

CORPORATE LAW IN THE SHANGHAI PEOPLE'S COURTS, 1992-2008: JUDICIAL AUTONOMY IN A  
CONTEMPORARY AUTHORITARIAN STATE

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*In late 2005 China adopted a largely rewritten Company Law that radically increased the role of courts. This study, based on a review of more than 1000 Company Law-related disputes reported between 1992 and 2008 and extensive interactions with PRC officials and sitting judges, evaluates how the Shanghai People's Court system has fared over 15 years in corporate law adjudication. Although the Shanghai People's Courts show generally increasing technical competence and even intimations of political independence, their path toward institutional autonomy is inconsistent. Through 2006, the Shanghai Court system demonstrated significantly increased autonomy. After 2006 and enactment of the new Company Law, a new, if partial, limitation on institutional autonomy seems to be at work, as the Shanghai People's Courts refused to accept or adjudicate claims explicitly permitted in the revised 2006 statute but not yet elaborated in Supreme People's Court Regulation. This reaction is perverse, as the same Courts had liberally adjudicated the same claims before 2006 without any statutory or Supreme People's Court Regulatory authorization. That strange dynamic illustrates the bureaucratic embedding of the People's Courts in China's modified authoritarian system and how such entrenchment can divert or constrain the progressive autonomy won by the same Courts in the formal legal system. The conclusions have positive and negative aspects. On the positive side, there is significant momentum toward ever-increasing competence and autonomy of the People's Courts in Shanghai, at least for the application of corporate and commercial law. On the negative side, a familiar paradox may be at work: with formal substantive law and institutional "modernization" promised and even partially delivered alongside equally apparent failures in*

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*the exercise of judicial autonomy, the result may be to de-legitimize the very institutions offered by the state and ruling Party as twin pillars of “modern” governance and “rule of law.”*

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## I. INTRODUCTION

Political-legal reform in the People’s Republic of China (“PRC” or “China”) has lagged far behind the pace of economic system change and growth. Corporate law theorists hold that in transitional jurisdictions where the judiciary is politically weak or subject to oppressive influence, lacking in autonomy, or simply without technical competence, then company law and corporate governance must be largely “self-enforcing.”<sup>2</sup> By “self-enforcing,” theorists mean a corporate law design characterized by voting rules and transactional rights granted to firm investor-principals, and reliance on procedural protections, clear prohibitions and bright-line

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<sup>2</sup> Bernard Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. 1911, 1914 (1996) (stating “company law that depends on fast and reliable judicial decisions is simply out of the question”).

rules—all meant to operate *ex ante* as substitutes for less precise judicial standards applied *ex post*. China's first post-1949 company law of 1994<sup>3</sup> was a textbook example of such a regime.<sup>4</sup> Given the constraints acting on the PRC People's Courts embedded in an authoritarian political system, and the burdens on China's overworked public companies regulator, the China Securities Regulatory Commission ("CSRC"), the 1994 statute's self-enforcing design and negligible allowance for judicial involvement were appropriate.

In late 2005, the national legislature of the PRC passed a wholesale reworking of the 1994 Company Law, effective as of January 1, 2006.<sup>5</sup> In a head-spinning departure from the self-enforcing model of corporate law, the Company Law was suddenly filled with broad invitations for sophisticated judicial involvement. Although there had been undeniable improvements in the quality of the PRC People's Courts up to 2005, few would have judged such progress a match for the significantly increased demands placed on the judiciary.

With the 2006 change in mind, I analyze corporate law adjudication in Shanghai between 1992 and 2008, focusing on People's Court practice after adoption of the new Company Law. My purpose is to better understand the demonstrated technical competence, institutional autonomy and political independence of one major People's Court system in the PRC. In particular, I examine how Chinese law and judicial institutions work for Chinese domestic stakeholders and enterprises, and thus not foreign investors, foreign-invested enterprises, or foreign participants in the global capital markets purchasing stock in PRC issuers—where

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<sup>3</sup> Adopted at the 5<sup>th</sup> Meeting of the Standing Committee of the Eighth National People's Congress on December 29, 1993 and effective January 1, 1994, and amended by the 13<sup>th</sup> Meeting of the Standing Committee of the Ninth People's Congress on December 25, 1999 and the 11<sup>th</sup> Meeting of the Standing Committee of the Tenth National People's Congress on August 28, 2004.

<sup>4</sup> The definitive text of the 1994 Company Law [hereinafter 1994 Company Law] referred to here appears (adjacent to the 2006 Company Law changes) at ZHONGHUA RENMIN GONGHEGUO ZHENGQUANFA, ZHONGHUA RENMIN GONGHEGUO GONGSIFA XINJIU TIAOWEN DUIZHAO JIANMING JIEDU 217-416 (Gui Minjie ed., 2005).

<sup>5</sup> Amended by the 18<sup>th</sup> Meeting of the Tenth National People's Congress on October 27, 2005. The definitive text of the 2006 Company Law [hereinafter 2006 Company Law] referred to here appears in GONGSI FALÜ GUIZHANG SIFA JIESHI QUANSHU 1-1 (State Council Legislative Affairs Office ed., 2006) [hereinafter CLC].

Chinese law and legal institutions may serve different aims. To do so, I analyze full-length corporate law opinions for more than 200 cases selected from a much larger sample,<sup>6</sup> a decade's worth of cases analyzed in a 2003 Shanghai Higher People's Court "Opinion" on the 1994 Company Law,<sup>7</sup> and more than 760 disputes described in a 2007 report on cases implementing the Company Law in calendar year 2006<sup>8</sup>—all for a very wide diversity of Shanghai jurisdictions and procedural postures.<sup>9</sup> I also rely on extensive discussions with Shanghai Court officials currently handling such disputes.

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<sup>6</sup> Derived from annual Shanghai case collections reproducing opinions in civil and criminal cases aggregating over 500 case opinion sets (trial level and appellate level).

<sup>7</sup> Reviewing cases from the previous decade (1993-2003) [hereinafter *Shanghai Company Law Opinion*] in GONGSIFA YINAN WENTI JIEXI (DI SAN BAN) 231-36 (Shanghai Higher People's Court ed., 2006) [hereinafter SHANGHAI HIGHER PEOPLE'S COURT 2006].

<sup>8</sup> Shanghai Higher People's Ct. No. 2 Civil Division, *Shanghai Fayuan Xin "Gongsifa" Shishi Yi Zhounian Sifa Diaocha [Judicial Investigation of Application of the New "Company Law" in the Shanghai Courts After One Year]*, GONGSI FALÜ PINGLUN (2007 NIANJUAN) 38-51, (2007) [hereinafter *Shanghai Higher People's Court No. 2 Civil Division 2007* or *Shanghai Company Law Report*].

<sup>9</sup> It should be noted that China, with a population of over 1.3 billion, has almost 200,000 judges (and approximately the same number of staff), more than 3,100 Basic-level People's Courts, 406 Intermediate People's Courts, 32 Higher People's Courts and the large institution which is the Supreme People's Court. See Jerome A. Cohen, *The Court of Mass Appeal*, S. CHINA MORNING POST, Apr. 4, 2009, at A11 [hereinafter *Mass Appeal Courts*]. In that broader picture, the Shanghai Municipality and its judicial institutions are relatively unique, and thus judicial institution performance in Shanghai is not easily generalized to the entirety of the PRC or the Chinese world. Shanghai shares some of the characteristics of other large coastal urban areas in China, such as Beijing, Tianjin, Chongqing (Yangtze River "coastal"), Guangzhou and Shenzhen. At the same time, Shanghai—certainly when compared to Beijing and Shenzhen—is far more politically conservative across the board, and thus would be thought to have judicial institutions which act equally conservatively. Shanghai is by the same token not "rural" (although some of the distant jurisdictions inside Shanghai Municipality are much more agricultural than the center or suburbs of Shanghai) and thus the People's Courts act very differently than similarly placed rural institutions (such as the Qinghe County (Hebei Province) People's Courts wonderfully analyzed by sociologist Liu Sida, see Liu Sida, *Beyond Global Convergence: Conflicts of Legitimacy in a Chinese Lower Court*, 31 LAW & SOC. INQUIRY 75 (2006) [hereinafter *Beyond Convergence*]). Notwithstanding, the People's Courts implicated in this study range very widely, and include every district in Shanghai, from the expected Pudong New District (*situs* of the Shanghai Stock Exchange) to far off Baoshan District and even Chongming Island, and extending to special courts established under separate ministries or departments, like the Shanghai Rail Transport Intermediate People's Court. As noted in the body of this article, in many cases the Shanghai People's Courts are forced to deal with competing proceedings and/or prior rulings from other jurisdictions, especially judicial institutions—some very rural—in the Yangtze River Delta (no doubt this made necessary the interesting treaty-like document between adjacent People's Court systems, the "Agreement for Cooperation and Exchange for Judicial Work by the People's Courts in the Yangtze River Delta Region," noted at Gu Wenjian, *Jinrong Weiji Youle Kuaishen Tongdao [Financial Crisis Cases Have An Accelerated Hearing Channel]*, DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Dec. 3, 2008, at A6 [hereinafter *Accelerated Hearings*]).

My case/opinion-centered study that focuses on the actual application of contemporary Chinese law in complex disputes is controversial. Many scholars in China and abroad share the attitude articulated by one Beijing academic in 2006:

Generally speaking, case law in the Anglo-American legal system is itself the law .... However, in a continental (civil) law system like China's, law is constituted only by what the legislators promulgate as law; the decisions of the Chinese courts at present are not law, and such decisions are not in any way systematized.<sup>10</sup>

Such scholars argue that there is no real value in studying Chinese cases and legal opinions, however unsystematically reported, because they are largely irrelevant in determining “what the law is.” In their view, the law is found in statutes and regulation promulgated by various legislative and administrative authorities and easily reviewed in abundant statutory collections. While it is true that judicial pronouncements on specific cases in China have no binding or persuasive effect on other decision makers in the same (regional) People's Court system, much less across the national judicial or regulatory system,<sup>11</sup> a study of individual cases and the

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<sup>10</sup> This scholar is China University of International Business and Economics Professor Wang Jun, see GONGSIFA ANLI XUANPING 1 (Ma Qijia ed., 2006) [hereinafter SELECTED COMPANY LAW CASES]. Ironically, the same Professor Wang Jun understands the nature of the pursuit embodied by this article, and approves, stating that only by reviewing actual cases by functioning judicial actors and seeing “the usual way” (“yiban zuofa”) in which the law is applied can the civil law system legislator understand how to make the law more perfect, in theory and in application.

