into" China's Company Law – more than 30 HK-listed gigantic Chinese SOE business groups have added in their articles of association words to the effect that the CPC is playing a core role

692 Li-wen Lin, above n 205, at 6.

693 Richard McGregor *The Party: The Secret World of China's Communist Rulers* (Penguin Books, New York, 2010), at 69.

in "providing direction [and] managing the overall situation".[694] For example, the articles of association of China Railway Group, one of China's biggest construction groups, now provide that when the board of directors decides on material issues, it will listen to the opinions of the party committee of the company. It is understood that ICBC (the world's largest bank by assets) and Sinopec are amongst those gigantic SOE business groups that have embedded the CPC into their constitutional documents. This move is believed by the SOEs concerned to be a step to "integrate the reinforcement of leadership of the CPC with the improvement of corporate governance".[695]

The idea that China's corporate governance system would one day become convergent to the western-style-best-practice-corporate-governance system through legal transplants was always a western-or-western-leaning notion, born of the western theories about the 'best practice' with which corporations should be governed and how their governance systems should evolve. Yet all the evidence suggests thus far these theories are 'wittingly-adjusted' to facilitate the Chinese government or CPC's agenda to preserve state ownership and control (and in turn Sino-Capitalism) in the name of improvement of corporate governance.[696]

5 Connections between Non-financial and Financial SOEs

As discussed in Section E 1 above, Chinese SOE big business groups usually have a finance company within the respective groups. Traditionally, there has been very limited equity connections or directorate interlocks between financial SOEs (i.e. banks) and non-financial SOEs in China. This is perhaps a calculated design by the Chinese policymakers. In China, banks are prohibited from owning equity shares in industrial firms.[697] Industrial business groups are discouraged (albeit

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694 Jennifer Hughes "China's Communist party writes itself into company law" *Financial Times* (Hong Kong, 15 August 2017): https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd.

695 Ibid.

696 Comments inspired by Richard McGregor "5 Myths About the Chinese Communist Party" (2011) (184) Foreign Policy 38, at 40.

697 The Law of the people's Republic of China on Commercial Banks (adopted at the 13th Meeting of the Standing Committee of the Eighth National People's Congress on 10 May 1995, promulgated by Order Number 47 of the President of the People's Republic of China on 10 May 1995, and amended in accordance with the Decision of the Standing Committee of the National People's Congress on Amending the Law of the People's Republic of China on

permitted by law) from holding controlling stakes in banks, although in the recent years some industrial SOEs have gradually expanded into the financial sector. Typical arrangements would be using the finance companies in the SOE business groups as a portal to get involved in the finance sector.[698]

That said, it appears that the Chinese government seldom rotates top executives or managers between financial and non-financial SOEs. Lin's research on the career paths of managerial elite from the largest 50 SOE banks (financial SOEs), 113 non-financial central SOEs under SASAC and the largest 100 non-financial SOE listed companies up to the end of 2013 indicates that virtually none of their top managers or executives have work experience across or straddling both the financial and non-financial sectors. It also reveals that there are very few or negligible connections across the major banks (financial) and the industrial (non-financial) SOEs. In sum, none of the top-tier bank CEOs had any work experience in any industrial SOE; and only one of the second-tier bank CEOs and two of the third-tier bank CEOs had work experience at an industrial SOE at some early stage of their careers.[699]

Despite multiple rounds of organisational restructures and ownership reforms (including domestic and overseas listings) vis-à-vis the SOEs since the 1990s, the current top executive career patterns of the industrial SOEs still reflect the vertical functional hierarchies or systems (*xitong*) in China. The CEOs of the industrial SOEs appear to develop their careers within a single business group, across multiple business groups in the same industry, or in a supervisory bureau related to or in charge of the groups' industrial sector. Only one of the 213 industrial CEOs has a career track across the vertical functional divide between finance and industry.[700] In short, the SOE executive personnel management appears to be still governed by this "vertical system" concept and the Chinese government does not seem to be keen on rotating top managers between the financial and non-financial SOEs.

Commercial Banks adopted at the Sixth Meeting of the Standing Committee of the Tenth National People's Congress on 27 December 2003), art 43: http://www.npc.gov.cn/englishnpc/Law/2007-12/12/content_1383716.htm.

698 Li-wen Lin, above n 205, at 7.

699 Li-wen Lin, above n 679, at 112-124.

700 Ibid, at 120.

Although equity (and to a notable extent personnel) ties between financial and non-financial SOEs are meagre, the financial ties from the financial SOEs and the non-financial SOEs by way of flow of funds are strong and ubiquitous. The number of central SOEs might have been reduced from around 200 in 2003 to 98 as at the end of 2017, non-financial SOEs are responsible for about 60% of the total corporate debt in China as at the end of the first quarter of 2017, according to a report from the National Institution for Finance and Development (NIFD).[701] In other words, such robust flow of funds is not sustained by equity or shareholding ties or personnel exchanges amongst SOEs but via vertical relations that ultimately tie the financial and non-financial SOEs under one overarching umbrella, the State Council, or at the end of the day, the Communist Party of China (CPC).

In short, China's big non-financial or industrial SOEs are administered by SASAC and its large banks (which are mostly state-owned financial SOEs) are controlled by the Ministry of Finance (MOF). Both SASAC and MOF are under the State Council (which is the highest administrative body in China) and ultimately the CPC. The State Council and the CPC coordinate both financial and non-financial SOEs through their respective vertical ownership arrangements and regulatory relations. It can be summed up that the very absence of the lateral connections between the financial and non-financial SOEs actually strengthens the vertical control of the party and in turn the state. Unlike other western or developed economies where banks stand on the centre stage as the lead actor in a corporate network, the state-owned corporate sector practises party-state-centricity in China as opposed to bank-centricity to which its western counterparts choose to adhere.

Chinese state ownership is composed of a remarkably complex ecosystem. This hierarchical structure is embedded in layers of networks not simply of other SOEs but also a multitude of government bodies and the CPC. They facilitate relational exchanges and collaboration on many levels. They also foster top down and bottom up information flow and provide incentives to actors in the system to attain business success which in turn leads to promotion and corresponding rewards in both the economic and political realms. This combination of authoritarian hierarchy and

[701] Xuequan Mu "Economic Watch: China SOE deleveraging on fast track" *Xinhuanet* (Xinhua News, Beijing, 24 July 2017): http://www.xinhuanet.com/english/2017-07/24/c_136469130.htm [18 February 2018].

collaboration within high-powered incentive structures is resonant of another mechanism of economic transition – private equity investments.[702]

These closely knitted networks link individual components of the system together to form various pathways. Some of them are structured through formal legal means, for instance, by way of contracts or shareholding relationships. Others are the result of personnel exchanges engineered by SASAC and the CPC. These encompassing organisations could enhance efficiency by encouraging information sharing, reduce opportunistic behaviour through controlled exchanges, provide high-powered incentives, and reduce frictions in policy implementation. However, they also reduce competition and transparency, complicates agency relationships and soften budget constraints.[703] That said, the focus of this discussion is not on whether the state sector is more efficient than the private sector but instead on how the state sector has produced internationally recognised big business groups and supported economic growth in the absence of formal infrastructure considered crucial in the western corporate governance theories on the relationship between institutions and economic development.

The first one and half decades of this twenty-first century have seen the unprecedented rise of Chinese big businesses on the international stage with the Chinese government rightfully claiming success of their "Going Out" policy. Today, China's SOE big businesses, together with its big private business groups such as Alibaba,[704] are recognised as significant players and daunting competitors in the international markets and major sources of FDI across the world. The question policymakers have to face is whether the existing regulatory systems anticipate the emergence of such an economy which is predominately supported as key players by China's state-owned or state-controlled enterprises and other big private business groups. Also, what role legal transplants play to facilitate such a rise. This will be further discussed in Chapters V and VI below.

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702 Lin and Milhaupt, above n 542, at 707.

703 Ibid, at 708.

704 The success story of Alibaba, the world's largest e-commerce business, which this research finds to be capable of serving as one of the examples of China's big-private-businesses that runs parallelly with the rise of China's SOE-big-businesses due to its *modus operandi* vis-à-vis treatment of western business and legal transplants, and contributing to the emergence of Sino-Capitalism, will be discussed in Chapter V below.

The following section considers the transplanted regulations which serve the function of enhancing interactions with China's SOE big businesses.

6 SOEs and Overseas Listing

As discussed in Section E 1 in Chapter III above, since China's installation of its own stock markets in the early 1990s, Chinese SOEs have shares listed in leading stock exchanges across the globe from Hong Kong, Singapore, the United Kingdom to the United States. It is understood that the main driver for 'Going Out' to attempt overseas listings is the Chinese government's desire to find a relatively more effective mechanism to restructure and regulate the SOEs in the name of improving SOEs' corporate governance which is in turn supposed to solve problems such as manager slack and still keeps things under control. This goal appears to align with John Coffee's bonding hypothesis in the corporate governance scholarship. That is, overseas or cross-listings can be a bonding mechanism for corporates established in jurisdictions with weaker investor protection or enforcement mechanisms as they "can *voluntarily* subject themselves to higher disclosure standards and stricter enforcement in order to attract investors who would otherwise be reluctant to invest".[705] One can infer through the application of this bonding hypothesis that in order to facilitate the Chinese SOEs' overseas listings, China would continue to adopt SOE reforms by way of transplanting western governance systems so as to improve its SOEs' corporate governance and show the world that they are largely able to ensure compliance with the rules in the foreign jurisdictions. Overseas listings demonstrate the Chinese SOEs' willingness and commitment to submit to more shareholder-or-investor-protective-regulatory-regimes of the target foreign jurisdictions and fuller disclosure to the foreign stock markets in return.

However, Donald Clarke's recent research shows that the actual bonding effect of such Chinese SOEs to the overseas markets is negligible. Clarke reviewed (i) class actions listed on the website of the Securities Class Action Clearinghouse (SCAC) which were against Chinese companies, and (ii) all civil suits in federal courts by

[705] John C Coffee Jr "Racing towards the top?: The impact of cross-listings and stock market competition on international corporate governance" (2002) Columbia Law Review 1757, at 1767: noting that Coffee claims that he was probably the first to publish this bonding hypothesis although he notes that others may have independently landed on the same idea at more or less the same time.

the Securities and Exchange Commission (SEC) involving listed companies with headquarters in China for which results were handed down by the SEC, between January 2011 and October 2015.[706]

Clarke's findings of both private and public enforcement of corporate and securities laws against Chinese overseas-listed companies do not appear to speak for themselves. Private enforcement actions show that it is justified to be sceptical about the actual bonding effect of cross-listing in that it is in no way certain as to whether the malefactors in fact suffered any adverse consequences. The results of public enforcement actions brought against Chinese corporates for fraud committed upon investors on the other hand indicate a relatively stronger than expected bonding effect albeit that the offending Chinese executives and directors appear to have been given no more than monetary sanctions and temporary bans from serving as officers or directors. Clarke thus suggests that the actual bonding effect of cross-listing by Chinese companies is a little more than zero and that the bonding hypothesis needs to be examined on a country-by-country basis to ascertain whether the bonding effect is in fact anything more than an illusion. He cautions that investors should take seriously the disclosures in the risk factors sections of the prospectuses of Chinese companies seeking listings in the United States bearing in mind that it will be difficult to hold such companies and their executives and management accountable under the law of the United States for obvious reasons.[707]

In the West, it is more common for domestically listed companies to opt for overseas listings. This is often referred to as 'cross-listing'. In China, a lot of Chinese SOEs have not completed their modern style of corporatisation restructure until the recent times. As discussed in Section C 2 in Chapter III above, these SOEs used to be of a structure without such modern corporate governance institutions as the board of directors and were regulated by the SOEs Law,[708] not the Company Law.[709] Chinese scholar Yinzhi Miao recently observes that it is not uncommon for

706 Donald C Clarke "The Bonding Effect in Cross-Listed Chinese Companies: Is it Real?" (2015) GWU Law School Public Law Research Paper No. 2015-55; GWU Legal Studies Research Paper No. 2015-55. Available at SSRN: https://ssrn.com/abstract=2710717, at 7 to 11.

707 Ibid, at 1, 12 and 13.

708 SOEs Law, above n 196.

709 Company Law, above n 184.

Chinese SOEs to 'go out' for overseas listing immediately after corporatisation, and then seek a domestic listing at a later stage.[710]

The direct description of 'overseas listing' is thus used (to distinguish from the term 'cross-listing' that is more commonly used in the West) for discussion purposes here. From discussions regarding the Chinese SOEs' eco-systems above, it appears that there can be many reasons for the decision-makers overseeing the SOEs to select overseas listing. One obvious reason is that an overseas listing on a more renowned stock exchange (usually an international finance centre) naturally subjects the SOEs to a more robust governance regime. This includes more stringent listing and information disclosure standards, reduced informational asymmetry, tightened regulation and other enhanced scrutiny. Such listing may assure investors that agency costs can be lowered, and managers and controllers' inappropriate behaviour may be restrained by the regulated requirements. The benefits for corporate governance in terms of investors and shareholders' protection appear to be evident. In contrast to such externally imposed governance mechanisms as regulations, lawsuits and media, overseas listings will only function if the SOEs voluntarily choose compliance. The benefits of overseas listing should not only outweigh the costs to be incurred by the SOEs and those actual decision-makers for the SOEs to opt for overseas listing (for example, SASAC, MOFCOM and MOF), but more importantly also prove to be beneficial to corporate governance in terms of investors and shareholders' protection if the SOEs were to select compliance with foreign codes and in turn improve their own governance and performance on home turf by way of introduction of foreign governance institutions through legal transfers from the foreign stock exchanges.[711]

This thesis elucidates that there is a conscious effort on the part of the government controllers of the SOEs to enhance corporate performance and governance,[712] hence, their decisions to take the SOEs overseas via listings on stock exchanges such as those in Hong Kong, Singapore, London and New York. It concurs with Miao that enhancement of corporate governance matters from the SOEs' controlling shareholders' perspective. Miao finds that Chinese SOEs are subject to

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710 Yinzhi Miao "The interplay of the state and the firms: Overseas listing as a governance institution for Chinese SOEs" (2015) 10 Frontiers L China 46, at 63-65. See generally Coffee, above n 705; and Gilson, above n 136.

711 Idea borrowed from Miao, above n 710, at 63-64.

712 Refer to discussions in Sections D and F in Chapter III above.

relatively little discipline within their national border due to their considerable political and economic powers. Top managers and executives could easily disregard the interests of their nominal state controlling shareholders and other minority shareholders. This in essence means that government controller agencies do not enjoy as much effective control of such SOEs as private controlling shareholders might naturally enjoy with respect to the private entities in which they invest. Especially in the case of central SOEs which are in much better financial positions, this may be even more problematic as they can afford to be more 'independent' and in certain circumstances more 'assertive' or 'defiant'. These government controller shareholders have thus more incentives to seek alternative measures to ensure the top managers and executives act with due diligence vis-à-vis investors or shareholders protection.[713]

Miao observes that conventional mechanisms such as independent litigation and media may lead to consequences which are uncontrollable and in turn threatens the sustainability of the current ruling system. For instance, to the state's mind, press influence may go beyond the policymakers' domain and litigation instigated by non-state agents may prove to be difficult to monitor. In short, the state may find these mechanisms undesirable and it is thus reluctant to enhance them. Other mechanisms, for instance, state-instituted-or-exchange-instituted regulations, are subject to political economy constraints. As discussed in Sections E 2 and E 3 above, the regulators or government-controller shareholder and the SOEs belong to the same ecosystems or 'inner circles' which form a co-existence relationship, it would be hard to expect them to fight against each other. In fact, it is questionable whether such SOEs would actually be sanctioned by the regulators even though they are empowered to do so for obvious reasons.[714]

A typical SOE which has undergone the "Going Out" pathway through overseas listing bears the following characteristics: (i) it enjoys a monopolistic or privileged position in one of the key-or-strategic sectors in the Chinese economy, hence, it stands tall and firm on the overseas exchange on which it is listed without the worries of suffering the disgrace of being delisted due to poor performance; and (ii) as it is usually a gigantic SOE and thus holds a significant position in the domestic political economy, it may not be easily 'tamed' by, or readily compliant with, such

[713] Miao, above n 710, at 64.