<sup>11</sup> This is not to say that there have not been experiments in post-Reform China with case law as precedents—e.g., the 2002 experiments in the Zhengzhou Zhongyuan District People's Court (judges encouraged to review prior cases on point in arriving at judgments) and the Tianjin Municipal Higher People's Court (prior cases, confirmed as “leading” cases by the People's Court system, can be referred to in arriving at judgments, but cannot be the “basis” for arriving at present judgments). See WANG SHIRONG, ZHONGGUO SIFA GAIGE YANJIU: PANLI YÜ FALÜ FAZHAN 151-52 (2006). See also Xin He, *Routinization of Divorce Law Practice in China: Institutional Constraints' Influence on Judicial Behaviour*, 23 INT'L J. L. POL'Y & FAM. 83, 104 [hereinafter *Divorce Law Practice*] (stating People's Court judges in family law cases rely on “precedents of upper level courts”); Benjamin Liebman & Timothy Wu, *China's Network Justice*, 8 CHI. J. INT'L L. 257 (2007) (noting People's Courts judges rely on the decisions of People's Courts in other jurisdictions). The careful reader will understand that hostility to case law precedents cannot remain the case forever, especially as the Chinese People's Courts continue to exercise increasing autonomy with respect to cases featuring complex fact patterns and requiring standard-applying doctrines like the corporate law that is the subject of this writing. This development track is understood by PRC corporate law specialists, and legal specialists and economists concerned with legal and judicial reform in China. See *Huajie Minyuan: Sifa Ying Ti Zhengzhi Huachu “Huanchongdai”* [Assuaging Popular Anger: The Judiciary Should Be A “Conflict Resolution Area” Substitute], NANFANG ZHOUMO [SOUTHERN WEEKEND], Nov. 13, 2008, at E31 [hereinafter *Assuaging Popular Anger*] (providing an edited transcript of discussion on the judiciary, rule of law and

opinions they conjure is a very good way to understand how the People's Courts apply China's published norms. Perhaps more important, my study of cases and legal opinions reveals a great deal about how PRC judicial officers understand their role, and the degree to which they are competent in applying complex doctrines when much is at stake.

A second objection to my study might be that data composed of formal judicial opinions results in an ill-advised emphasis on adjudication results expressed at their most symbolic. But that symbolism and the articulated jurisprudence supporting specific results are critically important. If interested in the way Chinese judicial institutions operate in Chinese society, for Chinese citizens, and thus the degree to which they are understood to be competent, autonomous and/or independent, there is no better gauge than what the judiciary does formally and for public consumption.<sup>12</sup> Accordingly, this study examines how complex legal doctrines are applied by the judiciary in Shanghai and entirely for public consumption. Thus, I do not bother much with

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the legal and political system by Zhang Sizhi, Wu Ge, Shen Hong, Cai Dingjian, Chen Ming, Qiu Feng, Mo Luo and others in November 2008); Luo Peixin, *Judicial Plights in the Context of the New Company Law of China* (May 26, 2006) (unpublished paper, presented at The Third Asian Law Institute Conference, Shanghai, China) [hereinafter *Company Law Plights*].

<sup>12</sup> The range of such formal action in this study is extremely wide, and thus indicates that the action itself is not merely formal. Most of the cases reviewed start at the District (or Basic) People's Court level, whence they are subject to appeal (to the intermediate level) at the litigants' initiative. Less frequently cases skip over the District level and proceed directly to an Intermediate People's Court, whence appeal is taken to the Shanghai Higher People's Court. In only one example in the sample, *Guangxi Xineng Sci. and Tech. Co. Ltd. v. Guotai Sec. Co. Ltd.*, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 211-12 (Shanghai Higher People's Ct., 2003), *aff'd*, Sup. People's Ct. (2003), does the case reach the Supreme People's Court. Indeed, many of the case opinions indicate seemingly endless re-hearings, often by the same court level (but by different panels of judicial officers). For instance, one 2004–2006 case shows a dispute heard twice by the District People's Court, an appeal to the Intermediate People's Court, remand to the original District level, and then appeal again to the higher Intermediate People's Court. *Shanghai Bund City Real Estate Comprehensive Dev. Co. v. Zhu Haimao*, 2006 HU ER ZHONG MIN SAN (SHANG) ZHONG ZI NO. 461 (Shanghai Jiading Dist. People's Ct., 2004), *reh'g granted*, Shanghai Jiading Dist. People's Ct. (2005), *rev'd*, Shanghai No. 2 Interm. People's Ct. (No. 3 Civ. Div.) (2006), *remanded to*, Jiading Dist. People's Ct. (2006), *appeal filed*, Shanghai No. 2 Interm. People's Ct. (2006), *available at* <http://www.hshfy.sh.cn/fyitw/gweb/>. The Chinese courts do not hold to the fact-law distinction between trial and appellate courts known in the United States, England and many non-Chinese jurisdictions. Accordingly, PRC appellate proceedings allow not only law pleadings, but *de novo* pleadings of law and fact. Yet, in the many cases reviewed for the study, very few show reversal at the second level of adjudication. Certainly higher-level courts demonstrate how free they are to undertake factual investigations *de novo*, and often apply different law and/or remedies, but the final judgments rarely change. That being said, the proportion of reversals or differentiated judgments seems higher in corporate and commercial cases when compared to criminal prosecutions or criminal appeals. All of this supports the belief that the Shanghai People's Courts are not just "going through the motions" in corporate law adjudication and thus not operating merely in the "formal".

difficult suppositions addressed in a good deal of current scholarship on the Chinese People's Courts: *i.e.*, the reality of why People's Courts' act in the corporate law sphere, as difficult as that would be to generalize even in one (regional) People's Court system. For example, I make no effort here to divine the real influence of "Political-Legal" or "Adjudication" Committees<sup>13</sup> staffed by political cadres and non-lawyers, the extent to which judicial officials hearing specific pleadings actually decide cases or write the related opinions,<sup>14</sup> political pressure or other factors at work in judicial responses or decision-making,<sup>15</sup> the extent to which lower Court judges seek explicit guidance from higher-level People's Courts prior to rendering initial trial-level judgments, the effect of cadre incentive systems on judges, the injuries done by high-levels of corruption and decision-making dominated by *ex parte* interactions, or any of the varied order of "social processes" at work. With this focus I do not mean to disavow the idea that Chinese judicial institutions—and in fact the entire PRC legal construction program—operate on at least two levels: (i) the symbolic/formal/globally-convergent/legitimacy-seeking, and (ii) the authentic/informal/indigenous/administration-requiring.<sup>16</sup>

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<sup>13</sup> See *infra* note 34.

<sup>14</sup> Although it should be noted that most post-2000 opinions in the Shanghai system declare the name(s) of the opinion-writing judge (and his or her or their secretary), and open with a declaration to the effect that the judges listed as opinion-writers were the same panel that heard the case.

<sup>15</sup> See Nicholas C. Howson, *Judicial Independence and Company Law in the Shanghai Courts*, in JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION 134 (Randall Peerenboom ed., 2009) [hereinafter *Shanghai Judicial Independence*]; *infra* note 34.

<sup>16</sup> See Nicholas C. Howson, *Rujiahua Zhi Si? [The Death of Confucianization?]*, 17 SHANGHAI SHUPING [SHANGHAI REVIEW OF BOOKS], Nov. 2, 2008, at 5; *Beyond Convergence*, *supra* note 9, at 91 (addressing the establishment of an "Administrative Division" in a local level Hebei People's Court notwithstanding very few petitions for administrative review, "One might reasonably pose the question why the judicial reform bothered to establish the Administrative Division in the basic level courts. Indeed, given the institutional constraints of administrative litigation, without considerations of legitimacy at the global level, the existence of the Administrative Division in Chinese basic-level courts would have become completely unnecessary. This clearly indicates the symbolic meaning of the judicial organization, *i.e.*, to create the outlook of a judiciary that is capable to check and balance the power of the government offices, as the judiciaries of the Western countries usually do. Meanwhile, the demand for economic growth produces an equally important type of legitimacy for the Chinese government. When these two types of legitimacy coincide in the judicial practice, the appropriated formal structure is decoupled from both. The decoupling of the judicial organization, therefore, shows the conflict and compromise between the two major types of legitimacy that are vital for the Chinese state.").

This study is highly significant from at least two standpoints. First, for corporate governance specialists, it provides a more accurate view of how effective corporate governance has developed in China, and might in the future develop in China and other transitional political economies. With the start of massive corporatization of state-owned and collectively-owned assets in the PRC starting in the 1990s, China and the world recognized that the achievement of effective corporate governance presents real difficulties.<sup>17</sup> Those obstacles threatened to embed in China's corporate law, and corporate governance practices, systems that would work against aggregating capital for significant development, attracting investment from private and public capital markets, or creating market participants that in turn respond efficiently in a semi-marketized economy. Throughout it has been understood that all other available instruments of corporate governance must be supported by the application and enforcement of corporate law, usually *ex post*, by a competent judiciary.<sup>18</sup> The 2005 amendments to the PRC Company Law were explicitly<sup>19</sup> directed to this critically important amelioration of China's corporate governance system.<sup>20</sup> A review of corporate law adjudication in Shanghai over almost two

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<sup>17</sup> Not least because of extra-legal, political-economic, factors, such as the nature of China's state-capitalism (or corporatization-without-privatization), the inability to really separate "government" and "enterprise" (*zhengqi fenkai* in the Chinese idiom), and the huge incentives working *against* effective corporate governance. See STOYAN TENEV, CHUNLIN ZHANG & LOUP BREFORT, CORPORATE GOVERNANCE AND ENTERPRISE REFORM IN CHINA: BUILDING THE INSTITUTIONS OF MODERN MARKETS (2002) [hereinafter CORPORATE GOVERNANCE AND ENTERPRISE REFORM].

<sup>18</sup> See ZHONGGUO GONGSI ZHILI BAOGAO (2003 NIAN) (Shanghai Stock Exchange Research Center ed., 2003) [hereinafter CHINA CORPORATE GOVERNANCE REPORT]; Donald C. Clarke, *The Role of Non-legal Institutions in Chinese Corporate Governance*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 168, 168-92 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) [hereinafter *Non-legal Institutions*]; Benjamin Liebman & Curtis Milhaupt, *Reputational Sanctions in China's Securities Markets*, 108 COLUM. L. REV. 929 (2009).

<sup>19</sup> See Cao Kangtai, *Guanyu "Zhonghua Renmin Gongheguo Gongsifa (Xiugai Caoan)" de Shuoming [Explanation Regarding "Company Law of the PRC (Amended Draft)"]*, in ZHONGHUA RENMIN GONGHEGUO ZHENGQUANFA, ZHONGHUA RENMIN GONGHEGUO GONGSIFA XINJIU TIAOWEN DUIZHAO JIANMING JIEDU 525-26 (Gui Minjie ed., 2005) [hereinafter *LAO Company Law Explanation*].

<sup>20</sup> Thus, the present story for corporate governance specialists is also tangentially about identification of "functional" as opposed to merely "formal" convergence in business organization and corporate and securities law in a transitional political economic system like the PRC, a topic I have already explored in some detail in connection with China's company law developments. See Nicholas C. Howson, *The Doctrine That Dared Not Speak Its Name: Anglo-American Fiduciary Duties in China's 2005 Company Law and Case Law Intimations of Prior Convergence*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 193, 193-254 (Hideki Kanda, Kon-sik Kim & Curtis



decades thus provides data on how China's People's Courts have done in supporting better corporate governance, and the real impact of formal change in substantive law that gives a greater role to court institutions.

Second, for legal institutional analysts this study offers a richer understanding of the function, operation and political-legal role of the judiciary in contemporary China's non-democratic, non-"rule of law" state, and the impact of substantive legal change and economic system change on the same institutions. The Chinese People's Courts are increasingly the subject of intense study by political scientists, sociologists, anthropologists and legal scholars.<sup>21</sup> Some of this work focuses on specific areas of adjudicatory (or mediation) practice, including hot button issues like family law,<sup>22</sup> labor rights,<sup>23</sup> environmental torts,<sup>24</sup> and even constitutional

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Milhaupt eds., 2008) [hereinafter *Doctrine That Dared Not*]; Ronald Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM. J. COMP. L. 329 (2001). See also CHAO XI, CORPORATE GOVERNANCE AND LEGAL REFORM IN CHINA 222 (2009) [hereinafter CORPORATE GOVERNANCE AND REFORM] (concluding Professor Xi Chao's broader study of China's corporate law); Iain MacNeil, *Adaptation and Convergence in Governance: The Case of Chinese Listed Companies*, 2 J. CORP. L. STUD. 289 (2002).

<sup>21</sup> For more generalized considerations, see RANDALL PEERENBOOM, CHINA'S LONG MARCH TOWARD RULE OF LAW 280-342 (2002) [hereinafter LONG MARCH]; Donald C. Clarke, *Power and Politics in the Chinese Court System*, 10 COLUM. J. ASIAN L. 1(1996) [hereinafter *Power and Politics*]. See also JUDICIAL INDEPENDENCE IN CHINA: LESSONS FOR GLOBAL RULE OF LAW PROMOTION (Randall Peerenboom ed., 2009) [hereinafter CHINA JUDICIAL INDEPENDENCE]; Pierre Landry, *The Institutional Diffusion of Courts in China*, in RULE BY LAW: THE POLITICS OF COURTS IN AUTHORITARIAN REGIMES 207-34 (Tom Ginsburg & Tamir Moustafa eds., 2008) [hereinafter AUTHORITARIAN RULE OF LAW]; Xin He, *Ideology or Reality? Limited Judicial Independence in Contemporary China*, 6 AUSTL. J. ASIAN L. 213 (2004); Xin He, *Why Do They Not Take Disputes? Law, Power and Politics in the Decision Making of Chinese Courts*, 3 INT'L. J. L. IN CONTEXT 203 (2007) [hereinafter *Not Taking Disputes*]; Benjamin J. Liebman, *China's Courts: Restricted Reform*, 191 CHINA Q. 620 (2007) [hereinafter *Restricted Reform*]; *Beyond Convergence*, supra note 9; Ethan Michelson, *Climbing the Dispute Pagoda: Grievances and Appeals to the Official Justice System in Rural China*, 72 AM. SOC. REV. 459 (2007). For an influential PRC scholar and onetime head of the Chinese Academy of Social Sciences Legal Research Institute writing on Reform-era Courts generally, but in a foreign language, see Chunying Xin, *What Kind of Judicial Power Does China Need?*, 1 INT'L J. CONST. L. 58 (2003) [hereinafter *What Kind of Judiciary*]. Of course, many PRC public intellectuals like Professor He Weifang continue to advocate in favor of judicial reform. See He Weifang, *Sifa Gai de Nanti Yü Chulu [Difficulties and the Way Out for Judicial Reform]*, NANFANG ZHOUMO [SOUTHERN WEEKEND], Sept. 17, 2008, at E31 [hereinafter *Judicial Reform Difficulties*]; He Weifang, *Sifa Shenmihua Gai Ruhe Qüchu [The Way in Which We Should Eliminate Mystification of the Judicial Function]*, NANFANG ZHOUMO [SOUTHERN WEEKEND], Sept. 25, 2008, at E30 [hereinafter *Judicial Mystification*].

<sup>22</sup> See *Divorce Law Practice*, supra note 11.

<sup>23</sup> See C.K. LEE, AGAINST THE LAW: LABOR PROTESTS IN CHINA'S RUSTBELT AND SUNBELT (2007) [hereinafter AGAINST THE LAW]; Mary Gallagher, "Use the Law as Your Weapon!" *Institutional Change and Legal Mobilization in China*, in ENGAGING LAW IN CHINA: STATE, SOCIETY AND POSSIBILITIES FOR JUSTICE (Neil J. Daimant, Stanley B. Lubman & Kevin O'Brien eds., 2005); Xin He & Su Yang, *Street as Courtroom: State Accommodation of Labor Protest in Southern China*, 44 L. & SOC'Y REV. 1 (forthcoming 2010).

rights and administrative law.<sup>25</sup> One American scholar analyzes the incentives at work for Chinese judges, and their bureaucratic roles and responses.<sup>26</sup> And some address comparisons between the workings of formal judicial institutions and local or central arbitration commissions.<sup>27</sup> There is less writing on how the People's Courts act in the commercial sphere,<sup>28</sup> and seemingly no writing whatsoever on corporate law (or securities law) adjudication— notwithstanding a corporatization project more than two decades old.<sup>29</sup> With respect to courts established in the embrace of authoritarian political regimes generally, two North American scholars have elaborated five primary functions: (i) social control and the containment of political opposition; (ii) bolstering regime “legality”; (iii) support of administrative compliance and coordination of competing factions; (iv) the facilitation of trade and investment; and (v) the provision of cover for controversial policies.<sup>30</sup> In this article I investigate how the Shanghai People's Courts perform their more “horizontally-oriented” conflict resolution and investment facilitation functions, and to a lesser extent their regulatory and administrative compliance functions. This is a sphere of activity far less provocative for China's rulers than other more explicit areas of “vertical” political-social control, such as enforcement of the criminal law or

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<sup>24</sup> See Rachel Stern's developing work on environmental litigation in China.

<sup>25</sup> See Keith Hand, *Using the Law for a Righteous Purpose: Sun Zhigang and Evolving Forms of Citizen Action in the People's Republic of China*, 45 COLUM. J. TRANSNAT'L L. 114 (2006); Thomas E. Kellogg, *Courageous Explorers? Education Litigation and Judicial Innovation in China*, 54 HARV. HUM. RTS. J. 141 (2007).

<sup>26</sup> This is Carl Minzner and his ongoing investigation of the workings of the cadre/judge “responsibility system” inside the People's Courts. See, e.g., Carl Minzner, *Judicial Responsibility Systems for Incorrectly Decided Cases*, in CHINESE JUSTICE: CIVIL DISPUTE RESOLUTION IN CONTEMPORARY CHINA (Margaret Woo & Mary Gallagher eds., forthcoming 2010) [hereinafter *Judicial Responsibility System*].

<sup>27</sup> See, e.g., Fuyong Chen, *Striving for Independence, Competence, and Fairness: A Case Study of the Beijing Arbitration Commission*, 18 AM. REV. INT'L ARB. 313 (2009) (examining local arbitration commissions (using the Beijing Arbitration Commission), as distinguished from the long-standing China International Economic and Trade Arbitration Commission charged with hearing “foreign-related” disputes).

<sup>28</sup> See Xin He, *Enforcing Commercial Judgments in the Pearl River Delta of China*, 57 AM. J. COMP. L. 419 (2009).

<sup>29</sup> But see *Doctrine That Dared Not*, supra note 20. See also *Non-legal Institutions*, supra note 18 (providing a consideration of necessary judicial institutions substitutes in respect of public company corporate governance).

<sup>30</sup> AUTHORITARIAN RULE OF LAW, supra note 21, at 4.

police action against anti-Party critics.<sup>31</sup> This approach is not meant to ignore the political-ceremonial role the People's Courts have even in corporate law adjudication. That role is as substantial today as it was in Chinese imperial history (via the magistrate), and is in the criminal law sphere in contemporary China, and corporate law adjudication in foreign jurisdictions.<sup>32</sup> In fact, Company Law application in the Chinese People's Courts has extremely significant implications for politics and governance in the PRC. Since 1994 the Chinese People's Courts have been given the power and technical bases to act in corporate and commercial law cases with a degree of expertise and autonomy far beyond the traditional role of Communist-era courts, and in cases where very significant material interests are at stake. Not only that, but the PRC Courts are now increasingly asked to apply the newly-justiciable corporate law in disputes arising between independent commercial actors and other more privileged political-economic actors, thus challenging judicial institutions to act "independently" as well as "autonomously". Consider for example a shareholder's lawsuit against a company director who represents the interests of a state agency-related or municipal government controlling shareholder—or the controlling shareholder itself<sup>33</sup>—for breach of corporate fiduciary duties, abuse of the corporation, shareholder oppression, or impermissible related party transactions. Here the PRC judiciary is called upon to protect legal rights and norms under the PRC Company Law against

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<sup>31</sup> It is also a sphere where at least the Shanghai People's Courts appear to engage in markedly lower rates of mediation. Of the total number of corporate law cases accepted by the Shanghai People's Courts in 2006, for first hearing cases, 55.21% gave rise to judgment, 11.46% were concluded via mediation, and 33.33% were subject to some kind of Court order. For cases subject to re-hearing and/or appeal, judgments were issued in 43.41% of the cases, 55.13% were subject to Court order and a paltry 1.46% were resolved through mediation. *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 37-51. Sociologist Liu Sida notes that this percentage of mediation is significantly lower than in other civil cases in the PRC nationally. E-mail from Liu Sida, Assistant Professor of Sociology and Law, University of Wisconsin-Madison, to Nicholas C. Howson, Assistant Professor of Law, University of Michigan Law School (Feb. 2009) (on file with author).