[714] Ibid, at 64-65.

conventional governance mechanisms as courts, gate-keepers, market competition, media, or even regulators. Their government-controller shareholders or agencies will need to expose them to a robust international 'machinery' called 'overseas listing' to enable monitoring of their performance and imposition of sanction when needed. Overseas listing works as an external force to transform the management approach of those SOEs' top executives and managers so they are equipped to be better stewards of the assets and resources they are entrusted to control which will in turn improve investor protection. This is important given that the domestic governance institutions appear to lack 'teeth' or can be viewed as under-developed.[715]

Overseas listing can be seen as a desirable corporate governance mechanism for Chinese SOEs for a number of reasons. First, the listing rules which constitute good corporate governance institutions originating from jurisdictions with proper rule of law are not only of higher standards, but they are also more stringent and less likely to be 'defied' by such SOEs. This is because those SOEs would not be able to exert the same influence as in China in which the domestic gatekeepers, for instance, the product markets, capital markets, regulators and courts, are less likely to sanction them in the event of non-compliance due to the economic and political connections and privileges they enjoy. This will be less likely to happen in an international market in which such SOEs will be treated like other listed companies and are expected to be compliant.[716]

Second, SOEs that are listed overseas are able to "reincorporate in foreign jurisdictions" which will require such foreign-listed SOEs to bind themselves to comply with the ongoing governance institutions set by the foreign exchanges and their respective regulatory authorities.[717] China's adoption of such a "Going Out" policy does not appear to be a coincidence but a calculated strategy to expedite its economic reform and boost financial performance without uprooting the existing practices of the domestic economic and political elites. This may, to a certain extent, be compared with Brazil's "New Market" experiment for corporate share listings

715 Miao, above n 710, at 65.

716 Ibid, at 66.

717 Hansmann and Kraakman, above n 131, at 464. See also Coffee, above n 134, at 675-676, in which Coffee observes that resorting to listing in foreign capital markets appears to be a standard stage in individual firms' economic development in some economies and that interaction among different legal regimes can be complementary.

which has been described as a "textbook example" of Gilson, Hansmann and Pargendler's regulatory dualism theory. Gilson, Hansmann and Pargendler advocate that regulatory dualism functions as a strategy to defuse the tension between future growth and the current distribution of wealth and power in a society. It mitigates political opposition to reforms by permitting the existing corporate elites to be governed by the old regime, while allowing other or modern firms to be regulated by a new parallel regime that is more efficient.[718] China apparently finds it edge by adopting a similar strategy whether or not it is conscious of the existence of such a school of thoughts. It is, however, quite possible for the Chinese policymakers to be informed of such an example which they may borrow or mirror as they obviously will leave no stones unturned when looking out for measures to improve or enhance the sustainability of their own system. Hence, it can be considered a coincidence at the very least, if not another legal transplant adapted with Chinese characteristics.

Third, despite its apparent economic success, China is still a country which finds it hard from time to time to catch up with its western counterparts in terms of the development of its corporate governance mechanisms due to political and other constraints. To China's mind, compliance by its "going-out" SOEs with international institutions gives them corporate legitimacy which could earn praises and recognition for the state's controller elites and the SOEs which are pushing for the move.[719]

Fourth, overseas listing opens an avenue for SOEs formed under the old socialist regime to undergo a restructure which is significant for their long-term governance goal. Such SOEs normally take a long time to reform themselves to become modern companies. Overseas listing can be a one-off push which gives them a boost that can prove to be the way to overcome the on-going challenging reform hurdles imposed from time to time by the state.[720]

Fifth, as dual or even triple listings become more popular or prevalent, domestic exchanges in China are "expected" or otherwise "pressured" to import international

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[718] Ronald J Gilson, Henry Hansmann and Mariana Pargendler "Regulatory dualism as a development strategy: corporate reform in Brazil, the United States, and the European Union" (2010) 63 Stan L Rev 475, at 536.

[719] See generally Hansmann and Kraakman, above n 131, and Gilson, Hansmann and Pargendler, above n 718, for the theory of corporate legitimacy.

[720] Miao, above n 710, at 66.

corporate governance practices by way of legal transplants to bring themselves up to scratch to be competitive. SOEs would have to charge up their governance thresholds and expedite their restructure efforts even if they do not choose to be listed overseas themselves because investors have now got a better choice. This will inevitably benefit domestic investors.

Since the promulgation of the Special Provisions of the State Council Concerning the Floatation and Listing Abroad of Stocks by Limited Stock Companies at the 22nd executive meeting of the State Council on 4 July 1994[721] (Overseas Listing Provisions), pathways for SOEs which had been corporatized to directly opt for overseas listing were formally opened. This marked the first wave of overseas listings which became prevalent from the second half of the 1990s. These SOEs typically underwent IPOs soon after corporatisation. For instance, Sinopec Limited was established as a company limited by shares (**CLS**) under the China Petrochemical Corporation Group (Sinopec Group) in February 2000. The company was simultaneously listed in Hong Kong, New York and London in October 2000. Its Shanghai listing was completed in June 2001.[722] PetroChina Company Limited was established as a CLS in November 1999 and was listed in Hong Kong and New York in April 2000. Its Shanghai listing took place in November 2007.[723] China Mobile Limited was founded in September 1997 and listed in both Hong Kong and New York a month later in October 1997.[724] Such an expeditious practice was unprecedented for ordinary domestic companies which are not "owned" by, or under the watch of, SASAC or other state controller agencies.

The next wave took place following China's accession to the WTO in December 2001. As discussed earlier in this Chapter, the Chinese government was concerned about whether it could, and how to, ensure its SOE big businesses remain competitive when facing vigorous competition resulting from an influx of foreign direct investment into China as an inevitable outcome of its commitment to further open its market as one of the conditions upon its joining the WTO. Following a complete overhaul or some may call it a 'drastic restructure', China accomplished cross-border listings of its five largest SOE commercial banks – the Bank of Communications (BOCOM) was the first to list in Hong Kong in June 2005 and

721 See http://en.pkulaw.cn/display.aspx?cgid=10446&lib=law [accessed 7 April 2018].

722 Sinopec Group, above n 632.

723 PetroChina website, above n 632.

724 China Mobile website, above n 690.

then Shanghai in May 2007, followed by the 'Big Four', namely China Construction Bank (CCB) (listed in Hong Kong in October 2005 and Shanghai in September 2007); Bank of China (BOC) (listed in Hong Kong in June 2006 and Shanghai in July 2006); Industrial and Commercial Bank of China (ICBC) (listed in both Hong Kong and Shanghai in October 2006); and Agricultural Bank of China (ABC) (listed in both Hong Kong and Shanghai in July 2010).[725] China's 'Big Four' – ICBC, CCB, ABC and BOC – are ranked 22nd, 28th, 38th and 42nd respectively on the Fortune Global 500 2017 List.[726]

In the non-bank sector, similar operations were carried out in most of the central SOEs and certain of the provincial and regional SOEs. For example, Ping An Insurance (Group) Company of China Limited (Ping An Insurance) was founded in 1998 and listed in Hong Kong in June 2004 and Shanghai in March 2007. As of January 2018, Ping An Insurance is the world's largest and most valuable insurance conglomerate and is worth US$217 billion (RMB¥1.4 trillion). It is also one of the world's biggest investment and asset management companies, with a total asset of US$848.5 billion (RMB¥5.6 trillion), as of 2016.[727] Ping An Insurance is ranked 39th on the Fortune Global 500 2017 List.[728]

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725 2018 Annual Report, Bank of Communications Co., Ltd: https://vpr.hkma.gov.hk/doc/100023/ar_18/ar_18_eng.pdf;
Annual Report 2018, China Construction Bank Corporation: http://en.ccb.com/en/newinvestor/upload/20190429_1556547562/20190429222208956602.pdf;
2018 Annual Report, Bank of China Limited: http://pic.bankofchina.com/bocappd/report/201903/P020190329601110675116.pdf;
Annual Report 2018, Industrial and Commercial Bank of China Limited: http://v.icbc.com.cn/userfiles/Resources/ICBCLTD/download/2019/2018AnnualReport20190425.pdf; and
2018 Annual Report, Agricultural Bank of China Limited: https://www.banktrack.org/download/annual_report_2018_27/190412_2018_annual_report.pdf.

726 Brand Rankings – Fortune Global 500 (100) 2017 List: https://www.rankingthebrands.com/The-Brand-Rankings.aspx?rankingID=50 [**BR2017 List**] [accessed 8 April 2018].

727 Annual Report 2018, Ping An Insurance (Group) Company of China Limited (**PICC**): http://doc.irasia.com/listco/hk/pingan/annual/ar208726-e101.pdf.

728 BR2017 List, above n 726.

Another Chinese insurance giant is China Life Insurance Company Limited (**China Life**). The predecessor of China Life, People's Insurance Company of China (**PICC**) was founded in 1949, which was not a legal person or corporate entity. With the promulgation of the Company Law in 1993 and the implementation of the corporatisation reform of SOEs, PICC was restructured by way of corporatisation, and PICC (Life) Co., Limited was set up in 1996 after its separation from the former PICC. In 1999, PICC (Life) Co., Limited was renamed China Life Insurance Company. With the approval of the State Council and the China Insurance Regulatory Commission, the former China Life Insurance Company was restructured as China Life Insurance (Group) Company, which exclusively initiated the establishment of the current China Life.[729] China Life was dual-listed in New York and Hong Kong in December 2003.[730] It returned to China to trade in the A share market in January 2007 and became the first insurance which is triple-listed in New York, Hong Kong and Shanghai.[731] China Life is ranked 51st on the Fortune Global 500 2017 List.[732]

On the other hand, PICC is the holding company of PICC Property and Casualty Company Limited (**PICC P&C**) and PICC Asset Management Company Limited. PICC P&C was listed in Hong Kong in November 2003. PICC's subsidiary, The People's Insurance Company (Group) of China Limited (**PICC Group**), an investment holding company, was listed in Hong Kong in December 2012.[733]

China Railway Group Limited (**CREC** – the acronym of its predecessor and parent company, being central SOE China Railway Engineering Corporation) is a Chinese construction company which floats in the Shanghai and Hong Kong Stock Exchanges through dual-listing in December 2007.[734] CREC was recognised in

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729 China Life website: https://www.chinalife.com.cn/yw/index/index.html [accessed 8 April 2018].

730 Loretta Ng and John Ryan "China Life Files for U.S. Listing: Insurer's $2.5 Billion IPO in New York, Hong Kong Would Be Biggest in 2003" *The Wall Street Journal* (New York, 24 November 2003) https://www.wsj.com/articles/SB1069617343364220 00; and Allen Wan and Steve Gelsi "China Life gets $3 bln in biggest IPO" *MarketWatch* (New York, 12 December 2003) https://www.marketwatch.com/story/china-life-rakes-in-3-bln-in-worlds-biggest-2003-ipo [accessed 8 April 2018].

731 China Life website, above n 729.

732 BR2017 List, above n 726.

733 Annual Report 2018 – PICC, above n 727.

734 2017 Annual Report, China Railway Group Limited: https://www.marketscreener.com/CHINA-RAILWAY-GROUP-738306/pdf/837525/China%20Railway%20Group_Annual-Report.pdf.

2015 by Engineering News-Record "The 2015 Top 250 Global Contractors 1-100" as the largest construction company in the world by revenue.[735] It has however been surpassed by China State Construction Engineering Corporation Limited (CSCEC) as of 2016.[736] CREC is ranked 55th on the Fortune Global 500 2017 List.[737]

Another central SOE which has also made it to be one of the top 100 companies on the Fortune Global 500 2017 List is China Railway Construction Corporation Limited (CRCC) – formerly the railway arm of the People's Liberation Army (found in 1948 and became part of the Ministry of Railways (**MOR**) from 1982). Along with China Railway Engineering Corporation, both railway construction super conglomerates were under the MOR until 2000. In 2003, China Civil Engineering Construction Corporation, another former entity of the MOR, was assigned to China Railway Construction Corporation as its subsidiary. CRCC was incorporated in 2007 as a CLS in preparation for listing. It received most of the assets of its parent company. CRCC was subsequently dual-listed in Hong Kong and Shanghai in March 2008.[738] CRCC is ranked 58th on the Fortune Global 500 2017 List.[739]

Having an overview of how well such central SOEs perform through overseas listing sheds light on the fact that it could be strategically useful to encourage the SOEs to proceed to actively "Going Out" through overseas listing. This inference is drawn because it clearly points to the reality where overseas listing gives them a

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735 Engineering News-Record "The 2015 Top 250 Global Contractors 1-100": https://www.enr.com/toplists/2015_Top_150_Global_Contractors1 [accessed 14 April 2018].

736 Engineering News-Record "The 2017 Top 250 Global Contractors 1-100": https://www.enr.com/toplists/2017-Top-250-Global-Contractors-1 [accessed 15 April 2018]. To clarify, although CSCEC has surpassed CREC as the world's largest construction company since 2016 and is ranked 24th (31 places ahead of CREC) on the Fortune Global 500 2017 List, its listing process is not discussed in this section because it was listed only in Shanghai in 2009 and has yet to be listed on any overseas stock exchange: see Wikipedia – China State Construction Engineering: https://en.wikipedia.org/wiki/China_State_Construction_Engineering [noting that the CSCEC website (www.cscec.com.cn) has been down].

737 BR2017 List, above n 726.

738 2018 Annual Report, China Railway Construction Corporation Limited: http://english.crcc.cn/module/download/downfile.jsp?classid=0&filename=1f87f6a2b3d340dcbc8c964068dafe99.pdf.

739 BR2017 List, above n 726.

definitive goal of meeting international governance standards and competing with the world's most successful companies to attain top global rankings.

Throughout the "Going Global" campaign, overseas listing can be seen as an attempt by the Chinese state controlling shareholder to 'outsource' and 'delegate' corporate governance law enforcement to external or foreign regulatory agencies. This is a profound step that does not only entrust authority to parties other than the state (which is extraordinary for a socialist state like China) to regulate their SOEs, but also further subject the SOEs and SOEs' controlling agencies under the state to continuous obligations to abide by the corporate governance rules stipulated by these foreign stock exchanges. That said, overseas listing may not alleviate all the afflictions that the SOEs may be facing in terms of their corporate governance issues, delisting also remains theoretically a possible option to withdraw from such tougher foreign governance platforms. In reality, these SOEs and their controlling state agencies would rather be painfully adapting to the international rules than going backwards and suffering the humiliation of delisting.[740]

"Going Global" is also a reflection of the broad picture of institutional evolutions in China. It can be observed that within the diversified eco-systems of China's political authorities, there are senior leaders who have been fighting to maintain a firm grip of this gigantic bureaucratic machinery, constrain officials' unfettered authority, keep corruption under control, and advance economic growth, which is expected in return for their political or party legitimacy and longevity.[741] In sum, purposely designed reforms through legal transfers from the West to impose constrains on SOEs for the sake of achieving economic growth as a means to fundamental ruling legitimacy is employed to ensure the government as a whole is able to hold onto its dominant position. In other words, such reform measures canvassing overseas listing all point to the same goal as far as the state is concerned – enhancing the

740 Miao, above n 710, at 74.

741 Guilhem Fabre "Xi Jinping's Challenge: What Is behind China's Anti-Corruption Campaign?" (2017) 5(2) Journal of Self-Governance & Management Economics 7-28. See also Samuel Osborne "Chinese parliament passes constitutional amendment to allow Xi Jinping to remain president indefinitely" *The Independent* (London, 11 March 2018): https://www.independent.co.uk/news/world/asia/xi-jinping-china-communist-party-leader-president-national-peoples-congress-a8250426.html; and Jun Mai "Xi Jinping is changing the constitution, but what's his endgame?" *South China Morning Post* (Beijing, 11 March 2018) http://www.scmp.com/news/china/policies-politics/article/2136676/xi-jinping-changing-constitution-whats-his-endgame.

party's legitimacy and institutionalising the party rule by fusing the line between the party and the state.

It is worth noting that reporter Jun Mai quotes in his SCMP article of 11 March 2018 Taisu Zhang, a law professor at Yale University, who puts forward a very good point:[742]

> Using the law as a political tool has the long-term consequence of deepening its socio-political salience and legitimacy… As soon as [Xi] continues to use it as a political tool, he will find that it becomes more socially entrenched, and therefore that the political costs of violating it increase.

In essence, unexpected occurrences usually take place as the newly transplanted corporate governance laws begin to take on an enduring life of their own and flourish in an environment that is far from perfect. On the novel international platform rendered by overseas listing, even ordinary investors can be bestowed with a new expectation on the enhanced protective capacity of law along with empowered leverage to exert their investors' rights over the SOEs, directing them to be more concerned with investors' rights and welfare even in the domestic context. For example, senior executives of the SOEs, government controllers and party leaders may become more concerned about and be more cautious in terms of dealing with legal risks after witnessing their fellow central SOE, China Life's struggle with the class action brought by nine investors for its alleged contravention of Section 10(b) of the United States' Securities Exchange Act 1934, 15 U.S.C. §78 j(b).[743]

Faced with its first taste of litigation in the United States in March 2004, China Life vowed that it would "vigorously contest" this shareholder class action.[744] The proposed class consists of those who purchased the shares on the New York Stock Exchange and the Hong Kong Stock Exchange. Four and a half years later in September 2008, the New York Southern District Court dismissed the claims by purchasers on the New York Stock Exchange, or any other exchange in the United States, or Americans who purchased shares elsewhere on the ground that those

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742 Mai, above n 741.