<sup>32</sup> Consider the clear "political ceremonial" role allowed the Delaware Court of Chancery in the most authoritative corporate law adjudication in the United States, embodied in that same Court's high-flying rhetoric and articulation of legal standards matched with non-application of the standards it proclaims. See *In re The Walt Disney Co. Derivative Litigation*, 907 A.2d 693, 755 (Del.Ch. 2005).

<sup>33</sup> Permitted under the 2006 Company Law, where controlling shareholders explicitly have fiduciary duties to the corporation and by implication to the minority shareholders. See 2006 Company Law, *supra* note 5, art. 20.

the superior power and influence of the government (or Party which controls the state), which power has for many years included absolute domination and funding-control of the People's Courts hearing the case.<sup>34</sup> As the PRC Courts act autonomously in this apparently mundane

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<sup>34</sup> This article does not focus on questions of (explicit) political independence. For a consideration of that aspect, see *Shanghai Judicial Independence*, *supra* note 15, invoking as explicit examples of demonstrated judicial (political) independence: (i) the 2003 case where a District level Shanghai People's Court says it will enforce the contractual rights of the occupier of a condemned industrial site against a local government agency (which offers as a defense against payment of compensation under the contract the idea that it signed the contract on behalf of the District People's Government and did not perform accordingly pursuant to the "instructions of higher levels" (*shangji zhishi*)) because the contract was validly formed under law, and the rights arising thereunder shall "receive the protection of the law" (implicitly against the government)—Shanghai Kangpasi Enter. Gen. Co. v. Shanghai Mun. Admin. of Industry and Com. Huangpu Dist. Branch, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 352 (Shanghai No. 2 Interm. People's Ct., 2001), *aff'd*, Shanghai Higher People's Ct. (2003); and (ii) the 2007 veil-piercing case which demonstrates court action against the interest of what is almost certainly a large (and central) state player, but presents the more expected circumstance of the Shanghai People's Courts acting against the interest of a *non-Shanghai* government political power—Shanghai Huaxin Elec. Wire and Cable Co. v. China Tietong Group Co., 2007 HU GAO MIN ER (SHANG) ZHONG ZI No. 145 (Shanghai No. 2 Interm. People's Ct. (No. 4 Civil Division), 2007), *aff'd*, Shanghai Higher People's Ct. (2007), *available at* <http://www.hshfy.sh.cn/fyitw/gweb>. See also the cases noted *infra* notes 220 to 224 and accompanying text, where the Shanghai People's Courts lecture former collective leaders metamorphosed into directors and officers with fiduciary duties, and forbidding the use of corporatization and corporate law as a shield for misappropriation of public assets. With respect to the political independence inquiry, there seems to be general agreement that "about 80%" of all People's Court judges are Communist Party members. See Wu Yulian (Hunan Higher People's Ct.), *Faguan Sanzhong Shenfen* [*The Three Statuses of Judges*], DONGFANG FAYAN, Oct. 12, 2008, *available at* <http://www.dffy.com/fayanguancha/sd/200810/20081012174522.htm>. Yet, there continues to be a good deal of controversy and some mystery over the function of the so-called "Political-Legal Committee" (*zhengfawei*) or "Adjudication Committee" (*shenpan weiyuanhui*) inside the People's Court system generally, and with respect to judgments rendered on individual cases specifically. At their worst, such Committees—staffed with officers devoid of legal training—are understood as purely Party political institutions deciding cases without reference to the considered views of the judges actually hearing the case and solely on political (or worse bureaucratic "quota") grounds. At their sunniest, the Political-Legal Committees are merely lofty administrative organs that issue policy guidance to the Court system under their jurisdiction. The truth is probably somewhere in the middle, and seems to vary among jurisdictions and the nature of the cases. It is certain that such Committees function for each of the three levels in the Shanghai People's Courts system—thus, inside the Higher People's Court, the Intermediate People's Courts, and each Basic (or District) Level People's Court. According to officials at the Shanghai People's Courts, most corporate and commercial case opinions are first drafted and then "filed" (*beian*) with the Adjudication Committee. Yet the same officials noted that if a specific case is "particular" (*teshu*), potentially impacting on social stability (*wending*) or "conflicting authority", the panel actually hearing the case and its People's Court level will seek the opinion of the Political-Legal Committee before accepting or deciding a case. These same officials declared that the notion of "conflicting authority" does not accommodate political conflict or political-economic privilege, but instead "conflicting jurisdictions" (for instance CSRC regulation or the application of the corporate law by the Courts). It is difficult to know how realistic that appraisal is, and the extent to which Courts acting alone or under the power of such Committees would not be very sensitive to the political background of the cases and litigants who appear before them. The normative dispute about politicization of the People's Courts, and these Committees, in China as joined between Beijing University Law School colleagues Zhu Suli and He Weifang is described in *Beyond Convergence*, *supra* note 9, at 81 (n.4), 92-93, and *Not Taking Disputes*, *supra* note 21, at 203-04.

context of corporate and commercial law it must have significant implications for the exercise of the judicial power independently in other, more sensitive, contexts.<sup>35</sup>

This article makes two central claims with respect to corporate governance and development of the judiciary. First, this survey confirms what must now be understood universally among corporate convergence scholars: formal convergence is only one aspect of how and whether legal and governance systems work. Perhaps more important is the way in which path-dependent factors determine the articulation, implementation and ultimately the relevance of proclaimed legal norms and procedural mechanisms. This article shows that law does indeed matter in the Chinese People's Courts, and that the same Courts evidence a startling degree of competence, but pre-existing indigenous forms, specific political-economic forces, and institutional strength and legitimacy are strongly determinative of how apparently convergent forms are implemented. Given this data, there remains a very serious question as to whether corporate governance can operate in China over the long term to support more secure property rights, large-scale investment, efficient allocation of capital, and ultimately growth. Second, the formal grant of greater autonomy to, and implicitly greater demands on the competence of, the Chinese judiciary has brought about somewhat contradictory effects. On one hand, the invitation to action by the People's Courts assumed in the successive Company Law statutes has undeniably spurred the Courts towards far greater autonomy than ever before. On the other hand, there are very serious limitations—both instructed within the bureaucratic system and self-

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<sup>35</sup> I note that the study relates to a time period during which the rhetoric applied to the People's Courts has shifted significantly, and in a direction which most outside observers understand as *away* from professionalism and autonomy. The Supreme People's Court's Second Five-Year Program for the People's Courts released in late 2005 exhibited extraordinary emphasis on judicial professionalism and autonomy. Starting in late 2007, with a change in leadership at the top of the Supreme People's Court (from Xiao Yang to Wang Shengjun), and confirmed in the March 25, 2009 Third Five-Year Program for the People's Courts, the Supreme People's Court now exhorts the People's Courts towards a revived "mass line" (called "democratic") style. See *Mass Appeal Courts*, *supra* note 9; Nicholas C. Howson, *Review of Xiaoqun Xu, Trial of Modernity: Judicial Reform in Early Twentieth-Century China, 1901-1937*, 57 AM. J. COMP. L. 518 (2009) [hereinafter *Trial of Modernity Review*]; *Judicial Reform Difficulties*, *supra* note 21; *Judicial Mystification*, *supra* note 21.

initiated—on the autonomy of the Shanghai People’s Courts in the course of their Company Law work. Again over the long term, the resulting paradox may challenge the legitimacy and effectiveness of the Chinese legal system for some of its most important consumers.

In this article I proceed as follows: In Part II, I describe the character of China’s modern company law establishment, and explain the expanded justiciability of PRC corporate law under the 2006 statute. In Part III, I detail indications of increasing autonomy of the Shanghai People’s Courts in Company Law adjudication from 1992 to 2008, but note one counter-intuitive constraint at work after promulgation of the 2006 Company Law. In Part IV, I offer evidence contrary to the data presented in Part III, and show how the Shanghai People’s Courts act with diminished autonomy in applying the corporate law over the same period. Part V concludes, with a Table of Selected Cases and Case Reports Appendix (detailing the full proceedings and judgments in several highly indicative corporate law cases) appended.

## II. THE 2006 COMPANY LAW – A NEW JUSTICIABILITY

China’s formal company law after 1992<sup>36</sup> was always an expression of the standard shareholder-oriented form of corporation and thus in formal terms a vindication of pre-2008 Global Financial Crisis declarations of the “end of corporate law history.”<sup>37</sup> China’s company law model was fashioned in this manner for two reasons. First, the Law was intended to respond to the demands of domestic and globalized capital markets on Reform-era China—where the purpose of corporate establishments was to attract finance from value-seeking shareholders

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<sup>36</sup> See Nicholas C. Howson, *China’s Company Law: One Step Forward, Two Steps Back? A Modest Complaint*, 11 COLUM. J. ASIAN L. 127, 128-29 (1997) (arguing that the 1994 Company Law —with respect to indicia of “shareholder-orientation”—was a *retreat* from the better form of “Opinion on Standards for Companies Limited by Shares” of May 1992) [hereinafter *One Step Forward*].

<sup>37</sup> Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439 (2001).

wielding non-state, domestic and foreign, capital.<sup>38</sup> Second, the adoption of a shareholder-oriented company model was the continuation of China's century-long quest for "modernity" so often synonymous with the formal adoption of perceived state of the art institutions, laws and practices.<sup>39</sup>

In form at least, the 1994 Company Law exemplified the so-called "self-enforcing" corporate law model.<sup>40</sup> The company statute and much of the elaborating regulation and mandatory forms promulgated by the CSRC were characterized by voting rules and transactional rights granted to direct participants in the Chinese corporation, reliance on procedural protections and clear prohibitions with respect to disfavored transactions, and bright-line rules meant to operate *ex ante*—all as substitutes for judicial or administrative actor-articulated standards applied *ex post*.<sup>41</sup> For instance, the 1994 Company Law required supermajority (two thirds) shareholder approval before *any* change to the company's articles of association.<sup>42</sup> Likewise, the CSRC's 1997 "Mandatory Articles of Association for Overseas Listing Companies" provided for class-like shareholder negative veto rights,<sup>43</sup> and separate CSRC regulations issued in 2004

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<sup>38</sup> So, in fact a partial vindication of Professor Coffee's ideas of more than a decade ago. See John Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U. L. REV. 641 (1999). This appraisal of the philosophical underpinnings of China's corporate law system remains true, even if China's first try at a modern company law statute in 1993-94 was in parts self-contradictory and simply incoherent. See *One Step Forward*, *supra* note 36.

<sup>39</sup> See WELLINGTON K.K. CHAN, *MERCHANTS, MANDARINS, AND MODERN ENTERPRISE IN LATE CH'ING CHINA* (1977); DOU JIANMIN, *ZHONGGUO GONGSIZHI SIXIANG YANJIU* (1999) [hereinafter *HISTORY OF CHINESE CORPORATE THOUGHT*]; *CORPORATE GOVERNANCE AND ENTERPRISE REFORM*, *supra* note 17, at 9-10; WANG XIAOWEN, *GONGSI LUN* (1930); C.K. Lai, *The Qing State and Merchant Enterprise: The China Merchant's Company, 1872-1902*, in *TO ACHIEVE SECURITY AND WEALTH: THE QING IMPERIAL STATE AND THE ECONOMY* (J.K. Leonard & J.R. Watts eds., 1991); Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 494-95, 497-502 (2003); William C. Kirby, *China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China*, 54 J. ASIAN STUD. 43, 44 (1995).

<sup>40</sup> Separately, one would look at the 1994 statute as something steeped in a business regulation model of law, and distant from the "enabling" forms seen in most Western jurisdictions after the rise of the corporate form at the end of the 19<sup>th</sup> century.

<sup>41</sup> See *Doctrine That Dared Not*, *supra* note 20.

<sup>42</sup> 1994 Company Law, *supra* note 4, arts. 106 & 107.

<sup>43</sup> This at a time when PRC corporate law did not recognize different "classes" of shares (and so these mandatory corporate charters speak to different "types" (*leibie*) of shares). See *Mandatory Articles of Association for Overseas Listing Companies*, CLC, *supra* note 5, at 4-43. This Articles of Association-based provision alone

required disinterested “public” shareholder approval of related party transactions, including the wide-scale abuse whereby controlling shareholders burdened their dominated public subsidiaries with guaranty obligations benefiting such shareholders.<sup>44</sup> Consistent with this self-enforcing orientation, little in the 1994 Company Law invited judicial participation in sorting out corporate disputes, whether for external actors (*e.g.*, corporate veil piercing) or internal participants (*e.g.*, traditional corporate fiduciary duties).<sup>45</sup>

The rationales supporting a self-enforcing design in early 1990s China—and many would say mid-2000s China—are easily understood. The PRC’s reforming judicial structures were and are widely perceived from abroad as being subject to political and other extra-legal pressures, and lacking in real sophistication or competence.<sup>46</sup> The criticisms openly leveled at the PRC People’s Courts from inside China then and now range even more widely, and include their perceived lack of political independence,<sup>47</sup> lower courts seeking guidance from higher courts prior to rendering judgments,<sup>48</sup> funding by and resulting deference to local government and Party

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proved effective in defeating a PRC central government-disfavored Singapore Airlines bid to acquire something close to control of China Eastern Airlines Company, Limited in 2007. See Barry Naughton, *SASAC and Rising Corporate Power in China*, 24 CHINA LEADERSHIP MONITOR 1 (2007).

<sup>44</sup> China Securities Regulation Commission, “Guanyü Jiaqiang Shehui Gongzhonggu Gudong Quanyi Baohu de Ruogan Guiding” [Several Provisions on Protection of the Rights of Public Shareholders], (2004) ZHENG JIAN FA No. 118, issued Dec. 7, 2004—which in the case of guarantees for affiliates notably came after an immediately useless 2003 CSRC and Ministry of Finance Notice stipulating merely super-majority *board* approval or majority *shareholder’s meeting* approval: “Guanyü Guifan Shangshi Gongsì Yü Guanlianfang Zijin Wanglai Ji Shangshi Gongsì Duiwai Danbao Ruogan Wenti de Tongzhi” [Notice on Several Issues Concerning the Standardization of Funds Transfers Between Listed Companies and Their Affiliates and the Provision of Guarantees by Listed Companies], (2003) ZHENG JIAN FA No. 56, issued Aug. 28, 2003, ¶ 2(3) (“useless” because the board was dominated by the controlling shareholder, likewise the approving full shareholders’ meeting).

<sup>45</sup> The notion of “self-enforcement” of course goes merely to the design of a legal stipulation, and does not mean that apparently self-enforcing mechanisms do not need some degree of external enforcement, or that such external enforcement is actually implemented.

<sup>46</sup> See LONG MARCH, *supra* note 21; CHINA JUDICIAL INDEPENDENCE, *supra* note 21; *Power and Politics*, *supra* note 21; *Not Taking Disputes*, *supra* note 21; *Restricted Reform*, *supra* note 21; *What Kind of Judiciary*, *supra* note 21.

<sup>47</sup> See CHINA JUDICIAL INDEPENDENCE, *supra* note 21; *Judicial Reform Difficulties*, *supra* note 21; *Assuaging Popular Anger*, *supra* note 11.

<sup>48</sup> See Zhao Lei, Qūxiao “Anjian Qingshi” Husheng Zai Qi [Calls Raised Again to Eliminate “Seeking Guidance in Cases”], NANFANG ZHOUMO [SOUTHERN WEEKEND], May 5, 2009, at



organs,<sup>49</sup> inability to act against local governments whether to enforce central government policy or vindicate the asserted rights of citizen individuals or groups,<sup>50</sup> powerlessness against the police and secret police,<sup>51</sup> inability to accept cases which involve large numbers of plaintiffs and thus have implications for “social stability,”<sup>52</sup> wide-ranging corruption,<sup>53</sup> lack of technical competence,<sup>54</sup> writing of opinions *before* judicial hearings and trials,<sup>55</sup> lack of due process and procedural consistency,<sup>56</sup> endless procedures, appeals, and frustrations which do not deliver a resolution or compensation much less anything resembling “justice”,<sup>57</sup> understaffing and over-

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<http://www.nanfangdaily.com.cn/epaper/nfzm/content/20090521/ArticleA03002FM.htm> [hereinafter *Seeking Guidance*] (stating that the Supreme People's Court is drafting a prohibition on the practice).

<sup>49</sup> On November 28, 2008, a proposal by the Central Legal-Political Commission to create central funding for all People's Courts—the “Opinions of the Central Legal-Political Commission on Several Issues in the Deepening of Reform in the Judicial System and Work Mechanism”—was endorsed by the Chinese Politburo. If implemented, this may prove a very important step in creating a more independent judiciary in the PRC and unhooking the Courts from the power and influence of their current paymasters, the local governments and Party organs in jurisdictions where they sit. See Chen Huan, *Fayuan Jingfei Yilai Tongji Caizheng Zhi Sifa Daishang Difang Zhuyi Yinji* [Court Relying on Local Government Financing and Administration for Funding Leads to Signs of Localism], SINA.COM, Dec. 5, 2008, at <http://news.sina.com.cn/c/2008-12-05/015716785000.shtml> (considering this proposed reform and its perhaps limited effect). See also Wang Jianxun, *Celiang Shehui de Hexie Chengdu* [Measuring the Degree of Harmony in Society], DONGFANG ZAobao [ORIENTAL MORNING NEWS], Dec. 7, 2008, at D24 [hereinafter *Measuring Harmony*]. Yet, as noted above, this proposed reform will have to battle with the new “mass line” for PRC judicial institutions pushed by the Supreme People's Court and the Communist Party. See *Trial of Modernity Review*, *supra* note 35; *Mass Appeal Courts*, *supra* note 9; *Judicial Reform Difficulties*, *supra* note 21; *Judicial Mystification*, *supra* note 21.

<sup>50</sup> See *Assuaging Popular Anger*, *supra* note 11.

<sup>51</sup> *Id.*

<sup>52</sup> See Xiao Han, *Qunti Peichang: Quanyi Yü Jiuan* [Mass Compensation: Rights and Stability], CAIJING, Oct. 13, 2008, at 152 [hereinafter *Mass Compensation*].

<sup>53</sup> See Qin Xudong, Wang Xiaolin & Luo Jieqi, *Zuigaofayuan Fuyuanzhang Huang Songyou Shean Beicha* [Supreme People's Court Vice President Huang Songyou's Case Involvement Investigated], CAIJING, Nov. 10, 2008, at 141; Yang Tao, *Xiaochu “Zhixing Fubai” Libukai Jiancha Jiandu* [The Elimination of “Corrupt Enforcement” Cannot Be Separated from Oversight by the Procurate], DONGFANG ZAobao [ORIENTAL MORNING NEWS], Nov. 12, 2008, at A23. In the first article, a discussion of the Autumn 2008 fall of Supreme People's Court Vice-President Huang Songyou on alleged corruption charges, the authors invoke the prosecution and dismissal of the President of the Guangdong Province Higher People's Court, the former President of the Hunan Higher People's Court, the President of the Liaoning Province Higher People's Court, and many examples from the Intermediate and Basic (or District-) level People's Courts.

<sup>54</sup> See *Judicial Mystification*, *supra* note 21.

<sup>55</sup> Chen Dongli, “Zaochan Panjue” *You Hai Sifa Gongxin* [Public Confidence in the Judiciary is Hurt by “Pre-Manufactured Judgments”], XIN JING BAO [NEW CAPITAL NEWS], Oct. 27, 2008, at A03.