743 In re China Life Securities Litigation, No. 04 Civ. 2112 (TPG), 2008 WL 4066919 (S.D.N.Y. Sept. 3, 2008) United States District Court, S.D. New York.

744 Christine Chan "China Life vows to contest lawsuit by US shareholders" *South China Morning Post* (Hong Kong, 19 March 2004): http://www.scmp.com/article/448826/china-life-vows-contest-lawsuit-us-shareholders [accessed 29 April 2018].

claims lacked merit despite its ruling that there is subject matter jurisdiction. The New York Southern District Court also ruled that it had no subject matter jurisdiction over foreigners who purchased shares on the Hong Kong Stock Exchange.[745] The plaintiffs then notified the United States Court of Appeals for the Second Circuit of their intention to appeal but subsequently withdrew the motion in January 2009. The Court of Appeals thus granted a motion of voluntary dismissal of appeal filed by those plaintiffs, making the summary judgment decision granted by the New York Southern District Court final.[746] That being the case, it was considered that China Life's reputation was badly tarnished in the eyes of the Chinese public as early as the time when it was reported by the media that it was involved in a class action complaint lodged by nine investors in the United States. While it may be perceived as ordinary commercial risks in the United States, it is usually considered as too humiliating for the SOEs in question and probably the Chinese leaders in charge of the SOEs (and in the case of China Life, the Ministry of Finance), let alone the fact that China Life was found to be "innocent" years later.[747]

The real advantages of listing their SOEs overseas from the perspective of the SOEs' decision-makers or government controllers include the prospect of (i) securing substantial capital funds; (ii) maintaining sustainable economic growth to ensure longevity of its one-party rule; and (iii) installing tougher or more stringent disciplines and corporate governance rules for senior managers and executives which will in turn benefit the SOEs at home as there would be inevitable legal transfers of such institutions and rules back to China to ensure consistency and improvement in their own capital markets to attain and maintain competitiveness with their international counterparts. Chinese leaders may also want to lean on a foreign hand to help keeping senior executives and managers on their marks as none of them would want to put a foot wrong to earn themselves any bad publicity across the globe. To many of them, money is not too much of a concern, but 'face' is. They cannot afford to have their SOEs' board members and senior executives

745 In re China Life, above n 743, at 17 and 19. See also Chris Oliver "China Life investor lawsuit dismissed" *MarketWatch* (Hong Kong, 5 September 2008): https://www.marketwatch.com/story/china-life-investor-lawsuit-dismissed [accessed 29 April 2018].

746 Rebecca Ng "Plaintiffs Lose Securities Lawsuit Appeal Against China Life" *Insurance News Net* (Hong Kong, 13 January 2009): https://insurancenewsnet.com/oarticle/Plaintiffs-Lose-Securities-Lawsuit-Appeal-Against-China-Life-a-102354 [accessed 29 April 2018].

747 Miao, above n 710, at 72.

who are also high-ranking government office holders being involved in such high-profile but damaging events as being reported or sued for breaching the rules of a foreign stock exchange because they would mostly likely regard these to be almost as disgraceful as being convicted.[748]

Other external players with increased courage would likely seize opportunities to move the Chinese bureaucratic machinery to a more desirable direction through the introduction of foreign corporate governance mechanisms and skills under a multitude of different circumstances. One class of the very active external parties pushing for overseas listing of the SOEs is investment banks both inside and outside China. It goes without saying that they were motivated by the prospect of making substantial gains from driving the IPOs to achieving successful launches on the foreign stock exchanges for such SOEs, however, their efforts did produce the outcome of leading the Chinese SOEs to a pathway which take them to internationally recognised markets.[749]

In this process, renowned foreign companies were invited to participate in these SOEs to enhance their credibility and attractiveness vis-à-vis their IPOs. They understood that such foreign companies would be able to offer and introduce international business experience, management and governance skills which will in turn improve these SOEs' corporate governance. For instance, some of the top-tier commercial banks had joined these Chinese SOEs as strategic investors before they launched their IPOs. Typical examples include (i) the acquisition by the Bank of America (BOA) of a 9% stake in CCB for US$3 billion in June 2005, which shareholding was increased to about 10.75% in June 2008 following BOA's exercise of its call options;[750] (ii) the subscription by the Royal Bank of Scotland in 2005 of 10% shares in BOC for US$3.1 billion in the runup to its IPO in June 2006;[751] (iii) the acquisition by Goldman Sachs of a 5.8% stake in ICBC in April 2006 prior to its IPO launch in October the same year;[752] and (iv) the formation of a strategic partnership between Agricultural Bank of China (ABC) and Standard

748 Miao, above n 710, at 72.
749 Ibid, at 75.
750 Construction Bank of China (CCB), above n 725.
751 Bank of China (BOC), above n 725.
752 Industrial and Commercial Bank of China (ICBC), above n 725.

Chartered Bank (SCB) in June 2010 which was followed by SCB becoming a cornerstone investor in ABC's IPO launch in Hong Kong a month later.[753]

During this process, even those in power have come to realise the inherent laws of operation of a sound economy have gradually impressed on the SOEs' government agency controllers to act within their invisible boundaries. Having had a taste of the intricacies of the international market, even those in power would realise that other than the traditional approach to instrumentally using the law to achieve economic advancement, it is also beneficial for them to keep check on the SOEs. Permitting the implantation of foreign corporate governance institutions into China's reform-oriented SOE constituencies in a gradual but steady pace has been the core principle of China's endeavour in its economy developing and law building in the last four decades. It appears that despite being implanted in soil which may from time to time receive suboptimal nutrients this implanted tree of corporate governance laws and practices has been slowly and occasionally bearing the intended and unintended fruit which will be beneficial to China in the years to come.[754]

As the *quid pro quo* for the SOEs to achieve and maintain prosperity through overseas listing is for them to abide by a comparatively stronger, more reliable and easily observable external governance and enforcement mechanism, SOE managers have consequently become more accountable, cautious, diligent and law-abiding. The special characteristics of overseas listing as a more effective and functional governance institution rest with the fact that this works outside China's national border but can transfer the effects across the border back to homeland through legal transplants. The attempt of "Going Out" to trade in an international finance centre is in essence a form of governmental reform. Overseas listing may initially be a measure purposely used by the state to introduce good governance, but the state may consequentially be won over by the logic of good governance of a modern capital market in the West and the universal order of law adopted therein. Overseas listing represents China's great leap to embrace globalisation, and whether the outcome is intended or unintended, expected or unexpected, once this

753 Agricultural Bank of China and Standard Chartered "Press Release - Standard Chartered Bank and Agricultural Bank of China Further Solidifying Strategic Cooperation" (18 October 2010): https://www.sc.com/global/av/cn-en-news-media-101018.pdf.

754 Ideas inspired by Miao, above n 710, at 75.

mechanism is put to work, it would be irresistible and irreversible.[755] To date, it appears that the general trend in the Chinese capital market is that "[r]egulators and investors alike are paying more attention to the fundamentals of corporate governance"[756]

In sum, overseas listings open an avenue for Chinese SOEs which may not be very well disciplined by conventional governance institutions at home to turn over a new leaf with a view to at least achieving the status of an internationally recognised good company, if not rubbing shoulders with members of the 'world's largest companies' club by gaining a position as a Fortune Global 500 company. They will usually undergo certain pre-IPO restructuring to strive to be conforming to the prerequisite requirements of an overseas listing and the required structure of a modern company with sound corporate governance mechanisms in place. These requirements also canvass ongoing monitoring and compliance with governance and disclosure regulations stipulated by the relevant international exchanges. Amongst the advantages that overseas listing may bring along, what appeals to the Chinese government-controllers appears to be a relatively more effective mechanism to restructure and regulate such SOEs which may result in better solutions to managerial problems without completely uprooting the traditional domestic systems whilst keeping things under control back in China. In essence, the government-controllers and the SOEs appear to be after a certain level of legitimacy and recognition internationally and one of the by-products of such endeavours turns out to be an improvement of their corporate governance mechanisms and institutions through imports of foreign legal institutions into China. In their efforts to reducing management glitches and making SOEs more sustainable by "Going Global", the establishment of a trend of overseas listing for SOEs and the corporate legitimacy that they brought along as a result of exercising an internationally acceptable level of governance disciplines will mean that they are bound to sacrifice certain privileges and benefits that they might enjoy on home turf as they strive to be compliant with international norms because no exception will be given to a particular firm from overseas as far as the international exchanges are concerned. In other words, transplanting corporate governance institutions into China through overseas listing of central-or-strategically-important SOEs becomes the means to achieve a much more important goal – that is, maintenance of

755 Miao, above n 710, at 76.

756 Liebman and Milhaupt, above n 669, at 956.

sustainability of its state control and economic growth. Corporate governance legal transplants through overseas listing turn out to be particularly feasible in many respects when alternative corporate governance institutions may not work well in China's political economy.

F Conclusion

This Chapter has provided a contextual review of corporate governance transplants in China. It has uncovered the ways legal transplants in China's corporate governance laws have been modified and in turn fostered the rise of China's modern state ownership of big businesses. It argues that western legal institutions are simply implanted in form but not in substance to serve a different agenda, that is, maintenance of the sustainability of China's economic growth and one-party rule. This Chapter has also examined legal transplants through the Chinese government's "Going Global" lens. It elucidates that legal transplants from the West have facilitated neither China's convergence to, nor divergence from, the western text-book-or-best-practice corporate governance practice but have essentially been misunderstood or lost in translation to China's unique form of capitalism – Sino-Capitalism during this implantation process.

The Chinese government's 'Open-Door-and-Going-Out' policies and reforms implemented through corporate governance transplants from the West has resulted in the continuous and sustainable economic growth, unprecedented rise of Chinese big businesses in the international arena and the emergence of Sino-Capitalism. Today, China's SOE big businesses and its big private business groups are recognised as significant players across the globe. For instance, (a) Alibaba (the world's largest e-commerce business, which will be discussed as a representative case study in Chapter V below), (b) Baidu (one of the world's largest AI and internet companies and has the 2nd largest search engine in the world), (c) Haier (the world's largest white goods and home appliances producer and owner of Fisher & Paykel in New Zealand and GE Appliance in the United States), (d) Huawei (the world's largest IT equipment manufacturer and 2nd largest smartphones producer), (e) Lenovo (holder of the top spot in the world's personal computer (PC) market and owner of big businesses such as IBM's PC and Intel

and Motorola Mobility in the United States, and Medion in Germany), and (f) Tencent (the world's largest gaming and social media company), to name a few.[757]

Chapter V will use the Alibaba story as a case study to illustrate that China's *modus operandi* vis-à-vis its handling of corporate legal transplants has been so deep-rooted in all walks of life that the most successful e-commerce business in the world has, whether consciously or subconsciously, mirrored China's SOE big business ecosystems and its treatment of imported business and corporate governance systems.

757 Alibaba Group: https://www.alibaba.com; Baidu: https://www.baidu.com/; Haier: http://www.haier.net/en/; Huawei: https://www.huawei.com/en/; Lenovo: https://www.lenovo.com/us/en/about/; and Tencent: http://www.tencent.com/en-us/index.html.

Chapter V Case Study

A Introduction – Alibaba as a Case Study

The Chinese economic reforms have turned China from an insular and poverty-stricken socialist country into a country with a modern thriving economy. Almost four decades of stellar economic growth, at an annual unprecedented rate of more than 10%, has taken China to be the world's second largest economy and the largest trading nation.[758] From a standing start in 1978, China now produces more than 50% of the world's steel;[759] is the world's largest e-commerce market;[760] and has four[761] of the world's top five banks measured by Tier 1 capital.[762]

Business ownership has changed drastically since China first rolled out its economic reforms in the early 1980s. SOEs contributed over 80% of GDP in 1978. However, by 2010, corporate or private ownership accounted for over half the economic output. Despite such dramatic evolution, as discussed in Chapters III and VI above, the State has not relinquished control of the country's key industries. It still fully owns or controls, whether directly or indirectly, strategic industries like aviation, communications, defence, and oil, and it has a strong influence on other cornerstone sectors, such as information technology, steel, design and automotive.[763]

In the finance sector, China's two stock exchanges are flourishing despite the short-term setbacks suffered during the global financial crisis in and about 2008. While SOEs still receive the lion's share of available financing from large state-

758 WTO (2015 trade statistics), above n 178.

759 Alicia Micklethwait and Patricia Dimond "China: Land of Opportunity but Beware of Landmines" in *Driven to the Brink: Why Corporate Governance, Board Leadership and Culture Matter* (Palgrave Macmillan, London, 2017) 157-180, at 157.

760 Alicia Micklethwait and Patricia Dimond "Alibaba: Largest Etailer on the Globe a Mere 15 Years On" in *Driven to the Brink: Why Corporate Governance, Board Leadership and Culture Matter* (Palgrave Macmillan, London, 2017) 181-200, at 181.

761 Industrial and Commercial Bank of China (ICBC) (1st), Construction Bank of China (CCB) (2nd), Bank of China (BOC) (3rd) and Agricultural Bank of China (ABC) (4th). See also The Banker "Top 1000 World Banks 2018: Top 5 by Tier 1: Global": https://www.thebanker.com/Top-1000.

762 Stefania Palma "Top 1000 World Banks - Chinese banks go from strength to strength" (2016) The Banker: http://www.thebanker.com/Top-1000-World-Banks/Top-1000-World-Banks-Chinese-banks-go-from-strength-to-strength.

763 Micklethwait and Dimond, above n 759, at 158.

owned banks, the combination of equity capital and a growing shadow banking system has allowed the private sector to thrive.[764]

Since 1978 China has set a sterling example for lifting its people out of poverty. The World Bank estimated that 12% of Chinese people were living in extreme poverty[765] in 2010, down from 84% in 1981. It was reported that extreme poverty has virtually been eliminated in urban areas, albeit that China still has a long way to go because its GDP per capita measured by purchasing power parity is only a third of the OECD average. The Communist Party of China (CPC) believes that China needs strong growth to ensure social stability and, ultimately, CPC's own survival. Members of the Chinese public have been largely content with sacrificing a certain degree of freedom and with the dominance of the CPC while they are getting richer. Slowing growth could disrupt this profound understanding and indulgence and consequently causes unrests. The CPC is thus determined to do whatever is necessary to boost this burgeoning economy.[766]

Having adopted its ground-breaking 'Open-Door' policy in 1978 and the more recent 'Going Global' policy at the turn of this century, China has not only become a significant recipient of global FDI, but has also emerged as a prominent foreign investor in the current global arena.[767] Many Chinese enterprises, by listening to and learning from their foreign investor partners and customers, by learning lessons from the West through transplanting governance institutions and by embracing long term growth as opposed to short term gains, have developed into global conglomerates.[768]

Furthering the discussion relating to SOE's overseas listing and China's "Going-Out" policy in Section E 6 in Chapter IV above, this chapter outlines the emergence of China as a modern global investment force, discusses the strategic importance of China's outward foreign direct investment and highlights the value of foreign investment as a governance mechanism which steers China in a more market-oriented and rule-abiding direction. The investment journey and governance system of Alibaba, China's marque private-big-business-group, mirror China's

764 Micklethwait and Dimond, above n 759, at 158.

765 Extreme poverty is defined as an income of less than US$1.25 per day.

766 Micklethwait and Dimond, above n 759, at 158-159.

767 Megan Bowman, George Gilligan and Justin O'Brien "China: Investing in the World" (2013) UNSW Law Research Paper No. 2013-70, at 2.

768 Idea inspired by Micklethwait and Dimond, above n 759, at 159.

economic development and *modus operandi* vis-à-vis its deep-rooted treatment of corporate governance and business model transplants from the West. This research also finds that Alibaba contributes, like China's other private-and-SOE-big-businesses, to the emergence of Sino-Capitalism. Alibaba's story will be used as a case study to shed important light on the profound similarities between SASAC's control of their SOE big businesses and Alibaba Partnership's control of the various big businesses under the Alibaba 'umbrella'.