<sup>56</sup> See *Assuaging Popular Anger*, *supra* note 11.

<sup>57</sup> See Zhao Lei, *Zhongguo Zuimangde Fating* [China's Busiest Court], NANFANG ZHOUMO [SOUTHERN WEEKEND], Dec. 4, 2008, at A7 [hereinafter *China's Busiest Court*]; *Assuaging Popular Anger*, *supra* note 11.

stretched resources,<sup>58</sup> failure to provide long-promised public hearings of cases,<sup>59</sup> enforcement “chaos”,<sup>60</sup> and much more.

Given the perceived state of the Chinese judiciary and the resulting requirements for a self-enforcing model of corporate law, the extensive amendments to the 1994 Law announced in November 2005 were startling. The new Company Law unveiled in late 2005 expanded the original statute with two new chapters, reduced the original 230 Articles to 219, and added 44 new Articles, amended 91 Articles and completely eliminated 13.<sup>61</sup> Most important, in the words of corporate law scholar Professor Liu Junhai the 2006 Company Law radically changed and augmented the “justiciability” (or “litigability” (*kesuxing*)) of China’s corporate statute and the entire corporate governance regime.<sup>62</sup> Similar views issued from the No.2 Civil Division of the Supreme People’s Court in Beijing, that part of the Court bureaucracy charged with hearing corporate law cases, with its statement that the new form of Company Law “strengthened the justiciability of civil [law] rights protection” (*zengqiang minshi quanyi de kesuxing*).<sup>63</sup> The Shanghai Higher People’s Court echoed these academic and Court leadership pronouncements in

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<sup>58</sup> See *China’s Busiest Court*, *supra* note 57.

<sup>59</sup> See *Assuaging Popular Anger*, *supra* note 11.

<sup>60</sup> See Ye Doudou & Luo Jieqi, *Qiuzhi “Zhixing Luan”* [*Seeking Remedies for “Enforcement Chaos”*], *CAIJING*, Nov. 24, 2008, at 136.

<sup>61</sup> *Zuigao Renmin Fayuan Minerting Fuzeren Dui “Guanyü Shiyong ‘Zhonghua Renmin Gongheguo Gongsifa’ Ruogan Wenti de Guiding (Yi)” Da Jizhewen* [*Responsible Person of the Supreme People’s Court No. 2 Civil Division Responds to Journalists’ Questions Regarding “Several Regulations on Questions Regarding “Regarding Implementation of the Company Law of the People’s Republic of China (First)”*], in *ZUIGAO RENMIN FAYUAN GUANYÜ GONGSIFA SIFA JIESHI (YI)*, (ER) LIJIE YÜ SHIYONG 4 (Xi Xiaoming ed., 2006) [hereinafter *SPC Press Conference 2006*].

<sup>62</sup> LIU JUNHAI, *XIN GONGSIFA DE ZHIDU CHUANGXIN: LIFA ZHENGDIAN YÜ JIESHI NANDIAN* 622-31 (2006). Separately, and less relevant to this study, the 2006 Company Law is far more “enabling” than its predecessor, although it preserves some significant color of a business regulation statute.

<sup>63</sup> *SPC Press Conference 2006*, *supra* note 61, at 4-5.

2007<sup>64</sup> and noted the concrete effect of such formal changes, saying that the amended statute “must affect the way in which corporate cases are heard by the judiciary.”<sup>65</sup>

Behind this seemingly radical change of direction was the fact that corporate governance at China's corporate entities—whether small privately-held close corporations and corporate partnerships, or the largest corporatized SOEs now publicly-held companies with shares listed in Shanghai, Hong Kong, London, or New York—was not functioning. In the private, closely-held context, corporate establishments became the fertile setting for fraud, looting and asset stripping, minority shareholder oppression, and firm mismanagement. In the public company setting, notwithstanding mandatory PRC and foreign disclosure requirements, the power of PRC and foreign securities and exchange regulation, and the ready threat of foreign securities class action suits, the situation proved even worse. Public companies were run as instruments meant to conveniently attract passive capital from the stock markets and serve the needs of a controlling shareholder (often an identity of the central or local government) and its insider appointees (just as often political cadres advancing through a *nomenklatura* (Party personnel) system divorced from the reach of corporate or securities law),<sup>66</sup> with ample opportunity for conflicted transactions or outright stealing of assets.<sup>67</sup> The deficit understood in the public company context contributed to both the perception and reality of dysfunctional capital markets, understood as either a “casino” (in the famous words of Chinese reform economist Wu Jinglian) or an insiders' playground with an informational asymmetry overwhelmingly in favor of such

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<sup>64</sup> Saying: the revised Law “makes a new arrangement with respect to the civil law rights and privileges” in relation to the corporate form, and opens a new era of “private-ordering”. *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 37.

<sup>65</sup> *Id.*

<sup>66</sup> Nicholas C. Howson, *China's Restructured Commercial Banks: The Old Nomenklatura System Serving New Corporate Governance Structures?*, in CHINA'S EMERGING FINANCIAL MARKETS: CHALLENGES AND GLOBAL MARKETS 123-63 (Martha Avery, Cai Jinqing & Zhu Min eds., 2009).

<sup>67</sup> See STEPHEN GREEN, CHINA'S STOCKMARKET: A GUIDE TO ITS PROGRESS, PLAYERS AND PROSPECTS 118-53 (2003) [hereinafter CHINA'S STOCKMARKET]; *LAO Company Law Explanation*, *supra* note 19, at 528-30.

insiders and their political masters.<sup>68</sup> As the Shanghai Stock Exchange summed up in an influential 2003 “China Corporate Governance Report,” China’s corporate governance regime and implementation were deeply flawed because of lopsided shareholding structures, the failure to divorce the government from enterprise ownership and control, weak self-regulation and enforcement, obstacles in the way of shareholders seeking legal protections, insider control of enterprises and personnel appointments, weak external governance mechanisms,<sup>69</sup> a failed information disclosure regime, lack of a fiduciary duties “culture” and supporting ethical commercial norms, and a passive media failing to communicate reliable information to the public.<sup>70</sup> As recognized by everyone from external analysts to the highest reaches of the PRC government,<sup>71</sup> one of the ways to reverse this disturbing development path was to involve the judiciary and the legal system, as an adjunct to the over-stretched securities regulator and the perhaps equally over-taxed but certainly technically deficient and politically-conflicted People’s Procurate (China’s public prosecutor).<sup>72</sup> As the Shanghai Stock Exchange said in respect of public company governance:

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<sup>68</sup> *LAO Company Law Explanation*, *supra* note 19, at 529-30. This in turn led to fears that the Chinese domestic capital markets would become so discredited as to produce a classic expression of George Akerlof’s “lemons problem” and resulting “death spiral” or simply fail in achieving rational allocation of capital to the most efficient enterprises (as an adjunct to the commercial banking system, itself reforming only very slowly). See George A. Akerlof, *The Market for “Lemons”: Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970); Bernard Black, *The Core Institutions That Support Strong Securities Markets*, 55 BUS. LAW. 1565 (2000). At the end of 2008, announcing emergency measures to deal with the worldwide financial crisis, President Hu Jintao as chair of the Central Economic Commission declared five key measures designed to increase growth and domestic demand, one of which showed the same, continuing, concern about corporate governance, market supervision and investor participation. In that statement, President Hu outlined policy initiatives designed to raise the quality of listed companies and their level of corporate governance, strengthen regulation of the securities markets, and increase investor trust in the same market and its issuers. See *Jingji Yunxing Kunnan Zengjia Zhongyang Paiding 5 Da Renwu Quebao Zengchang [Difficulties in Operation of the Economy Increase: The Central [Authorities] Set Out Five Major Tasks to Ensure Growth]*, DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Dec. 11, 2008, at A2-A3 (describing the policy statement as reported in the Shanghai papers).

<sup>69</sup> The market for corporate control, creditors’ rights and a bankruptcy regime, institutional investors, and executive compensation.

<sup>70</sup> CHINA CORPORATE GOVERNANCE REPORT, *supra* note 18, at 20-32.

<sup>71</sup> *LAO Company Law Explanation*, *supra* note 19, at 525-26.

<sup>72</sup> This was recognized explicitly in the public remarks by the President of the Changning District People’s Court, who noted that the People’s Court *had* to get involved in *ex post* standards application to attack phenomena

In practice, the punishment of illegal behavior by insiders as well as securities markets violations reflects an emphasis on administrative and criminal responsibility instead of civil liability, an over-reliance on government regulation and intervention, an unsatisfactory implementation of shareholders' civil actions, and the difficulties faced by investors in search of legal protection.<sup>73</sup>

Thus, the Shanghai Stock Exchange report proposed, China had to (i) amend the Company Law and the Securities Law to give wider scope for self-enforcing regulation and shareholder action (over administrative oversight and the business regulation model), (ii) strengthen the effectiveness, economic structure, and enforceability of judicial remedies to allow shareholders to seek such remedies in a low-cost and effective way, and thus participate fully in corporate governance, (iii) provide additional substantive remedies (and claims) for shareholders in the Company and Securities Laws, and (iv) expand the private right of action for securities markets fraud and manipulation and include public interest plaintiffs.<sup>74</sup>

Interestingly in light of the findings below regarding the relative absence of public company cases in the Shanghai Courts,<sup>75</sup> the initial response to these governance failures and the

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like opportunism and shareholder oppression which are simply impossible to regulate *ex ante*. Remarks of President Zou Bihua (Dec. 5, 2008) (notes on file with author).

<sup>73</sup> CHINA CORPORATE GOVERNANCE REPORT, *supra* note 18, at 23.

<sup>74</sup> CHINA CORPORATE GOVERNANCE REPORT, *supra* note 18, at 135. The Shanghai Higher People's Court recognized this in its own 2007 report on application of the Company Law. While admitting that the 1994 statute was "incomplete", it also emphasized that that the decade before 2006 saw problems with China's company law and corporate governance systems far more serious than mere incomplete, sloppy or contradictory drafting, including rampant fraud visited on shareholders, controlling shareholder opportunism, misuse of corporate limited liability to harm the legitimate rights of creditors, etc. As the Court somewhat poignantly observes, "the great tide of the marketized economy called out for... a company system which the Courts might actually be able to implement. . ." SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 1. See the lovely echo of this energy in a 2007 Shanghai case, where a defendant controlling shareholder's defense against piercing the corporate veil to the defendant—to the effect that "the [piercing] claim is not a proper subject of litigation [as against administrative fiat]"—is roundly rejected by the Shanghai No. 2 Intermediate People's Court and the Shanghai Higher People's Court, both of which endorse the idea that this is precisely the kind of remedy civil parties are to avail themselves of under the new 2006 Company Law. See Shanghai Huaxin Elec. Wire and Cable Co. v. China Tietong Group Co., 2007 HU GAO MIN ER (SHANG) ZHONG ZI NO. 145 (Shanghai No. 2 Interm. People's Ct. (No. 4 Civil Division) 2007) (upholding the assertion and adjudication of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law), *aff'd*, Shanghai Higher People's Ct. (2007), available at <http://www.hshfy.ah.cn/fyitw/gweb>.

<sup>75</sup> See *infra* notes 308 to 356 and accompanying text.

consequent push for judicial involvement came not from the People's Courts, the PRC legislature, or even the CSRC, but the new class of public shareholders themselves.<sup>76</sup> After 1998, and much to the judiciary's discomfort, they flooded the PRC Courts with claims of false or misleading disclosure claims against securities issuers.<sup>77</sup> Those developments, and the pressure starting with public shareholders and belatedly supported by the CSRC, and channeled by the Supreme People's Court, resembled the effort almost 10 years later to make the PRC Company Law itself "justiciable". Yet, mere justiciability of the Company Law was not enough, for the institutions applying the corporate and commercial law had to be seen as acting autonomously, or even independently. As economist Chen Zhiwu noted in a Chinese language essay arguing for increased justiciability of shareholders' claims under China's corporate law and securities regulation, "if the judiciary [in China] does not have real independence, then

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<sup>76</sup> The People's Court system, led by the No. 2 Civil Division of the Supreme People's Court and working with a good many of the PRC's top corporate law academics, later had an instrumental role in re-forming the Company Law and expanding justiciability.

<sup>77</sup> See *Jiang Shuzhen v. Hongguang Indus. Co., Ltd.*, (Shanghai Pudong New District People's Ct., 1998), *appeal denied*, (1999) in XU ZHAOHONG & ZHENG HUI, *ZHENGQUANFA ANLI JINGJIE* 58-64 (2001) [hereinafter *COLLECTED SECURITIES CASES*]. The Supreme People's Court, pushed behind the scenes by a then very reformist and pro-rule of law CSRC, finally relented with a half-hearted permission in January 2003, allowing a shareholders' private right of action to sue for compensation on false or misleading disclosure claims (but only after determination of liability by the securities regulator or the criminal justice system), and without providing a civil action for stock manipulation, insider trading, or insiders' breach of corporate fiduciary duties. As noted below, the securities regulatory authority (and the state, through the People's Procurate) still monopolizes regulation of every other aspect of public company and securities regulation and enforcement aside from false or misleading disclosure—such as stock manipulation or insider trading. Only in the Fall of 2008—in the midst of a "strike hard" campaign against stock manipulation—did the CSRC first levy a fine exceeding US\$1.5 million for stock manipulation (coupled with confiscation of US\$2 million in illegal profits, and reference for criminal prosecution) in the Shoufang Financial Advisory-Wang Jianzhong "pump and dump" case. See Xin Shanlun, *Shoufang Zhangmenren Beifa Zhongshen Jinru – Zhengjianhui Tongshi Gei Wang Jianzhong Kaichu Zuida Geren Fa Mo Dan 2.5 Yi Yuan* [*Shoufang Manipulator Penalized by Being Barred for Life – At Same Time CSRC Levies Against Wang Jianzhong Largest Fine for Individual and Confiscates RMB 25 Million Yuan*], DONGFANG ZAobao [ORIENTAL MORNING NEWS], Nov. 22, 2008, at A23 [hereinafter *Manipulator Penalized*]. This fine and reference for criminal prosecution was the high point in a six month period which saw very vigorous enforcement by the CSRC against market manipulators, corrupt funds trading, false disclosure, insider trading, etc., including the public investigation of the trading activities of one of China's commercial superstars, the Chairman of the Guo Mei ("Gomei") electronics concern. See *Bannian Lai Zhengjianhui Xingzheng Chufa Jueding* [*Administrative Penalties and Decisions Imposed by CSRC Within the Past Six Months*], DONGFANG ZAobao [ORIENTAL MORNING NEWS], Nov. 24, 2008, at B9 (detailing CSRC enforcement actions and fines levied between April 8 and November 21, 2008) [hereinafter *Penalties Imposed by CSRC*].

investors will not be able to enjoy real and reliable legal protections.”<sup>78</sup> And if investors do not enjoy, or perceive they may not enjoy, “real and reliable” legal protections of their property interests in firms, the corporate and capital markets system will fail or at least not measure up to its historic task in ensuring efficient capital allocation and growth.

Although the new Company Law preserves or augments certain of the prior self-enforcing mechanisms imposed in the 1994 Law and CSRC regulation,<sup>79</sup> it also presents an entirely new world for the often dismissed PRC judiciary. A partial list of important changes which constitute unprecedented invitations to private party litigation and extensive judicial involvement includes:

- *Ex post* corporate veil-piercing and liability for controlling shareholder oppression (Article 20);
- *Ex post* liability for related party transactions that injure the company (Article 21);
- *Ex post* invalidation of shareholders resolutions which violate law or administrative regulations (Article 22);<sup>80</sup>
- Shareholders’ right of action for *ex post* invalidation of board or shareholders resolutions or voting arrangements in violation of law or administrative regulations (Article 22);
- Shareholders’ right to sue for financial information and accounts of limited liability companies (Article 34);
- Shareholders’ right to put shares back to company in the event of non-distribution of dividends (Article 75);

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<sup>78</sup> Chen Zhiwu, *Sifa Duli, Panlifa Yü Gudong Quanyi Baohu* [Judicial Independence, Case Law and the Protection of Shareholders’ Rights], in CHEN ZHIWU, FEILIXING KANFEN 207 (2008). Dr. Chen might have crafted the statement to say “investors will not *believe* they enjoy real and reliable legal protections.”

<sup>79</sup> Such as the disinterested shareholder approval of controlling shareholder guarantees now written into Article 16 of the 2006 Company Law, *supra* note 5: “Where a company intends to provide a guarantee for a company shareholder or the company’s actual control party, the matter must be subject to a resolution adopted by a shareholders’ meeting or the shareholders’ general meeting. The shareholder or actual control party specified in the preceding paragraph shall not be permitted to participate in the vote on the matter specified in the preceding paragraph. The resolution shall be passed if it is voted for by other shareholders attending the meeting who hold more than half of the voting rights.”

<sup>80</sup> A function specifically and properly assigned to the Delaware Court of Chancery sitting in equity under the DEL. CODE ANN. tit. 8, § 225.

- Shareholders' right to sue for appraisal rights if no agreement reached on put of equity in limited liability companies (Article 75);
- *Ex post* liability of directors for corporate actions which cause serious damage to the company (and the director has not recorded an objection) (Article 113);
- Shareholders' right to sue for declaration that stolen, lost or destroyed share certificates are void (Article 144);
- *Ex post* applied corporate duty of care and duty of loyalty standards (Article 148);
- Company's right to sue directors and officers for restitution of "earnings" gained after violation of duties of loyalty determined *ex post* (Article 149);
- Derivative action against company officers and directors, either by supervisory board members on behalf of the company, or as initiated by the shareholders directly if the supervisory board does not act (Articles 54, 119 & 152);
- Shareholders' direct right of action to sue directors, officers and supervisory board members for violations of law, regulation or company articles of association where shareholders are injured (Article 153); and
- Court powers to declare companies bankrupt after conforming liquidation (Articles 181-191).

Perhaps the most significant provision in this impressive list is Article 153 of the 2006 Company Law, which effectively confers on shareholders of companies limited by shares<sup>81</sup> a very broad right of action to sue senior management of companies limited by shares for *any* breach of law or regulation or the company's articles of association. This provision makes any breach of law, regulation or stipulated procedure by the company, or the senior management that directs it, actionable, so long as it causes injury to plaintiff shareholders. Some reputable PRC corporate law scholars even see in the 2006 Company Law the most robust invitation to judicial action imaginable, for instance divining a private right of action to sue for the creation and enforcement

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<sup>81</sup> The Chinese Company Law allows for two primary corporate forms: the "company limited by shares" (*gufenyouxian gongsi*) and the "limited liability company" (*youxianzeren gongsi*). The Company Law also authorizes a sub-form of the latter type of company, the SOE-friendly "wholly state-owned company" which has no shareholders' meeting and is invested in by state administrative departments, and a third form, the "single person company". The company limited by shares is like a joint stock company in Western parlance, and the limited liability company like a close corporation or corporate partnership.



of CSR standards (Article 5) or even limitations on Communist Party involvement in firm management (Article 19).<sup>82</sup> In sum, although the 2006 Company Law undeniably “modernized” China’s corporate law and governance system, and ironed out some of the incoherencies of the 1994 statute,<sup>83</sup> it also squarely addressed what many have seen as the central problem in governance reform: the role and power of the Chinese judiciary.

### III. AUTONOMY DEMONSTRATED

“Autonomy” in the context of the PRC People’s Courts should be distinguished from two other important concepts: “competence” and “independence.” Competence is the easier concept to understand, and goes to the technical expertise of judicial institutions in evaluating fact- and law-complex disputes. For example, competence refers to the extent to which Chinese People’s Courts can adjudicate corporate fiduciary duty-of-care cases with the very rich facts and difficult application of law those entail, or equally subtle and complex inquiries allowing *ex post* corporate veil-piercing and disregard of a bedrock corporate attribute (shareholder limited liability).<sup>84</sup> The idea of autonomy is distinct from “independence,” although the two concepts

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<sup>82</sup> Company Law Plights, *supra* note 11.

<sup>83</sup> For instance, elimination of the plain silly Article in the 1994 Company Law which declared that state-owned assets contributed to a corporate legal person by the state remained the property of the state—giving the state an apparent property-rights windfall, continuing ownership of the assets and the equity interest in the intervening company representing the contributed assets. *See* 1994 Company Law, *supra* note 4, art. 4.