Like SASAC, China's 'Megashareholder'[769] (as discussed in Chapter IV above), Alibaba has set up an interconnected web of eco-systems around its adaptation (with conscious sino-centric modifications to suit the needs of the Chinese market) of various western business models and governance systems since its inception in 1999. Today, Alibaba is an "e-commerce empire" and has become so influential across the globe that it can be seen as an "encompassing organisation" as advocated by Mansur Olson[770] in the Chinese society. Like SASAC, Alibaba (under the watch of the members of the Alibaba Partnership) "owns so much of the society" [771] that their primary objective has to be ensuring Alibaba achieve continuous corporate performance because Alibaba's (like those SOE-big-businesses') corporate sustainability is, as MW Meyer puts it, "an imperative, a given that is deeply institutionalized and will be maintained at almost any cost"[772] in China for reasons set out in Sections B and D below.

In order to effectively uncover the fact that the rise and development of Alibaba as one of the "Chinese-private-big-businesses" serves as a mirror of the rise of "Chinese-SOE-big-businesses" and in turn contributes to the emergence of Sino-Capitalism, the following section will present Alibaba's development pathway in terms of its gradual installation and continuous restructuring of its business eco-systems which can be likened to those set up by the SOE-big-businesses under the watch of SASAC.

769 Aguiar and others, above n 639.

770 Olson, above n 642, at 48 – please refer to Section E 1 in Chapter IV above.

771 Ibid.

772 Idea inspired by, and the quote is from, MW Meyer, above n 621, at 15.

B Alibaba's exponential growth in less than 20 years

On 19 September 2014, Chinese e-commerce conglomerate Alibaba was listed on the NYSE. This was the largest initial public offering (**IPO**) in history, raising approximately US$25 billion. Alibaba is considered the Asian answer to Amazon, eBay and PayPal combined. Its IPO success, business achievements within only 15 years and swift rise in the international business arena have been considered as one of the most significant miracles in business history – this simply mirrors China's own success story[773]. After the release, Alibaba share price soared by almost 30%, resulting in an enhanced ability of the company to issue more shares. At the time of its IPO, the business was valued at over US$230 billion, heading towards the position of the 11th largest company in the world by market capitalisation in the Standards & Poor's 500.[774] As of June 2018, Alibaba's market cap stood at US$542 billion.[775]

Since the IPO, Alibaba has been growing at an exponential rate. In 2017, Alibaba made it to the Fortune Global 500 List for the first time, taking the 462th spot with a revenue of US$23.52 billion.[776] It has risen to the 300th spot in 2018 reporting US$37.77 billion in revenue.[777] In January 2018, Alibaba became the second Asian company, after Tencent, to break the US$500 billion valuation mark to take one of the top 10 spots of the most valuable brands in the world. As of 2018, Alibaba has the 9th highest global brand value.[778]

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773 Qiao Liu *Corporate China 2.0: The Great Shakeup* (Springer, 2016), at 194.

774 Lauren Davidson "In five charts: how Alibaba pulled off the largest IPO ever" *The Telegraph* (London, 22 September 2014): http://www.telegraph.co.uk/finance/newsbysector/retailandconsumer/ 11106146/In-five-charts-how-Alibaba-pulled-off-the-largest-IPO-ever.html.

775 Alibaba Group, above n 757.

776 Celine Ge "Alibaba, Tencent included in Fortune Global 500 list for the first time " *South China Morning Post* (Hong Kong, 21 July 2017): https://www.scmp.com/print/business/companies/article/2103604/alibaba-tencent-included-fortune-global-500-list-first-time?edition=hong-kong; and Jie Zhang, above n 569.

777 Fortune Global 500 2018 List – Alibaba: http://fortune.com/global500/alibaba/.

778 David Meyer "China Now Has 2 of the Top 10 Most Valuable Brands in the World For the First Time" *Fortune* (Time Inc, 29 May 2018): http://fortune.com/2018/05/29/chinese-brands-alibaba-tencent-brandz/. According to David Meyer, the 2018's top 10 global brands – in order – are Google, Apple, Amazon, Microsoft, Tencent, Facebook, Visa, MacDonald's, Alibaba and AT&T.

Alibaba is currently the world's largest retailer. Since 2015, its online sales and profits surpassed all US retailers (including Walmart, Amazon and e-Bay) combined. It hosts the largest B2B (Alibaba.com) and B2C (Taobao, Tmall) marketplaces in the world. [779]

Alibaba was founded in 1999 by Jack Ma and seventeen co-founders, from Ma's residential apartment in Hangzhou, China. This venture was the direct result of Ma's earlier trip to the United States where he learnt about the Internet. He later returned to China believing that the Internet would provide small businesses with the necessary, widely-accessible and thus powerful platform to trade domestically and internationally. Ma has made Alibaba's mission crystal clear from the outset – it is to create an internet platform to help small and medium sized enterprises (**SMEs**) with the promotion and sale of their products and services. In particular, there are millions of SMEs in China, many of which trade in fragmented markets, with very limited access to channels and information that are able to assist them in promoting and marketing their products. To add to their woes, for want of resources, the SMEs are not in a position to gauge the creditworthiness and trustworthiness of any trading partners.[780] Alibaba was thus created to at least lend them a helping hand, if not to come to their rescue. Since then, Alibaba has continued to launch new business ventures which are typically successful business models from the United States, transplanted into the Chinese market.

Alibaba's first internet business, alibaba.com, was launched as a global wholesale marketplace with an English language platform canvassing a 'business to business' (B2B) exchange for SMEs to find overseas trading partners. By the same token, Alibaba launched a China marketplace (now known as 1688.com) for domestic wholesale trades, through which it raised US$5 million from a consortium of small investors.[781] The name Alibaba was picked from the famous Middle-Eastern fable *Ali Baba and the Forty Thieves* [782] – to Ma's mind, the allegory surrounding Alibaba can be globally recognised – this universally-known story (albeit another transplant from the West) is capable of mesmerising images of

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779 Alibaba Group, above n 757.

780 Q Liu, above n 773, at 194-195.

781 Micklethwait and Dimond, above n 760, at 183.

782 Ali Baba is a character from the Middle-Eastern folk tale *Ali Baba and the Forty Thieves* which was included in the story collection *The Book of One Thousand and One Nights* by French Orientalist Antoine Galland in the 18th century, see https://en.wikipedia.org/wiki/Ali_Baba.

small businesses calling out 'open sesame' to new opportunities and treasures (or "pots of gold") through the Internet.

In January 2000, Ma secured an investment of US$20 million from Softbank, the Japanese conglomerate in the mobile and information communications sector. Softbank has since become one of Alibaba's long-term partners. The business reached a number of significant milestones in the next two to three years – hundreds of thousands of small enterprises were emboldened by Alibaba's internet platforms. Consequently, they enlisted more than one million registered users and a positive cash flow status.[783]

While Alibaba's B2B business went well, Ma became interested in the business model of eBay. He formed a small team that locked itself in his apartment to build and launch in May 2003 an online shopping website *Taobao*, which literal meaning in Chinese is 'search for treasures'. This business was built on the principle of eBay, which was a great success in the Chinese market at that time. Taobao takes it further by setting up an online shopping website that combined the functionalities of eBay and Amazon – that is, selling through fixed prices or auctions. Taobao's mission is to serve the needs of the burgeoning middle class which allows consumers to sell to each other. Ma saw an edge over a 'David and Goliath' story here – Taobao could inculcate more Chinese elements than such a formidable competitor as eBay because Taobao Marketplace, as a Chinese company, had an in-depth and more relevant understanding of Chinese consumers and culture as well as their consumption behaviours and needs.[784]

Taobao Marketplace has positioned itself right from the outset to conduct 'business to consumer' (**B2C**) and 'consumer to consumer' (**C2C**) exchanges for Chinese retailers and consumers. Whilst the highly regimental and fragmented brick and mortar retail business in China offered limited choices and avenues for its consumers and customers, Alibaba took a big leap to focus on the unmet needs in the Chinese retail business world by taking consumers and retailers onto their online Taobao Marketplace.[785]

In order to develop Taobao Marketplace, Alibaba and Softbank established a joint venture and they contributed a total of US$50 million to a series of investments.

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783 Micklethwait and Dimond, above n 760, at 184.

784 Ibid.

785 Ibid; see also Q Liu, above n 773, at 195.

Ma believed in the need of keeping customers happy, so the platform was offered without charge for the first three years – this measure ultimately crippled the competitor eBay China. In May 2003 when Taobao was launched, eBay China had a 79% market share. Within three years, Alibaba's Taobao took over almost 60% of the market, resulting in eBay China's market share plummeted to less than 40%.[786] In short, eBay's US model was unable to compete with Taobao because it failed to secure a local partner and in turn struggled to fully understand its Chinese consumers. This failure led to the inevitable outcome of eBay suffering a humiliating withdrawal from the Chinese market in 2006.[787]

During 2004, Alibaba celebrated its five-year anniversary, raised US$82 million via a private equity commitment,[788] developed and launched *Aliwangwang*, a personal computer-based messaging and video-conferencing tool which facilitates text, audio and video communication between customers and retailers on Taobao Marketplace.[789] In December 2004, Alibaba introduced *Alipay* (which Chinese name carries the literal meaning of 'payment treasure').[790] Alipay, the Chinese equivalent of PayPal and the preferred payment method on Taobao, is an escrow service designed to minimise settlement risk amongst the parties involved in the transactions.

Alipay was originally introduced as a third-party online payment platform on Taobao Marketplace. This platform allows customers to deposit their money in Alipay until receipt of confirmation that the products have been received from the sellers and guarantees refunds to the customers who have lost money in shoddy transactions. Through the platform of Alipay, a purchaser deposits payment in an Alipay account for an outstanding order or transaction. Alipay will inform the seller when it has received the funds from the purchaser, the seller then ships the products to the purchaser. When the purchaser confirms receipt and satisfaction with the delivery of the products, Alipay instructs its bank to release the payment to the seller. Alipay addresses the issue of the lack of trust online between the

786 Micklethwait and Dimond, above n 760, at 184.

787 Ibid, at 184-185.

788 Ibid, at 185.

789 Alibaba Group Holding Limited, Prospectus (Form 424B4) (18 September 2014): http://www.nasdaq.com/markets/ipos/filing.ashx?filingid=9762912#D709111D424B4_HTM_TOC709111_11 [**Alibaba Prospectus**], at 86.

790 Ibid, at 83.

purchasers and the sellers which could have been the stumbling block for the development of e-commerce in China. By 2013, according to iResearch, Alipay has become the largest online third-party payment service provider in China by total payment volume.[791] Alibaba's motto states that suppliers or sellers do not get paid until their customers say they are happy with the products. This was a principle that eBay would later copy. Not surprisingly, Alipay sets the standards for, and has become, China's largest online payment service provider, and as of 2015, Alipay has more than 400 million active users.[792]

In 2005, Yahoo and Alibaba established a strategic partnership – Yahoo invested US$1 billion in cash and contributed Yahoo China to Alibaba Group, in exchange for 40% of the equity in Alibaba, which was valued at US$4 billion. For Alibaba, this enabled its B2B, B2C and C2C marketplaces to join forces with a search engine and a significant amount of cash to invest on further development. For Yahoo, its entry into this necessary and relatively low risk partnership has gone on becoming its most valuable asset.[793]

Yahoo was one of the first American internet companies to enter Asia. It had experienced success in Japan through giving its Japanese partner, Softbank, autonomy in terms of its local operation decisions. Yahoo's alliance with Alibaba was considered to be synergetic in that they shared a common partner in Softbank, and Yahoo's co-founder, American-Taiwanese Jerry Yang, was on a similar wave length to Jack Ma. Yahoo was well rewarded for placing its faith in Alibaba during the period of its investment – it was reported that Yahoo US received from Alibaba over US$20 billion in cash by 2015, whilst its remaining interest therein was valued at more than US$30 billion at the same time.[794]

Alibaba built an ecosystem during its first ten years by way of setting up a network of internet business services for its buyers and sellers, which accounts for much of

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791 Alibaba Prospectus, above n 789, at 86. See also Q Liu, above n 773, at 195.

792 Ibid, Q Liu, at 195 and 210, and ibid, Alibaba Prospectus, at 86: Alipay was divested from the Alibaba Group in 2010 in a controversial matter. Since 2011, Alibaba no longer controls or holds any equity interest in Alipay, albeit its continuous participation in certain of Alipay's economic benefits through contractual arrangements with Alipay to facilitate the provision of payment and escrow services to Alibaba's customers. It is now a core part of Ant Financial, a financial conglomerate set up in November 2014 by Ma and his Alibaba management team.

793 Micklethwait and Dimond, above n 760, at 185.

794 Ibid.

its success today. The trading platforms were complemented by the establishment of Taobao University, which was launched to provide e-commerce education to its members. In 2007, *Alimama* was launched as a marketing technology platform to provide sellers with online marketing services for both personal computers and mobile devices. To complete the services, a computer software program, *Alisoft*, was also released to handles finances, inventories and customer information for the Alibaba subscribers. In the same year, the Taobao Marketplace also started to monetise through 'pay for performance' (**P4P**) marketing services and display marketing.[795]

In April 2008, Alibaba launched Taobao Mall (now known as Tmall.com), a dedicated B2C platform for third-party brands and retailers. Tmall is intended to complement Taobao's C2C marketplaces. It has an independent web domain: Tmall.com. Tmall was introduced because Alibaba recognised that Chinese consumers had developed an increased desire for branded products and a first-rate online shopping experience. Similar to Amazon but with a Chinese twist, Taobao Mall's (or Tmall) unique selling point was the online 'mall' experience it provided where brands set up their own website. Brands usually have more than one website – their own flagship site and one within the mall, a virtual store. They pay a deposit to list on the Tmall site and then a commission on each transaction. The Tmall model has proven to be a tremendous success – its level of success is akin to that of Taobao. Taobao Mall became an independent business in June 2011 and changed its Chinese name to *Tian Miao* (Tmall) in January 2012. It was also reported that in 2012 Tmall accounted for 51% of China's B2C online sales, up from 35% in 2010. Comparatively, Amazon has an approximately 20% market share in the United States.[796]

To complete the trading platforms and complement its retail business, Alibaba looks proactively for expansion opportunities. It has made swift moves into adjacent or complementary sectors, which include financial services, cloud computing and social media. In 2009, Alibaba announced its acquisition of HiChina, the leading Internet infrastructure provider, and Alibaba Cloud Computing (*Aliyun*) was established to handle Alibaba's substantial volume of transactions and

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795 Alibaba Prospectus, above n 789, at 86. See also Micklethwait and Dimond, above n 760, at 186.

796 Ibid, Alibaba Prospectus. See also KPMG *E-commerce in China: Driving a new consumer culture* (China 360, January 2014), at 3.

data from its trading platforms. Today, Aliyun addresses the data management needs of Alibaba and the businesses that form an integral part of its ecosystem (which includes Alipay). It also generates third party revenue from sellers trading on its marketplaces and other businesses that have cloud computing needs. This increased revenue gives Aliyun's sellers computing power and scalability so that they can handle spikes in transaction volume such as during its Singles Day promotion which was launched in 2013 to take place on 11 November every year.[797] To illustrate its popularity, it was reported in the Alibaba Prospectus that the Singles Day promotion which took place on 11 November 2013 recorded a gross merchandise value (**GMV**) settled through Alipay of RMB¥36.2 billion (US$5.8 billion).[798]

In March 2010, Taobao Marketplace launched *Juhuasuan*, which is an online group buying marketplace comparable to Groupon. It offers quality products at discounted prices by aggregating demand from consumer groups, through flash sales of products for a limited period of time. Taobao also operates a travel booking business called Taobao Travel, which provides similar services to Expedia in the United States. In April 2010, AliExpress was launched as a global consumer marketplace to enable exporters in China to directly trade with consumers across the world.[799]

In 2011, Ma established a separate entity, Ant Financial, which is independent of Alibaba, to hold Alipay which provides financial services to over 400 million users. Alipay's business include Alibaba's small business lending, consumer finance, internet insurance and money market funds.[800] By 2013, according to iResearch, Alipay was the largest online third-party payment service provider in China by total payment volume.[801]

Between 2010 and 2014, Alibaba's consolidated revenue grew from almost RMB¥6.7 billion to RMB¥52.5 billion (approximately US$8.5 billion). During 2014, Alibaba transacted 14.5 billion orders of products, recording a GMV of US$296 billion – more than Amazon and eBay combined. In the fiscal year 2014, Alibaba's

797 Alibaba Prospectus, above n 789, at 86; see also Micklethwait and Dimond, above n 760, at 186.

798 Ibid, Alibaba Prospectus, at 83.

799 Ibid, at 86. See also Q Liu, above n 773, at 196.

800 Ibid, Q Liu.

801 Alibaba Prospectus, above n 789, at 86.

net income was nearly US$3.8 billion, increased by over 170% from the preceding year.[802]

On 28 September 2014, only two weeks after it went public, Alibaba announced that it agreed to pay US$457 million for a 15% stake in Beijing-based company which provides hotels with technology software and services, Beijing Shiji Information Technology. This transaction is meant to strengthen Alibaba's travel booking business.[803] It also shows that this Chinese e-commerce giant's determination to continue its growth and acquisition spree after its record-breaking IPO in the United States.

In sum, Alibaba managed to establish an ecosystem around its online trading platforms, creating China's own integrated version of Amazon, eBay and PayPal with annual turnover greater than US$500 million and around 480 million registered users during its first ten years. From 2010 to its IPO in New York in September 2014, Alibaba continued to develop organically at an inexorable pace – its revenues hit US$7.5 billion and handled transactions worth over US$240 billion, more than the volume on eBay and Amazon combined. As at the end of June 2014, Alibaba had almost 280 million active buyers with the average purchaser placing over 50 orders each year.[804] After all, Alibaba is more profitable than its peers probably because it has the most advantageous edge over its overseas counterparts in that it is located in the world's most populous country and fastest growing e-commerce market – China. Not surprisingly, foreign investors flocked to buy Alibaba shares in its IPO on the NYSE which resulted in its raising US$25 billion.

Considering its current business portfolio, it can be said that Alibaba Group has been developing into the Chinese equivalent of Amazon, eBay, Expedia, Groupon and PayPal combined under one conglomerate which relies heavily on borrowing western business, and in turn legal, models, institutions and structures as long as they are capable of assisting it in achieving its economic expansion goals. This *modus operandi* is very much akin to China's approach to its economic reform and

802 Stefan Petry "Founder Firms and Bad Corporate Governance Design? The Case of Alibaba" (2014) FIRN Research Paper No. 2530063, at 6.

803 Juro Osawa "Alibaba Buys Stake in Chinese Hotel-Tech Company" *The Wall Street Journal* (New York, 28 September 2014): https://www.wsj.com/articles/alibaba-buys-stake-in-chinese-hotel-tech-company-1411942798.

804 Davidson, above n 774.

development as discussed in Chapter IV above. Like China's SOE big businesses, Alibaba's current trajectory is embracing disproportional central management control to ensure economic growth through legal transplants which mirror the portico of Western governance institutions but not necessarily bear their actual substance.

C Issues surrounding Alibaba's 2014 IPO

Alibaba is, as discussed above, the largest e-commerce provider which dominates the Chinese online market, with over an 80% market share.[805] Alibaba's operation is very much based in China but is akin to Amazon, eBay and PayPal, and is as popular as Google, Facebook, Twitter and Yahoo, with unique Chinese characteristics. It is not only transmuting the Chinese economy and making a positive impact on the everyday life of the Chinese people, but also leading the way in Chinese entrepreneurialism. Alibaba is changing China's retail and finance sectors via its online shopping sites, Taobao and Tmall, and major online payment platform, Alipay.[806] Its listing has, however, given rise to a number of ripples in the commercial law world. One of them touches upon China's regulatory measures in its handling of the variable interest entity (**VIE**) structure, and another lies with the controversy surrounding its failed attempt to list on the HKSE with its dual-class share structure.

Alibaba's 2014 IPO success in the United States has epitomised the spectacle of a spate of Chinese internet companies seeking to raise funds in the US stock markets by employing a similarly novel but sometimes misunderstood corporate ownership and governance system – the disproportional control model and/or the VIE system. The VIE system can be considered a legal transplant from the United States which is deemed by numerous Chinese Internet companies, the most well-known of which is certainly Alibaba, as an answer to China's restrictions on foreign investments. This however can be challenged by the state declaring it unlawful

805 Petry, above n 802, at 6.

806 Shen Wei and Angus Young "Dual Share Plan in Context: Making Sense of Hong Kong's Decision Not to Embrace Alibaba's Listing" (2015) 26(1) International Company and Commercial Law Review 4-17, at 4.

when it renders it necessary to introduce new rules and regulations to crack down on undesirable overseas investments from China or capital outflows.

Such risks have been elaborated in the Alibaba Prospectus which describes the legal ambiguity of its VIE structure and the consequential risks and in turn forewarns its foreign investors:[807]

> If the PRC government deems that the contractual arrangements in relation to our variable interest entities do not comply with PRC governmental restrictions on foreign investment, or if these regulations or the interpretation of existing regulations changes in the future, we could be subject to penalties or be forced to relinquish our interests in those operations.

The disproportional control model which usually operates in the form of dual-class share structure is largely another legal transfer from the United States to China. It assists founding partners and controlling shareholders in maintaining post-IPO control over the listed company even where there is a drastic reduction of equity stake or shareholding following the IPO.[808] Such maintenance of disproportional control post-IPO by the founding partners and controlling shareholders is substantially similar to the scheme employed by the state to let SOEs go public to increase the value of its assets without parting with state control as discussed in Section B in Chapter IV above – an old wine in a new skin.

Similar to most US technology companies which adopt dual-class structures to maintain control following listing by their founders, Alibaba grants a partnership, consisting of its founders and executives, an exclusive right to nominate the majority of its board directors. Alibaba also puts in place various anti-takeover measures to enhance insider control, many of which are traditionally considered by commentators to be detrimental to minority shareholders' interests. Such structures present an enigma as to the success of the world's largest IPO and cast doubt on the longstanding debate as to whether text-book-or-best-practice corporate governance truly matters when things are examined through the lens of economic 'success or failure' of a company or country.

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807 Alibaba Prospectus, above n 789, at 48, under the section entitled "Risks Related to Our Corporate Structure".

808 Yu-Hsin Lin and Thomas Mehaffy "Open Sesame: The Myth of Alibaba's Extreme Corporate Governance and Control" (2016) 10 Brook J Corp Fin & Com L 437, at 438.

D VIEs in China and Alibaba's VIE structure

In 1978, Deng Xiaoping led China in economic reform under the aegis of his ground-breaking Open-Door Policy. Foreign direct investment (**FDI**) from the West, which spurs economic growth in China and in turn brings along various legal norms and institutions by way of legal transplants, has since been welcomed. That said, protectionism continues to persist in the form of restrictions on foreign investments in specific industries. FDI guidelines and restrictions are set out in the Catalogue of Industries for Guiding Foreign Investment (**FDI Guiding Catalogue**). The FDI Guiding Catalogue classifies industry sectors into three categories, designating FDI as "encouraged", "restricted" or "prohibited" for various industries. FDI is "permitted" in those industries not expressly specified in the FDI Guiding Catalogue. Conversely, foreign investors are not permitted to invest in "prohibited" industries in whatever circumstances. The prohibited industries are those deemed by the Chinese government to be strategic and emerging industries, or otherwise those that are sensitive for political or national security reasons. The Internet sector, where the VIE structure is commonly used, is classified as prohibited, disallowing foreign investment and forbidding foreign ownership in PRC-domiciled companies.[809]

VIE is a typical investment structure used by Chinese companies and foreign investors to bypass Chinese government restrictions on FDI. The VIE structure is commonly referred to as the Sina-model structure. Sina Corporation was the first PRC-domiciled company to acquire an offshore public listing through a VIE structure in 2000. Foreign investors have since then replicated the VIE structure in various sectors in China where FDI is either restricted or prohibited under Chinese law.[810]

A VIE is a company that is consolidated into the financial statements of a listed company as it is controlled through contracts, not ownership. This means that the

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809 The Catalogue of Industries for Guiding Foreign Investment (Revision 2017) (approved by the Party Central Committee and the State Council by No. 4 Decree of the National Development and Reform Commission and the Ministry of Commerce of the People's Republic of China on 28 June 2017 and took effect on 28 July 2017): http://www.fdi.gov.cn/1800000121_39_4851_0_7.html.

810 Kaitlyn Johnson "Variable Interest Entities: Alibaba's Regulatory Work-Around to China's Foreign Investment Restrictions" (2014) 12 Loy U Chi Int'l L Rev 249, at 252-253.

basis of control of the company is contractual arrangements, as opposed to the traditional equity ownership in the underlying company. In its most basic form, a VIE structure is comprised of three entities: an operating company that is incorporated in China and owned by individuals who are Chinese citizens, typically its founders; a wholly-foreign-owned enterprise (WFOE) domiciled in China; and an offshore holding entity (usually based in an offshore jurisdiction such as the BVI or the Cayman Islands) that owns 100% of the PRC-domiciled WFOE and contracts with the Chinese operating company. This offshore holding entity then seeks to be listed in the United States. US investors are enlisted to purchase shares in the US-listed offshore holding company. In essence, the offshore holding company links foreign investors to the operating PRC-domiciled company through contracts set up by the WFOE. These contractual arrangements and/or agreements in effect mirror equity ownership, however, do not confer actual equity ownership in the operating company. Operating control remains within the PRC-domiciled company. Since the VIE is owned by Chinese citizens, it technically meets the requirements for operating legally in China, it is thus permitted to conduct business in industries that prohibit foreign ownership in China. The VIE structure allows investors to purchase shares in the offshore entity which links the foreign investors to the PRC-domiciled operating company through a series of contracts between the listed offshore company and the PRC-domiciled WFOE. In sum, the enforceability of such an arrangement is conditional upon the validity of the underlying contracts. The VIE structure provides an innovative compliance mechanism – although the offshore foreign entity cannot operate in the restricted sector itself, it gives its foreign investors access to the revenues of the underlying company that does. In practice, the WFOE holds all material assets and conducts major operations for the listed company as the WFOE is wholly owned by the offshore holding listed company. The listed offshore company generates revenues directly through its ownership in the WFOE, which directly captures the VIE's profits through a series of contracts between the WFOE and the VIE. To an investor, a VIE investment is only as good as the validity of its underlying contractual arrangements. Such contracts are only enforceable if the Chinese courts are willing to uphold them. While listing a company under a VIE structure on the US exchanges is legal in the United States, Chinese authorities have yet to formally

confirm the validity of the existing VIE structures in China, leaving foreign investors in limbo.[811]

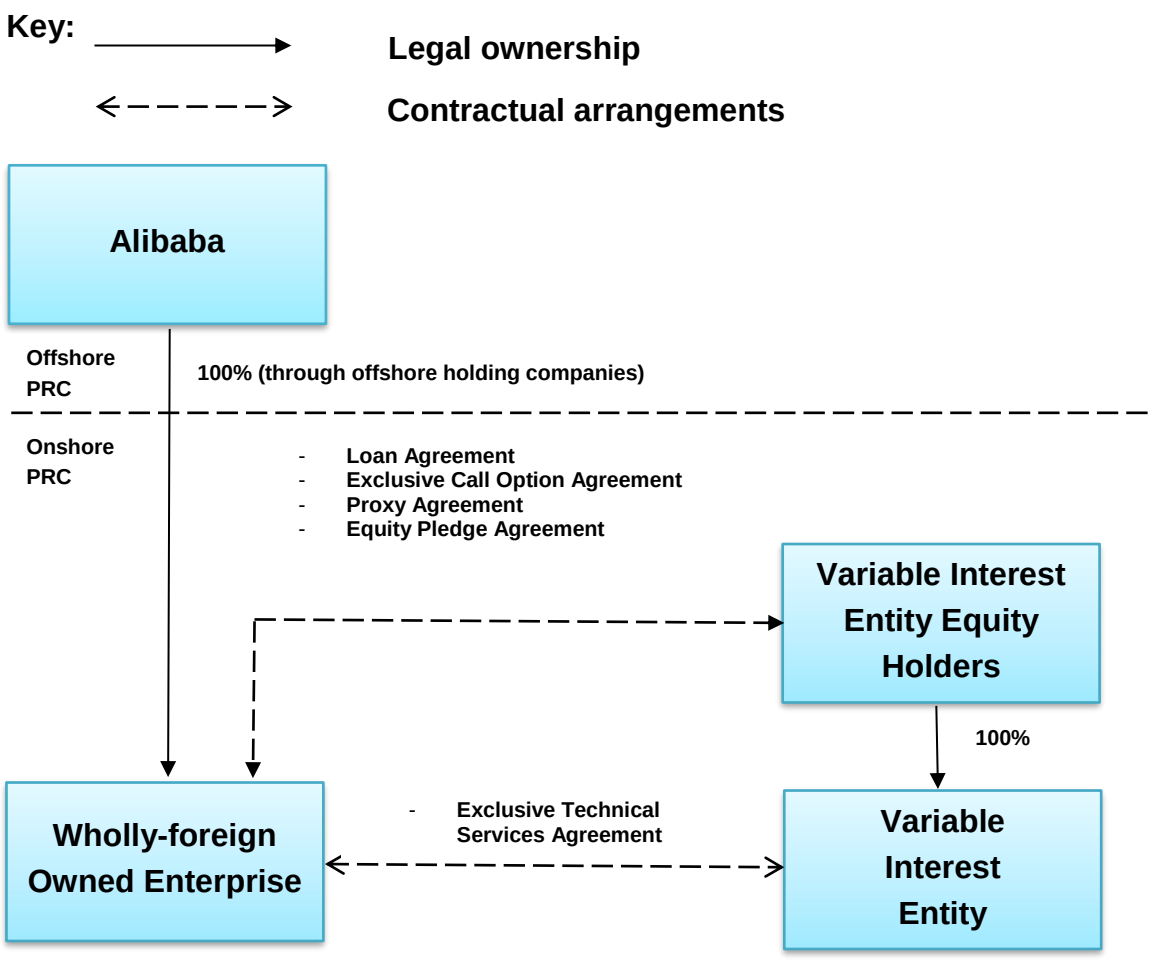
Like a typical VIE structure, Alibaba's structure includes such agreements that maintain effective control of the VIEs as loan agreements, exclusive call option agreements, proxy agreements, equity pledge agreements, and such contracts that capture substantially all of the economic benefits from the VIEs as exclusive technical services agreements and exclusive call option agreements.[812] The following diagram (Figure 1) sets out a simplified illustration of Alibaba's ownership structure and contractual arrangements which Alibaba believes will provide them with effective control of their material VIEs and enable them to receive substantially all the economic benefits from their operations.[813]

811 Lin and Mehaffy, above n 808, at 444-445.

812 Alibaba Prospectus, above n 789, at 90-91.

813 Alibaba Prospectus, above n 789, at 90.

Figure 1 – Simplified illustration of Alibaba's ownership structure and contractual arrangements



It appears from the above diagram and the Alibaba Prospectus that Alibaba generates a significant majority of its revenue through its wholly-foreign enterprises (WFOEs), which not only hold Alibaba's material assets and operations, but also directly capture the profits and associated cash flow from operations without having to rely on contractual arrangements to transfer such cash flow from the VIEs.[814] Similar to all other entities with foreign-incorporated holding company structures operating in the same industry in China, Alibaba operates its Internet and other

[814] Alibaba Prospectus, above n 789, at 12.

businesses in which foreign investment is restricted or prohibited in China through WFOEs, majority-owned entities and VIEs. The relevant VIEs, which are 100% owned by PRC citizens or PRC entities owned by PRC citizens, hold the Internet content provider (**ICP**) and other licences for regulated activities and operate various websites for its Internet businesses. This arrangement has been put in place due to the PRC legal restrictions on foreign ownership and investment in, amongst other areas, value-added telecommunications services.[815] It also appears that Alibaba has sought to minimise the VIE structure to the fullest extent possible. It has been reported that only approximately 12% of Alibaba's revenue is tied to the VIE structure.[816] Thus, Alibaba's structure provides a unique combination – a blend of the US-Silicon Valley-type-tech companies' insider control with elements of the VIE structure typically found in the Chinese Internet sector – another example of legal transfers from the West with Chinese adaptation based on its cultural, political and economic environment and orientation – a typical corporate governance law transplant in form but not necessarily in substance as discussed in the preceding chapters.

Alibaba's Chinese VIEs utilise many of the typical elements of the VIE structure. Investors in Alibaba's shares do not technically own shares in the Alibaba VIEs themselves, they have contractual rights to the VIEs' revenues instead. As mentioned above, Jack Ma and Simon Xie are the equity holders of most of Alibaba's VIEs.[817] Ma and Xie can authorise any person designated by the WFOE to exercise shareholders' rights in the VIEs, including the right to attend and vote at the shareholders' meetings and appoint directors.[818]

Given VIEs' vulnerable legal status, it is not unlikely for the VIEs' Chinese owners to back out of their VIE agreements thereby exposing its foreign investors to higher corporate governance risks. The crux of the issue lies in the risks of the VIE agreements being declared illegal under section (3) or (5) of Article 52 of the PRC Contract Law:[819]

> A contract is invalid under the following circumstances:

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815 Alibaba Prospectus, above n 789, at 10-11.

816 Lin and Mehaffy, above n 808, at 443.

817 Alibaba Prospectus, above n 789, at 11 and 88.

818 Ibid, at 91.

819 Contract Law, above n 479, art 52.

(1) a contract is concluded through the use of fraud or coercion by one party to damage the interests of the State;

(2) malicious collusion is conducted to damage the interests of the State, a collective or a third party;

(3) an illegitimate purpose is concealed under the guise of legitimate acts;

(4) public interests are damaged;

(5) mandatory provisions of laws and administrative regulations are violated.

The term VIE actually originates from American accounting rules, the Financial Accounting Standards Board's (**FASB**) Interpretation No. 46, *Consolidation of Variable Interest Entities* (**FIN 46**). FIN 46 was promulgated in 2003 to expand on the Interpretation of Accounting Research Bulletin (**ARB**) 51. Under ARB 51, a parent company was to consolidate its subsidiary if it had a "controlling financial interest". A controlling financial interest is present if the parent company had a majority of the voting interest (the voting interest principle). FIN 46 however revised how certain special purpose entities should be consolidated in financial statements. Under FIN 46 (which was reissued as FIN 46(R) in December 2003), the voting interest principle under ARB 51 is no longer the sole determinant of "controlling financial interests" where special purpose entities are concerned. Instead, there is a two-stage process.[820]

In the first stage, the entity must be considered a VIE; if so, then it will be consolidated if the "parent" (or primary beneficiary) is exposed to the majority risk of the entity/VIE's returns and losses (the risk and rewards principle). An entity is considered a VIE under FIN 46 if it is established with non-substantive voting interests and is lightly capitalised (in other words, it does not have sufficient equity investment at risk). Its residual equity holders do not control the entity, nor do they contribute fully in the entity's residual returns and losses. In the second stage, the question becomes, who is the "primary beneficiary"? The primary beneficiary is the entity which is, by the risk and rewards principle, exposed to the majority of the expected losses. If no party takes the majority of the expected losses, the "party which is entitled to the majority rewards of the VIE is the primary beneficiary".[821]

820 Guo Li "Chinese style VIEs: Continuing to sneak under smog" (2014) 47 Cornell Int'l LJ 569, at 572.

821 Ibid, at 572-573.

VIEs in China are in essence investment vehicles – a legal transplant from the United States again in form but may not necessarily in substance. It epitomises different contractual arrangements and undertakings that attempt to exert control and quasi-ownership over an entity without the utilisation of direct equity ownership. As discussed above, the historical and major reason for using VIEs in China is to avoid the restrictions on foreign direct ownership and investment in specific industries. The Chinese government's enhanced regulation of equity acquisition by foreign investors has significantly popularised the employment of VIE structures. Foreign investors usually directly acquire equity interest in a foreign invested enterprise (**FIE**) or local enterprise through an existing foreign or Chinese equity holder under either an equity acquisition agreement or a subscription agreement for new equity in the target enterprise. It is also rather common to find that such "foreign investors" are in fact offshore companies owned or controlled by Chinese residents and cornerstone foreign private equity investors. This mode of investment is nicknamed "round trip investments" and is often made in the context of an overseas listing pre-IPO restructure. Over time, it is understandable that the Chinese government may become increasingly suspicious of these structures which facilitate such "round trip investments" that are usually installed as part of their overseas pre-IPO restructures.[822]

Under the Provisions on Mergers and Acquisitions of a Domestic Enterprise by Foreign Investors (**M&A Provisions**), the merger of a domestic affiliated company by any domestic company, entity or natural person in the name of a foreign company which it lawfully established, or controls, will be subject to MOFCOM's approval.[823] Since no guidelines have been released by MOFCOM on how to apply for approval of such acquisitions, it appears that the Chinese authorities would rarely approve these acquisitions. As VIEs do not entail any cross-border equity acquisition, no MOFCOM approval is required. This in turn enables VIEs to avoid the need to apply for approvals under the M&A Provisions.[824] To date, China has yet to promulgate any outright ban, or tightened regulations to crack down, on the

822 G Li, above n 820, at 573-575.

823 The Provisions on Mergers and Acquisitions of a Domestic Enterprise by Foreign Investors (promulgated by No.6 Decree of the Ministry of Commerce of the People's Republic of China and took effect on 22 June 2009), art 11: http://www.fdi.gov.cn/1800000121_39_4115_0_7.html.

824 G Li, above n 820, at 575-576.

utilisation or perceived abuse of the VIE structures albeit noises from such stakeholders as MOFCOM, CSRC, and the Ministry of Industry and Information Technology (**MIIT**) have been drip-fed or "leaked" to the media. For instance, it has been reported in September 2011 that an official of the CSRC submitted an internal report to his superior condemning the VIE structures and calling for companies using VIE structures to be scrutinised and approved by MOFCOM and CSRC when seeking to list overseas (**CSRC Report**).[825] It has also been disclosed to the media that the CSRC Report noted forty major Chinese Internet companies with Tudou as the latest as at August 2011 were listed overseas (primarily on NASDAQ and NYSE) with a combined market capitalisation of US$160 billion.[826]

Two arbitration cases adjudicated by the Shanghai Sub-Commission of the China International Economic and Trade Arbitration Commission (**SH CIETAC**) and one judicial decision passed by the People's Supreme Court in 2010 and 2011 rendered the VIE agreements or similar contractual arrangements in question null and void. These cases are the first in which SH CIETAC has declared a direct award on the validity of VIEs although, legally speaking, such awards would not constitute a viable reference or be taken as precedents in future proceedings.[827]

To address the uncertainty surrounding such issues as the validity of various VIE arrangements, the Chinese government attempted to regulate VIE agreements in 2015 – the PRC State Council released on 19 January 2015 the Foreign Investment Law of the People's Republic of China (Draft for Public Comments) (**Draft FIE Law**).[828] It can be understood that the Draft FIE Law was stipulated to overhaul China's existing foreign investment regime and streamline the existing EJV Law, CJV Law and WFOE Law (as referred to in Section D 1 in Chapter III above) which last revisions took place in 2000 and 2001 respectively. The Draft FIE Law provides that "foreign investment" includes obtaining or controlling equity

825 G Li, above n 820, at 583-584.

826 Andrew McGinty and others "China VIE structure for foreign investment under attack from multiple directions: will it emerge (relatively) unscathed or is its very survival threatened?" (Hogan Lovells, Lexology Legal Intelligence, China, 2012): https://www.lexology.com/library/detail.aspx?g=94767bad-0dc0-4f05-ab90-9bdffa49cbee.

827 G Li, above n 820, at 592-595.

828 The Foreign Investment Law of the People's Republic of China (Draft for Public Comments), promulgated by the Ministry of Commerce (MOFCOM) on 19 January 2015 [**Draft FIE Law**]: http://english.mofcom.gov.cn/article/newsrelease/policyreleasing/201501/20150100875221.shtml.

in domestic companies by way of contract or trust.[829] "Control" is further defined in the Draft FIE Law to the effect that the law will treat a Chinese operating entity as being "controlled" by a foreign entity if the foreign entity is able to exercise decisive influence on the finance, human resource, management, or technology of the Chinese operating entity.[830] In short, through the operation of these two definitions, the Draft FIE Law effectively treats the VIE structures as a form of foreign investment whereby rendering such structures theoretically infringing the relevant foreign investment restrictions. If MOFCOM were to formally pass and promulgate the Draft FIE Law as the new foreign investment law, such existing VIEs as Alibaba would be put in a perilous situation. This is because the Draft FIE Law essentially acknowledges that existing VIEs that are in the restricted industries could be caught by the definition of "foreign investment" and hence could become unlawful under Chinese law.

At the time of finalising this section, which has been over three years after the release of the Draft FIE Law for public comments, a formal foreign investment law along the lines of the Draft FIE Law has yet to be promulgated. Put simply, it can be expected that the US$542 billion[831] of market capitalisation and Alibaba's success in becoming one of the top 10 most valuable brands in the world will not be ignored by the Chinese government, policymakers and lawmakers. What is clear is that a retrospective, or an outright, ban of the VIE structures would likely create significant market disruption in both China and those countries in which listing of foreign companies structured with VIEs is permitted, that is, predominantly the United States in the case of listed Chinese VIEs operating in the Internet and hi-tech sectors.

As hundreds of billions of dollars will not be considered as a small number, careful consideration will have to be given to adopting a workable and sustainable solution that does not cause both domestic and overseas investors to lose out or lead to more international controversies or a greater flight of capital out of China employing other 'new-found' mechanisms to circumvent the rules. Chinese regulators and legislators will need to consult and discuss amongst the State Council and other stakeholders like SASAC, MOFCOM, CSRC, and SAFE on this difficult and sensitive topic. They will need to reflect on why VIE structures were borrowed or

829 Draft FIE Law, above n 828, art 15(6).

830 Ibid, art 18.

831 Alibaba Group, above n 757; see also D Meyer, above n 778.

transferred from the United States in the first place when attempting to solve the conundrum of drawing up a solution that may tilt the balance between churning up a massive market disruption by adopting heavy-handed and ill-considered enforcement measures and bringing VIE structures within certain regulatory framework where the Chinese authorities will have at long last certain degree of regulatory visibility and oversight.

As discussed above, part of the issue has to be attributed to the long-standing restrictions on foreign investment in the Internet, telecommunications and high-tech sectors. China should consider acknowledging the very existence of these transplanted VIE structures as there is a market demand and business aspirational desire for Chinese entrepreneurs to list overseas and for foreign investors to invest in these sectors, and addressing the root cause of VIEs by well-thought-out, co-ordinated and sustainable policy changes. This may prove to be more effective than tackling the issue by way of imposition of restrictions and complex and time-consuming approval processes. The attractiveness of circumventing restrictions by way of employing VIE structures would fade away if such foreign investment restrictions could be relaxed to the effect that direct investment becomes workable, beneficial and sustainable.

As discussed in Chapter III above, China's stock markets might have come a long way in the recent years, however, they are still not considered to be as well-regulated and open to foreign investors or as prestigious as some of their overseas counterparts, albeit their attaining higher values. After all, there is no 'quick fix' for sectors which have grown up and expanded around VIE structures. There is no single governance model that will fit all kinds of corporates at all stages. It will take a comprehensive package of measures and perhaps a thorough rethink of how China regulates foreign investment and in turn corporate governance systems in such sensitive industries as those of the Internet and e-commerce sectors to persuade such 'star quality' Chinese companies as Alibaba to 'return home' when it comes to raising capital by way of listing in a stock market.

The Chinese government should consider cooperating more closely with its foreign regulator counterparts and provide stronger protection for foreign investors. Instead of rendering the existing VIEs illegal by way of introduction of the Draft FIE Law, such VIEs may be grandfathered should there be no other regulatory contravention on their part. As discussed above, a coordinated, less restrictive and more transparent legal framework might be set up for the VIE practice and in

general its corporate governance regime in the interest of maintaining long-term sustainability of China's economic growth.

The following section discusses Alibaba's dual-class structure which is another factor which has led to its taking the IPO to New York instead of having it listed in it preferred location – Hong Kong.

E Alibaba's dual-class share structure and Hong Kong IPO detour

Alibaba initially planned to list on the HKSE in 2013 with a dual-class share structure to enable the founders of the company to maintain considerable control over the company after it went public. One would have thought Hong Kong was a natural choice for Alibaba's listing due to its proximity to China and the fact that Alibaba was first floated in Hong Kong in 2007, albeit it was subsequently reprivatized in 2012 following Ma's buy-back from the outsider shareholders all of the outstanding shares at the initial offer price from 2007.[832] However, Alibaba's proposed structure was rejected by the Hong Kong regulators in 2013 because its dual-class share structure would violate Hong Kong's existing 'one share one vote' rule. Note that the same rule is applicable in China under its Company Law.[833] In contrast, the dual-class share structure is permitted in the United States, which allows insiders to control a company after its IPO. Facebook, Google and other US technology companies have all opted for this mode of organisation. These companies essentially issue two classes of shares with different voting rights, enabling the founders and corporate managers a comparatively greater control over shareholders' votes.[834]

As discussed in Section E 3 in Chapter IV above, the 'one share one vote' principle provides that a shareholder's voting right should be proportionate to his economic interest. Shareholders who contribute more equity to a company should gain more control through their voting rights. This is one of the fundamental rules in modern corporate governance in the West. In reality, controlling shareholders usually acquire more voting rights than their economic rights via control-enhancing mechanisms. This appears to be more prevalent in situations where entrepreneurs or business founders design or restructure their corporate models to ensure

832 Petry, above n 802, at 4.

833 Company Law 2005, above n 184, art 104 (Author's note: that is, Company Law 2013, art 103).

834 Wei and Young, above n 806, at 4.

maintenance of their control after public listing. Through the adoption of control-enhancing mechanisms, shareholders may maintain control of a company while holding a minority of the company's equity.[835]

In the United States, it is rather common that shareholders seek to employ dual-class share structures to leverage corporate control when going public. Founders of such US technology conglomerates as Google, Facebook and Zynga have all maintained control of key decisions and board composition after floatation by way of adopting dual-class share structures.[836] However, dual-class share structures could intensify potential governance problems in companies. LinkedIn, for instance, attracted criticisms in that it could embark on a "corporate governance nightmare" when it launched its IPO with a dual-class share structure, bylaw notice provisions designed to dissuade shareholder activism and a staggered board of directors. Worse still, its constitution also provides that the staggered board of directors may only be repealed by an 80% shareholders' approval. Given that the amendments of its constitution must be instigated by the board of directors, this is an "almost impossible threshold" as the board of directors will have very little incentive to amend the rule. In LinkedIn's case, its controlling shareholders have ten-to-one voting power, while the public shareholders have less than 1% of the voting power. LinkedIn's co-founder and chairman, Reid Hoffman, controlled the company with three venture capital shareholders.[837]

By the same token, the provisions of Facebook's constitution are more than sufficient to protect the company from hostile takeovers without the dual-class structure. Facebook has a staggered board of directors with a provision that prohibits actions by shareholder consent without a meeting.[838] On the other hand, Facebook's CEO Mark Zuckerberg can take action as a shareholder without any stockholder meeting or prior notice. Zuckerberg's Class B Shares get ten votes per

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835 Lucian A Bebchuk, Reinier Kraakman and George Triantis "Stock pyramids, cross-ownership, and dual class equity: the mechanisms and agency costs of separating control from cash-flow rights" in *Concentrated corporate ownership* (University of Chicago Press, 2000) 295, at 295.

836 Wei and Young, above n 806, at 4.

837 Tian Wen "You Can't Sell Your Firm and Own It Too: Disallowing Dual-Class Stock Companies from Listing on the Securities Exchange" (2013) 162 U Pa L Rev 1495, at 1509.

838 Ibid.

share. He can designate his successor if he still controls the company at the time of his death.[839]

Likewise, when gaming company Zynga went public, it created an unprecedented three-tier stock structure which would result in its CEO having shares with seventy times the voting power of public investors. In 2012, Google's co-founders announced that the company would create a new class of non-voting shares that would be issued as a part of employee stock incentive plans, acquisitions, and other stock sales. The reaction to the announcement was generally unfavourable because this shares issuance would further concentrate ownership of the company in its Executive Chairman and co-founders.[840]

In Alibaba's negotiation with the HKSE, Alibaba made a proposal that the company's leading executives, namely the Partnership (which includes Ma and other executives, totalling 20 partners, owning just over 10% of Alibaba), nominate a majority of its directors after the IPO, meaning that the founders of Alibaba have more voting rights than all the other future shareholders combined.[841] This structure essentially means the Partnership will control the future of the company, a concept akin to the dual-class share structures adopted by the technologies companies in the US as discussed above. During their negotiation with HKSE, Alibaba was prepared to cut the number of partners and bind them to a three-year share sale ban. However, the listing rules in Hong Kong would not allow the founders of the company to 'hand-pick' most of Alibaba's directors post IPO, although Alibaba had all along indicated that it did not seek to change the HKSE listing rules as all it wanted was an exemption. From HKSE's perspective, this made no difference because what Alibaba sought was a departure from the principle of 'one share one vote'.[842]

Alibaba did also have talks in London to ascertain the possibility of listing in the London Stock Exchange (**LSE**).[843] However, the talks did not last because LSE does not allow dual-class share structures either. That was why, for instance,

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839 Ronald Barusch "At Facebook, Governance = Zuckerberg" *Wall Street Journal* (New York, 1 February 2012), https://blogs.wsj.com/deals/2012/02/01/at-facebook-governance-zuckerberg/.

840 Wen, above n 837, at 1509-1510.

841 Wei and Young, above n 806, at 5.

842 Ray Chan "Alibaba Abandons Hong Kong for New York, Sources Say" *South China Morning Post* (Hong Kong, 26 September 2013).

843 Paul J Davies "Hong Kong IPO on Hold" *Financial Times* (New York, 11 November 2013).

Manchester United, the British soccer team, went public in the United States with a dual-class share structure in 2012.[844] To HKSE's credit, HKSE did discuss the possibility of conducting a market-wide consultation on alternative shares and control structures. Unfortunately, the consultation came too late in August 2014 when Alibaba was just a few steps away from listing in the United States. [845]

In reality, even though Alibaba managed to convince the New York regulators to accept its controversial executive partnership structure, New York was not a straight forward option for Alibaba either. Another hurdle that Alibaba had to overcome was its want of credibility on Wall Street after a dispute with Yahoo which took place in 2011 on its secret transfer of Alipay, one of the most valuable assets of the Alibaba Group, to a third-party company owned by Ma outside of the Group. The dispute was nicknamed a 'VIE problem' because a VIE model is employed to allow their PRC entities to access foreign capital from foreign investors through offshore platforms as opposed to those PRC entities to circumvent China's complex and tight foreign exchange controls and restrictive market entry rules.[846] Nonetheless, both NYSE and Nasdaq eventually accepted Alibaba's special partnership structure which permits its top executives to nominate the majority of Alibaba's board of directors post-IPO.[847] Listing in the United States also meant that it would be eligible for a foreign company exemption that would enable former and current company executives to exert a high degree of influence over the company's board of directors.[848]

The Alibaba Partnership consists of 30 partners, 24 of whom are Alibaba executives while the remaining six are executives of affiliated companies – five members of management of Small and Micro Financial Services Company and one member of China Smart Logistics.[849] The Partnership was formalised by the founders to preserve the spirit of partnership, and to ensure the sustainability of

844 Wen, above n 837, at 1507.

845 PJ Davies, above n 843.

846 Wei and Young, above n 806, at 5.

847 George Chen and Ray Chan "Alibaba in Talks with London Bourse after Hong Kong Snub" *South China Morning Post* (Hong Kong, 22 October 2013).

848 Wei and Young, above n 806, at 5.

849 Petry, above n 802, at 8.

their mission, vision and values and has been referred to as the Alibaba Partnership in the Alibaba Prospectus.[850]

The Alibaba Partnership elects new partners every year after a nomination process whereby existing partners propose candidates to the partnership committee. The partnership committee reviews the nominations and decides on whether the nomination of a candidate will be proposed to the entire partnership for election. All partnership votes are made on a one-partner-one-vote basis. Election of partners requires the approval of at least 75% of all the partners.[851]

Each partner is expected to maintain a meaningful level of equity interest in Alibaba through its equity incentive and share purchase plans. The partnership is in turn governed by a partnership committee of at least five, which initially consists of founder and executive chairman Jack Ma, co-founder and vice chairman Joe Tsai, CEO Jonathan Lu, co-founder and chief people officer Lucy Peng, and chief strategy officer Ming Zeng. The Alibaba Partnership has the exclusive right to nominate up to a simple majority the members of the board of directors. The election of each director nominee of the Alibaba Partnership will be subject to the director nominee receiving a majority vote from the shareholders voting at the general meeting of the shareholders (**AGM**). If an Alibaba Partnership director nominee is not elected by the shareholders or after election departs the board of directors for whatever reason, the Alibaba Partnership is entitled to appoint a different person to serve as an interim director of the class in which the vacancy exists until the next scheduled AGM, at which time the appointed interim director or a replacement Alibaba Partnership director nominee (other than the original nominee) will stand for election for the remainder of the term of the class of directors to which the original nominee would have belonged. In other words, should the Alibaba Partnership director nominee be rejected by the shareholders, the Partnership is still able to put in place another candidate without the shareholders' votes.[852]

The election of the partnership directors was basically guaranteed, as Alibaba's four largest shareholders, owning almost 70% of its stake, had entered into a voting agreement to vote for the candidates proposed by the Partnership. Also, this voting

850 Alibaba Prospectus, above n 789, at 229.

851 Ibid.

852 Petry, above n 802, at 8; and Alibaba Prospectus, above n 789, at 229-230.

agreement provided Softbank, Alibaba's largest shareholder, with the right to appoint one director as long as Softbank's stake in Alibaba would not fall below 15%. After the IPO, Alibaba's board of directors would consist of nine members. The board members are four Alibaba partners, Softbank's CEO, and four independent directors. Giving Alibaba's founder executives the power to elect the majority of the board of directors and in turn to control the board of directors is essentially adopting a structure which is akin to the dual-class share structures in other founder-led companies like Google, Facebook, Yahoo, LinkedIn, Twitter, Microsoft, Amazon, Groupon and eBay.[853] Further, under Alibaba's post-IPO amended articles of association, the Alibaba Partnership's nomination rights and the related provisions of the said articles of association may only be changed by the vote of shareholders representing 95% of the votes present in person or by proxy at the AGM.[854]

This super high threshold simply implies that the Alibaba Partnership will continue to control the e-commerce empire as long as Alibaba remains a listed company in the United States. This looks so similar to the control that SASAC has over its SOE big businesses that an obvious parallel can be drawn between the Alibaba Partnership and SASAC. It appears that China's *modus operandi* vis-à-vis its "form-over-substance" treatment of western corporate and governance transplants is so deep-rooted in that Chinese entrepreneurs naturally run their businesses in a substantially similar (if not identical) manner.

The reality is, for the last 25 years, the Company Law confers the Chinese shareholders with all the managerial powers to the extent that the highest authority of a corporate is not the board of directors but the shareholders' assembly (shareholder-centralism). As discussed in Section B in Chapter VI above, Donald Clarke rightly points out that private sector enterprises incorporated under the Company Law are "hamstrung" by having to follow rules that make sense only in a state-run economy.[855] And after 25 years of practice, those "corporate-governance-transplants-adjusted-with-Chinese-characteristics" must have been infiltrated into all walks of life in China to the extent that its entrepreneurs naturally adopt the same as the viable way to achieve economic growth and sustainability.

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853 Petry, above n 802, at 9 and 20.

854 Alibaba Prospectus, above n 789, at 231.

855 Donald Clarke, above n 543, at 30.

It is submitted that as long as the Company Law remains in force "as it is" to permit the shareholders' assembly to maintain management authority over and above the board of directors irrespective of the shareholders' actual holding of equity in the corporates, the "purposely-adapted-corporate-law-and-governance-systems-with-Chinese-characteristics" will subsist, irrespective of whether they are modified to achieve the goals set by the SOE-big-businesses or the private-big-businesses.

F Conclusion

The success of Alibaba, like that of China's SOE-big-businesses, illustrates in the starkest manner possible the gap between corporate governance issues and what attracts investors. It is obvious that the investors at large are prepared to overlook deviation from their traditional text-book-or-best-practice-corporate-governance-systems as "risk-control" mechanisms for their investments to pursue their perceived confidence in Alibaba's ability to sustain continuous growth and economic returns for its investors. Like the 120 Chinese big businesses (a high majority of which are central SOEs) which are on the Fortune Global 500 2018 List, following its IPO launch, Alibaba has not let down its investors – not only has it made it to the Fortune Global 500 List for the second year in a row, its revenues have grown from US$7.5 billion in 2014[856] to US$37.77 billion in 2018.[857] Better still, as discussed in Section B above, it becomes the second Asian company to take a spot as one of the top 10 most valuable brands in the world in 2018.[858]

Alibaba's VIE model and partnership control structure can be considered as typical corporate-governance-legal-transplants-with-Chinese-characteristics as they have borrowed the VIE structure from the United States (**US**) and the Alibaba Partnership substantively resembles the US dual-class share structure adopted by the US founder-led companies as discussed above. Not only is Alibaba's VIE structure is different from those normally adopted by US-tech companies as discussed in Section D above, Alibaba's partnership control structure is also different in substance from the US dual-class share structure employed by the US founder-led companies mentioned above, which typically issue two classes of shares, one of which gives their founders extensive rights, powers and privileges

856 Davidson, above n 774.

857 Fortune Global 500 2018 List – Alibaba, above n 773.

858 D Meyer, above n 778.

above their regular common shareholders. By contrast, under Alibaba's structure, like that of the SASAC and its SOEs, the Alibaba Partnership effectively controls its board of directors and the whole corporate empire structured as eco-systems akin to the structural concept of SASAC's SOE big businesses, albeit that the partners only hold a minority stake in the company.

Alibaba's legal structures and business-group-eco-systems form a classic epitome of the "in-form-not-in-substance" legal transfers from the West into China as this thesis has been elucidating in the preceding three chapters. Again, like the experience gained from China's SOE-big-businesses as discussed in Chapter IV above, it is a misunderstanding or loss in translation for western commentators to attempt to fit China's case into the 'law and finance' and 'divergence or convergence' debates as China has set its agendas to become, and sustain as, one of the largest economies (and desirably the largest) in the world to ensure longevity of its one-party rule, and hence, of its own unique form of capitalism – Sino-Capitalism.

Chapter VI Conclusion

A Introduction

This year marks the 40th anniversary of China's adoption of its "Open-Door Policy". Having assumed and maintained the spot as the second largest economy in the world since 2014, China can rightly be viewed as a rare example of a successful transition economy that gains its position in the international economic arena through transplantation. As discussed in Chapter I, there has been little analysis of what this means, beyond the fact that China has developed into a highly prosperous and relatively politically stable country, subsequent to its intensive and expansive implantation of Western corporate governance institutions over the last 25 years.

The Watson-Kahn-Freund-Legrand debates set the stage for this thesis to argue that legal transplants from the West do not necessarily present convergence or divergence. Rather the whole situation could be misunderstood or lost in translation. This thesis endeavours to delve into the analysis of the correlation between corporate governance transplantation and China's economic reforms and developments. This thesis proposes to shed light on such a correlation, which will in turn enable the assessment of whether there is any relationship between corporate governance legal transplants and China's economic development and how these transplants relate to or impact upon China's economic development. Through those investigations as set out in Chapters III to V, it is found that corporate governance legal transplants have been implanted with "Chinese tweaks" to serve as an instrument behind China's agendas to become one of the largest and most influential economies in the world without falling into the traps of social and economic crises or unrests. Hence, such legal transplants cannot be considered converging to, or diverging from, the traditional text-book-or-best-practice-corporate-governance-systems in the West because they are in fact misunderstood or lost in translation. They have facilitated the construction of Chinese big businesses and emergence of China's unique form of capitalism – Sino-Capitalism.

After almost three decades of self-deprivation of any economic advancement since the inception of the PRC in 1949, this Chinese 'dragon' has been woken up to attempts to integrate its economy into the world market. Bearing in mind that

"abiding by international practices" or "harmonisation with international practices" became the keywords for China's market economy reforms, Chapter II thus provides an overview of harmonisation, internationalisation and global initiatives for the development of "good-or-best-corporate-governance". The internationalisation of the Chinese corporate governance law system by way of legal transplants only makes sense when one understands the role and development of corporate governance law in the transformation of the Chinese economy from 1978. Chapter III thus critically reviews the development of corporate governance law surrounding the Chinese economic reforms since 1978. Chapter III has also presented an overview of China's development of its corporate governance systems through its adoption of the 2004 OECD CG Principles. Despite the CSRC's assertion by way of its self-assessment at great lengths that China has done its utmost to bring itself up to gear to be at par with its western counterparts, it appears that such transplants which are supposed to be mirroring or converging with those of their western donors are not functioning in the same manner as would be expected by their counterparts. This Chapter finds that evidence raised by the CSRC simply points to the conclusion that they are simply implanted in form to serve a different agenda to that of its western counterparts. It appears that attainment of sustainability of economic growth (as opposed to the western approach of maximisation of stakeholders' interests) is China's paramount consideration and that it will try its best to attain corporate performance and in turn economic growth at any cost. Hence, it may be concluded that corporate law and governance transplants into China to facilitate economic reforms and China's accession to the international arena as one of the world's economic powerhouses have led to neither convergence towards, nor divergence from, the western "text-book-or-best-corporate-governance-practices" but have been in essence lost in translation to Sino-Capitalism which China has developed during this process.

Through a contextual review of corporate governance transplants in China in Chapter IV, legal transplants in China's corporate governance laws have been found to be "purposely-modified-with-Chinese-characteristics" which have fostered the rise of China's modern big businesses or its own form of capitalism – Sino-Capitalism. Western legal institutions are simply implanted "in-form-but-not-in-substance" to serve a different agenda, that is, maintenance of the sustainability of China's economic growth and one-party rule.

Alibaba's fascinating success story as uncovered in Chapter V serves as a mirror or revelation of China's economic success. The company's success to date is attributed to its management team's (which is dubbed the 'Alibaba Partnership') 'owner mentality', a clear sense of mission, and a commitment to values. This echoes the Chinese government's determination to achieve success vis-à-vis its economic reforms and ambitions to become one of the largest economic powerhouses in the world. Their *modus operandi* is substantively similar – adoption of business and governance models by way of legal transplants from the West but with their typical Chinese tweaks to suit their own contexts and circumstances – having their foreign acquisitions and implantations in form but not in substance. In other words, their approach is less likely to be convergence to, or divergence from, the "western-text-book-or-best-practice-corporate-governance-practice", but more likely to be an unusual model which outsiders could see it to be 'lost in translation'. This in turn provides the chance for this research to develop the concept of Sino-Capitalism.

B Sino-Capitalism

1 Convergence? – A Misconception

Following the examination of various aspects of western corporate governance transplants into China in the preceding three chapters, this chapter summarises the discussions in this thesis by concluding that the implantation of foreign corporate governance institutions to facilitate economic reforms has given rise to China's own form capitalism – Sino-Capitalism. The "convergence-or-divergence" and "legal-origins-and-finance" propositions over the evolution of China's corporate governance and economic reforms turn out to be a misunderstanding or misconception. The more appropriate description of China's economic performance pathway is Sino-Capitalism.

Scholars like Lin, Zhang, Milhaupt, Liebman, Witt, Redding, Musacchio, Lazzarini and Aguilera term China's emergence from a socialist-economy to a market-economy "state capitalism",[859] this research however finds that the more accurate

[859] See generally Lin and Milhaupt, above n 542; A Zhang, above n 655; and Benjamin L Liebman and Curtis J Milhaupt (eds) *Regulating the Visible Hand? The Institutional Implications of Chinese State Capitalism* (Oxford University Press, New York, 2016); Michael A Witt and Gordon Redding "Asian business systems: Institutional comparison, clusters and implications

description of the Chinese reforms and economic development pathway is Sino-Capitalism. The concept of Sino-Capitalism is enlightening to China's reforms because it does ease the potential pressure of having to conform to the legal institutions and norms developed by its western counterparts, especially the advanced economies. It enables China to start from scratch and build up the momentum for reforms based on local conditions and contexts. It also opens avenues during the reform process for China to take the initiative to pick and choose through a filtering process the appropriate foreign institutions and norms which are capable of implantation into Chinese systems and commingling with local conditions. This concept confirms that China's reform process is a sino-centric-process. Sino-Capitalism demonstrates to other transition or emerging economies that they do not have to copy the exact institutions and norms from the advanced economies for them to be successful. It implies that an "in-form-over-substance-transplantation-with-local-adaptations-or-inculturation" may be a viable alternative and the "text-book-or-best-practice-corporate-governance-models" for which the advanced economies have been advocating may prove to be unworkable in China or possibly other transition or emerging economies.

Bearing this notion in mind, as discussed in Chapter III above, not only the civil law (notably German) elements but also the common law (primarily Anglo-American) components have been incorporated into the Company Law 1993 and the relevant regulatory corporate governance instruments and mechanisms. At the turn of the millennium, with its accession to the WTO, the CSRC played a pivotal role in setting the scene for China's promulgation of corporate and securities law reforms (including the substantial revision of the Company Law 1993 to turn-around the Company Law 2005 and subsequent regulations involving varying degrees of modifications to the numerous transplants predominantly from the common law jurisdictions as discussed in Chapters III to V above).

This gave rise to the misunderstanding that China was moving away from the civil law traditions and converging towards the Anglo-American common law model if China were to be placed in the case of the global convergence-or-divergence

for varieties of capitalism and business systems theory" (2013) 11(2) Socio-Economic Review 265-300; and Aldo Musacchio, Sergio G Lazzarini and Ruth V Aguilera "New varieties of state capitalism: Strategic and governance implications" (2015) 29(1) Academy of Management Perspectives 115-131.

debates. In fact, the increased adoption of common law ingredients (notably the 2004 OECD CG Principles and to a lesser extent the common-law-originated-independent-directors-system as discussed in Chapter III) in the corporate governance transplants following the turn of this century did not imply a total departure from the civil law traditions. As a matter of fact, commentators might have overlooked the fact that those civil law elements (for example, the two-tier-boards) that have been transplanted into the Chinese system were not removed when more common law components were adopted into the Chinese system. Instead, the Chinese system appears to have been implanting elements from both legal families as long as they suit the Chinese contexts and are beneficial to China's economic growth. Interestingly, China's growth trajectory with notable disparities between laws and practices in the corporate governance context as discussed in the preceding three chapters actually confirms the inapplicability of the convergence-or-divergence hypothesis for the case of China.

As discussed in Chapter II above, the "law-and-finance" scholars assert that legal systems of common law families appear to systematically provide more superior investor protection and law enforcement than legal systems of civil law families.[860] At first glance, China's experience fits the hypothesis – its legal system, ostensibly derived from the civil law families, is deemed to be weak in investor protection and law implementation.[861] Nonetheless, business groupism and corporate eco-systems developed as a result of government-policy-designs, production-and-customer-needs-concerns and desires from both state and private sectors to succeed as discussed in Chapters VI and V may have been the response to the institutional voids presented by the "law-and-finance" scholars and the attributes to the rise of Sino-Capitalism. The interplay between the 'foreign' and the 'local' is contextualised and internalised into the Chinese system. This forms the basis for the rise of Chinese big businesses, state and private, and in turn Sino-Capitalism. The Sino-Capitalism pathway has been discovered through this research as China's economic growth trajectory is sino-centric-and-specific without leaning towards or taking stance on a particular thesis or scholarship, be it "law-and-finance" or "convergence-or-divergence". With the Sino-Capitalism pathway,

860 See generally LLSV, above n 152.

861 This finding of "weak-investor-protection-and-law-implementation" concurs with Roman Tomasic "Company Law Implementation in the PRC: The Rule of Law in the Shadow of the State" (2015) 15(2) Journal of Corporate Law Studies 285-309.

China's corporate governance takes its own course, develops its own focus and remains neither convergent nor divergent.[862]

2 Sino-Capitalism? – Not State Capitalism?

China's emerging corporate governance regime and economic development pathway, after careful consideration through this research, is better ascribed as Sino-Capitalism, not state capitalism, the preferred term used by scholars like Lin, Milhaupt, Zhang, Liebman, Witt, Redding, Musacchio, Lazzarini and Aguilera.[863] Bremmer and Stewart defined "state capitalism" in the first decade of this century as follows:[864]

> [A] system in which governments use state-owned companies and investment vehicles to dominate market activity. The primary difference between this form of capitalism and the Western, more market-driven variety, is that decisions on how assets should be valued, and resources allocated are made by political officials (not market forces) with political goals in mind.

"State capitalism", if applied only to the development of China's SOE big businesses, would have been an appropriate description. However, unlike the situation about a decade ago, nowadays, China's big businesses include those conglomerates in the private sectors such as Alibaba (as discussed in Chapter V), Baidu, Haier, Huawei, Lenovo, Tencent, and so on.[865] China's economy cannot be regarded as simply state-driven as it has developed to be much more sophisticated and densely packed with "state-owned-or-controlled-or-private-big-businesses".

Sino-Capitalism posits a system of economic development through borrowing, contextualising, modifying and adapting western economic and corporate governance institutions into China's local contexts and domestic systems. This evolution captures a 'sinonisation' process and consequently departs from the economic and governance systems that China has borrowed from its western counterparts. Sino-Capitalism is a sino-centric system unique to China. This system sets itself apart from western capitalism although it has "mirrored many of

862 Idea inspired by Milhaupt, above n 11, at 778-780.

863 See generally Lin and Milhaupt, above n 542; A Zhang, above n 655; and Liebman and Milhaupt, Witt and Redding, and Musacchio, Lazzarini and Aguilera, above n 859.

864 Bremmer and Stewart, above n 594.

865 Refer to Chapter VI, Section F above.

its surface features".[866] This variety of capitalism can be viewed as the epitome of China's economic transformation employing a specific *modus operandi* for its treatment of transplanted western business and corporate governance systems by pooling them with local contexts which are commonly termed "Chinese characteristics" in order to facilitate its own economic reforms as discussed in the preceding three chapters. When Lin and Milhaupt called China's new form of capitalism "state capitalism", they cautioned that "[w]hile China appears to present a new variety of capitalism, frequently labelled *state capitalism*, the features and implications of this system are still poorly understood."[867]

During the filtering and implanting process, where western institutions do not meet China's local requirements, they will be 'tweaked' with Chinese characteristics. Consequently, some unique features which are non-existent in other countries may appear following this filtering and modification process. A typical case is the switching from the western norm of director-centralism [868] to shareholder-centralism vis-a-vis general corporate administration as discussed in Chapter III above. As uncovered in Chapters IV and V above, China's insistence on moving away from, and modifying, the western director-centralism norm, and its adoption of shareholder-centralism with Chinese characteristics[869] has contributed to the rise of modern Chinese SOE-and-private-big-businesses as evidenced by 120 of them making their way to the Fortune Global 500 2018 List.[870]

Looking beyond the focus of this thesis, that is, corporate governance transplants into China since 1978, Sino-Capitalism has a broader applicability in China. The promising prospect of Sino-Capitalism which has been brought about by SOE corporatisation, stock markets development, "Going-Out" policy, and overseas-listing does mean that a draconian shift from the current economic reform will not

866 MW Meyer, above n 621, at 8.

867 Lin and Milhaupt, above n 542, at 699.

868 This term "director-centralism", as opposed to the commonly used term "board-centralism", is used here to avoid confusion given that Chinese corporates operate under a dual-board system – board of directors and board of supervisors.

869 For instance, the installation of SASAC for the central SOE big businesses and the VIE, dual-class-share and super-partnership structures in the cases of private-and-overseas-listed conglomerates like Alibaba, Tencent and the others.

870 Fortune Global 500: https://en.wikipedia.org/wiki/Fortune_Global_500.

be welcomed.[871] The "sino-centric-transplanted-corporate-governance-reform-pathway", albeit not exactly a "yellow-brick-road-desired-by-its-western-counterparts", is expected to be carried on because it supports the on-going economic performance and growth and sustains Sino-Capitalism and China's one-party rule.

3 Determinants and Implications of Sino-Capitalism

(a) Determinants

Based on the investigation findings for this research as set out in Chapters III to V above, the following determinants or features have been identified from China's reform trajectory regarding the development of Sino-Capitalism.

(i) Local Conditions

The highlight of China's economic and corporate governance reforms has been the emphasis on considering China's local conditions (which is dubbed "reforms-with-Chinese-characteristics"[872]) when implanting foreign institutions into the Chinese system. This has led to the situation where western corporate governance transplants being bent over backwards to suit the local needs. For instance, state ownership is ear-marked to take precedence over director-centralism practiced in western jurisdictions in the name of protection of state-owned assets. Hence, "shareholder-centralism-vis-à-vis-corporate-administration" prevails as discussed above and the corporate legislation are thus shaped to cater for this need in favour of the state. Bearing in mind the potential risk of losing state assets, the imported form of the Company Law 2005 includes provisions to ensure stringent civil liabilities against directors' misappropriation of state assets.

(ii) Legal Misunderstanding or Misinterpretation

In the process of legal transplantation, inadequate understanding or misinterpretation of the borrowed legal institutions and concepts by the recipient

871 Refer to the discussions regarding unwelcome changes of laws which will affect both Chinese and foreign investors and may lead to market crashes in Section D, Chapter IV above.

872 Deng Xiaoping, "Opening Remarks" – opening speech delivered at the 12th National Congress of the Communist Party of China (1-11 September 1982).

lawmakers in China due to language barrier or want of relevant legal knowledge of the donor jurisdictions will result in unsatisfactory transplants, legislative confusions and misinterpretation. It is understandable that commentators may be puzzled by the fact that China introduced both the "independent-director-system" from the United States and the "supervisory-board-system" from Germany. Put simply, this could remain an enigma, or it might well be the case that Chinese policymakers were uncertain about these institutions or their interpretation and thus introduced both to ensure they "covered" all aspects in order to achieve risk management.

(iii) Gradualism

As discussed in Section E 2 in Chapter II above, China's economic reform style has always been one of "gradualism" or "experimentalism". That was why scholars like Nolan and Ash commented that China's success was probably due to its having the good sense of allowing gradual transition from a socialist economy to a market economy without rushing to adopt Russia's erratic approach to transform its economy using "shock therapy" which led to the collapse of the Soviet Union.[873] This is consistent with the findings of this research as set out in the preceding three chapters that Sino-Capitalism has been developed in China with policymakers giving relatively careful thoughts to the synchronisation of the transplanted western institutions with the local contexts in China.

(b) Implications

(i) For China

The rise of Sino-Capitalism and China's sino-centric treatment of corporate governance transplants show that the one-size-fits-all-or-text-book-or-best-practice-convergence-model does not suit China. The findings of this research as set out in the preceding three chapters point to the direction that China has developed its own form of capitalism. In essence, it is a complete misunderstanding or loss in translation for commentators to state that China, if being put in the context of the "global-convergence-or-divergence" and "legal-

[873] Nolan and Ash, above n 328, at 997-998.

origins" debates, is diverging away from the civil law traditions and converging towards the common law families.

First, one cannot deny that both the civil law and common law features made their marks in China's legal and economic reforms in the 1990s. However, the increasing adoption of the common law features (in particular, the almost verbatim adoption of the OECD 2004 Principles, at least in form, as discussed in Chapter III above) after the turn of this century did not imply a complete deviation or departure from the civil law traditions either. In fact, China has never dropped one law family for another. To the contrary, it is rather clear from the measures taken by China that it has usually considered various available institutions, absorbed and modified them to suit its local conditions and consequently infiltrated and codified them into the "Chinese-corporate-and-governance-systems". This is because it was Deng's motto and advocacy that China might pick and choose institutions (irrespective of whether they are domestic or foreign) which would implant well into China. In other words, China does not appear to be particularly concerned about from which jurisdiction(s) the institutions are borrowed and transplanted into the Chinese systems as long as they are beneficial to China's economy and social development.[874]

Second, a noticeable fact that has been overlooked is that those civil law institutions which have been introduced and transplanted into the Chinese system have not been removed or side-lined when more norms and institutions from the common law families are borrowed and implanted into the Chinese system. Instead, China has developed a unique sino-centric system – Sino-Capitalism – which absorbs legal "ingredients" from both sets of legal families in order to advance its legal and economic reforms.

Third, the development of Sino-Capitalism, and likewise, China's corporate reform and governance, has been a "trial-and-error" exercise or "work-in-progress". Its legal and economic infrastructure was neither broad nor sophisticated at the outset. Despite all odds, challenges and incompatibilities, its progressive approach enables improvement from unpolished-or-under-polished-legal-and-economic-institutions to compatible and enriched systems. Hence, the expectation or understanding that China has been adopting a "convergence-towards-western-text-book-or-best-practice-model" is therefore a misunderstanding or is lost in

[874] Deng, above n 872.

translation. This further confirms the inapplicability of the "convergence-or-divergence" and "legal-origins" debates vis-à-vis China.

As discussed in Chapter IV above, scholars like Allen, Qian and Qian have commented that China is a "counter-example" of its western counterparts in terms of its corporate system and performance.[875] It is perhaps appropriate to infer that China presents a "counter-example" of the western capitalism vis-à-vis its economic and corporate performance. This inference is drawn because China has developed a unique form of sino-centric-capitalism, Sino-Capitalism, albeit having "mirrored many of [western capitalism's] surface features"[876] – another typical example of "in-form-not-in-substance" transplantation with "Chinese characteristics".

By practising Sino-Capitalism, China's economic and corporate governance reforms have produced an exponential economic growth over the last four decades. While Sino-Capitalism appears to be the right direction for China to find its own corporate solutions and reforms pathway, it does not mean that it is the only suitable pathway, nor does this mean that it is not necessary to make changes and find alternatives from time to time to embrace a true market economy to ensure continuous sustainability and success. As a matter of fact, special attention may be given to address or strengthen issues such as the local conditions, legislation supporting China's economic corporate governance reforms, implementation and enforcement [877] (all of which will need thorough examinations and certain improvements). However, this thesis will not be delving into these discussions as they are beyond the scope of this research.

(ii) For other emerging or transition economies

Sino-Capitalism does not only have broader implications for other emerging or transition economies seeking to achieve economic success through breaking away from their existing economic, legal and institutional constraints, but also sheds light on the "global-convergence-or-divergence" and "legal-origins" debates.

China's experience in its development of Sino-Capitalism can be enlightening for corporate and economic reforms in emerging and transitioning economies. It

875 Allen, Qian and Qian, above n 608, at 57 and 59.

876 MW Meyer, above n 621, at 8.

877 Tomasic, above n 861, at 308.

reveals that transition economies do not necessarily have to replicate norms and institutions from advanced-or-western economies to be successful in terms of turning-around their own economies. Nonetheless, depending on the local conditions of the recipient transition economy, deferring to and borrowing from developed economies which possess sophisticated practices could serve as a desirable foundation from which the transition economy develops its own practices which suit their domestic conditions and contexts. This can at least be more time efficient because it may shorten the time required for the recipient transition economy to search for viable solutions.

China's experience is noteworthy because its transplantation of western corporate governance systems which has been "enriched" by the relevant Chinese characteristics does appear to be essential for China to build a system which better suits its own culture and domestic conditions. Careful investigation into the conditions and rationale behind the installation of the legislation and institutions in the donor and recipient jurisdictions will be imperative to achieve the desired legislative objectives for the recipient jurisdiction. The search for solutions should start from the examination of the borrowed institutions, bearing in mind that local conditions should always serve as the basis for any consideration of legal transplantation, not vice versa. Complementarity between the local conditions and the foreign-borrowed institutions appear to serve as the conduit to attain compatibility of the transplanted mechanisms into the recipient's system which should be crucial to the success of corporate and economic reforms.

C Concluding Remarks

It is noted in Chapter I above that Chinese corporate governance is usually defined by what it lacks in comparison to the western systems. The research findings set out in Chapters III to V above point to the direction that such a definition for China is either misunderstood or lost in translation to Sino-Capitalism. China has never attempted to fully converge towards any given system nor has it committed to a single legal family. The "mix-and-mingle-sino-centric" notion has always been China's preference as such an approach enables it to find a system which may be the best "fit" for it given its local conditions.

The global convergence and legal origins debates raise the possibility of a new (as opposed to the almost cliché depiction of "state capitalism" which applicability has

been put in question due to the rise in modern China of the "private-big-businesses" alongside the "SOE-big-businesses") [878] and possibly influential variety of capitalism – Sino-Capitalism. Chinese big businesses have over the last two decades entered the global economy through the Sino-Capitalism-pathway which bears almost no resemblance to the standard accounts in the West as to how corporates and businesses grow and how large and advanced economies develop. However inadequate western commentators might have found the Chinese corporate governance systems when comparing these Chinese systems to their own systems in the West, they probably cannot deny or ignore the fact that Sino-Capitalism has become a significant enigmatic force in global capitalism. It is submitted that China's global economic rise is likely to encourage reconsideration of collaborative links between the state and the private sector, and redeployed attention to a variety of issues such as business groupism, networked or interconnected corporate eco-systems and capitalism. The "end of history" for corporate law and governance as claimed by the convergence scholarship is not likely to take place in the near future in either the advanced or emerging economies.[879]

D Suggestions for future research

In order to stay within the scope of this thesis, certain important questions have surfaced out of this research but have not been investigated as they are beyond the scope of this research. For example, in the Alibaba case, what caused investors in the US to subscribe in such numbers to the Alibaba IPO given their lack of ability to control the fate of their investments caused by Alibaba's VIE-and-dual-class-share-and-governance structures? What gave them confidence that those controllers would not extract private benefits under such structures? In effect, is this the same 'cost' as excessive executive remuneration in the US corporates? These can be meaningful topics that other researchers may wish to explore.

Alibaba's innovative corporate ownership and partnership control measures also pose a unique set of challenges for both the Chinese and US authorities. Designing

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878 Refer to Section B 1 in this Chapter VI above.

879 Idea inspired by Milhaupt, above n 11, at 782. Also see generally Hansmann and Kraakman, above n 131; Franklin A Gevurtz "The Globalization of Corporate Law: The End of History or a Never-Ending Story" (2011) 86 Wash L Rev 475-522.

effective and user friendly internal and external governance mechanisms to manage risks and provide investors with avenues for their making of informed choices will prove to be absolutely imperative for sustainable economic development for China and the United States. There is again room for such further research and investigation which will make significant contribution to the corporate governance scholarship.

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