<sup>84</sup> The Shanghai’s Courts evidence increasing competence in adjudicating corporate law matters over the period 1992-2008, albeit with the occasional mistake. Interestingly, there is no necessary connection between the relative superiority (level) of a court in the Shanghai judicial bureaucracy and its demonstrated competence in corporate law cases: oftentimes the opinions show that the most expert adjudication is performed at very local District People’s Court levels, far away from the sophisticated action in Pudong New District, Jingan District, Luwan District, etc. or the exalted premises of the Shanghai Higher People’s Court. This indicates that the quality of judicial personnel is an important variable, and technically proficient judges are produced by good education and a superior intellect, just as the very highest reaches of a particular People’s Court system may be staffed with less well-educated, less intellectually-accomplished, individuals who are essentially senior bureaucrats and political cadres. The competence exhibited is indeed rather impressive given the very difficult hand dealt to Chinese judges generally in this area: a Company Law which largely regulates *partnerships*, apparent restrictions against using the corporate statute on large-scale companies limited by shares with a diffuse shareholder base, and the maddening presence in the Chinese business landscape of “other” business associations—ranging from entities “left over from

may be stops on a single continuum. Autonomy in the PRC context is the ability of the judicial institution to act with its own institutional authority, even if in Chinese parlance it has no “legal basis” (*falü yijü*) to act.<sup>85</sup> Examples of demonstrated autonomy presented in this article are the many cases in which the Shanghai People’s Courts accept, hear and decide cases on corporate fiduciary duties, corporate veil piercing, invalidation of board or shareholders’ resolutions, and shareholder petitions for company dissolution when the PRC judiciary has no legal basis for such action.<sup>86</sup> Judicial independence is still another idea, and goes to the ability of courts and judicial officers to act independently from, and against the interest of, political or military power. For an example of how these three conceptual distinctions operate, or not, together, consider how a People’s Court might invoke sophisticated corporate law doctrine and apply evidentiary analysis in evaluating *competently* a veil-piercing claim, act *autonomously* in accepting and then actually piercing the corporate veil to assert liability against the controlling shareholder of a debtor company without an authorizing legal basis, and yet be unable to act *independently* in proclaiming much less enforcing that legal responsibility if the controlling shareholder is a far more powerful instrument of the state, Party or military.<sup>87</sup>

I also note up front that judicial autonomy, however construed or implemented, may not be an undiluted good. This principle is especially true in a transitional economic and political culture such as the PRC’s, with just-developing notions of professionalism, public interest and

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history” to spontaneous business associations with no basis in PRC law or regulation. See *infra* notes 181 to 204 and accompanying text.

<sup>85</sup> So this is to be distinguished from a perhaps distinct conception of judicial autonomy familiar from the study of common law courts, the practice of such courts actually creating substantive legal principles which elaborate on, or even contradict, statutory or regulatory norms.

<sup>86</sup> Which in the PRC context would be making those disputes justiciable in the Company Law, or by provision of an explicit framework via Supreme People’s Court judicial “Regulations” (*sifa guiding*) (incorrectly called judicial “Opinions” (*sifa jieshi*)). See *infra* notes 91 to 105 and accompanying text.

<sup>87</sup> As I have noted elsewhere, see *Shanghai Judicial Independence*, *supra* note 15, it is extremely difficult to assess the degree of political independence exercised by the People’s Courts via the study of case outcomes or formal judicial opinions because the operative political background to any specific case is so opaque and not easily determined by judgment review or interactions with judges, lawyers or litigants.

ethics. In China, unconstrained autonomy may see judicial institutions departing from promulgated legal bases and regulatory controls as a result of corruption, bribery, or *ex parte* pressures.<sup>88</sup> This phenomenon is ever-present in contemporary China for all state institutions, not just the People's Courts. Nonetheless, given the absolute lack of institutional autonomy in the People's Court system historically, any demonstration of autonomy in the modern era should be deemed a generally positive development for the legal system and its institutions as a whole.

The five sub-sections of this Part III show the multiple ways in which the autonomy of the Shanghai People's Courts between 1992 and 2008 in corporate law matters is expressed: (a) judicial implementation of the Company Law or corporate law principles without statutory or bureaucratic authorization, or departing from such authorization;<sup>89</sup> (b) application of the law and remedies using common law or equity court-like powers; (c) refusal to apply badly-formulated corporate law to *de facto* partnerships; (d) articulation and protection of an autonomous sphere for commercial firms and market activity; and (e) application of corporate law with significant authority, often to invalidate or instruct re-arrangement of privately-ordered contractual or business arrangements.

A. *Adjudication in the Absence of Statutory or (Supreme People's Court) Regulatory Authorization; Caveat Autonomy*

Prior to adoption of the 2006 Company Law, the Shanghai People's Courts took up the challenge offered them in the early 1990s and—in relative terms—ran amok in accepting, hearing, adjudicating and pronouncing judgments on matters they were not formally authorized to accept. Specifically, they applied doctrines and procedural innovations such as corporate fiduciary duties, corporate veil-piercing and derivative lawsuits all without explicit authorization

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<sup>88</sup> I am indebted to Professor Mary Gallagher, University of Michigan, for this insight.

<sup>89</sup> Including application of the 2006 Company Law and remedies to pre-2006 claims, but with an “authorization-constraint” posited after January 1, 2006. See *infra* notes 153 to 156 and accompanying text.

in statute or judicial regulation, or even after authorization in statute, without the specific legal basis usually provided by Supreme People's Court Regulations.<sup>90</sup> The picture after 2005 and the passage of the 2006 Company Law is more complex and indicates some retreat on judicial autonomy.

As the apex of the bureaucratic system which is the Chinese judiciary, the Supreme People's Court in Beijing is empowered to issue three kinds of explanatory documents with the power of law or regulation: "Explanations" (*jieshi*), "Regulations" (*guiding*), and "Approving Responses" (*pifu*). Explanations provide substantive elaboration of statute or "Law" (*fa*) passed by the national legislature,<sup>91</sup> such as the PRC Company Law. Regulations give judicial institutions at all levels direction on how to apply Law to certain cases or with respect to certain common problems, often focusing on procedural aspects. Approving Responses are the Supreme People's Court's answers to submissions regarding specific application of law problems arising from Provincial or Province-level Municipality<sup>92</sup> Higher People's Courts and People's Liberation Army Courts.<sup>93</sup>

As of this writing, the Supreme People's Court has issued only two judicial Regulations concerning the 2006 Company Law, the first<sup>94</sup> on how the People's Courts should handle actions

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<sup>90</sup> These developments are consistent with one positive implication of the effect on the Chinese judiciary of new economic law and forms in the partially-marketized PRC. See *Doctrine That Dared Not*, *supra* note 20.

<sup>91</sup> In Chinese "*fa*", to be distinguished from State Council regulation or other normative documents or norms adopted by local-level People's Congresses (*guiding*, *banfa*, *tiaoli*, *guizhang*, etc.). See Perry Keller, *Sources of Order in Chinese Law*, 42 AM. J. COMP. L. 711 (1994).

<sup>92</sup> Shanghai Municipality is one such "directly-administered" Municipality, treated like a Province (or Autonomous Region)-level jurisdiction.

<sup>93</sup> Xi Xiaoming & Jia Wei, *Zhengquan Shichang Xujia Chenshu Minshi Peichang Zhidu* [*The Civil Compensation System for Misrepresentation in Securities Markets*], 3 ZHENGQUAN FALÜ PINGLUN [SECURITIES LAW REVIEW] 33, 41-47 (2003). Thus, the two Supreme People's Court pronouncements on the 2006 Company Law issued as of this writing, universally—and incorrectly—referred to as "Judicial Explanations" (*sifa jieshi*) in common discussion, academic articles and journalist treatments, are actually "Regulations" because they seek to explain the application of certain parts of the Company Law (or in the case of the first set of Regulations, the use of both the 1994 Company Law and its 2006 successor) in the People's Court bureaucracy.

<sup>94</sup> ZUIGAO RENMIN FAYUAN GUANYÜ GONSIFA SIFA JIESHI (YI), (ER) LIJIE YÜ SHIYONG 3 (Xi Xiaoming ed., 2006) [hereinafter SPC COMPANY LAW REGULATIONS]. See also the use of these Regulations in a post-January

which straddle January 1, 2006, and the second<sup>95</sup> on shareholder petitions for judicial dissolution of companies.<sup>96</sup>

Regulations can impact the application of a statute like the Company Law in at least four important ways: (i) providing a specific authorization for a claim or action already given a legal basis in Law; (ii) forbidding certain kinds of claims which the People's Courts might be tempted to accept, even where there is a colorable legal basis in Law; (iii) providing new bases for justiciability over and above what is set forth in Law; and (iv) prodding the People's Court to re-start acceptance and adjudication of cases they have voluntarily or by instruction ceased accepting. For an example of the first category, Supreme People's Court Regulations issued in January 2003 provided a specific legal basis for shareholders' claims against issuers, controlling shareholders, underwriters and accountants arising from false or misleading disclosure in the public stock markets.<sup>97</sup> That this authority is invested in judicial Regulations is also exemplified by the fact that the new PRC Bankruptcy Law remains basically unimplemented by the Chinese judiciary because there are no Regulations on that Law.<sup>98</sup> In the second, restrictive, category, are the same January 2003 Regulations alluded to above permitting shareholders' suits for false or misleading disclosure which also explicitly prohibited acceptance of shareholders claims on

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1, 2006 case in *Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd.*, ZHONGGUO ZUIJIN XIN GONGSIFA – DIANXING ANLI PINGXI 185 (Huai Xiaofeng ed., 2007) [hereinafter ANALYSIS OF NEW CASES], (Shanghai Changning Dist. People's Ct. and Shanghai No. 1 Interm. People's Ct., 2006), (showing the use of these Regulations in a post-January 1, 2006 case that contested shareholder resolutions passed at a dissident special shareholders' meeting that occurred pre-January 1, 2006; mandating application of only the 1994 Company Law to party claims).

<sup>95</sup> SPC COMPANY LAW REGULATIONS, *supra* note 94, at 7-11.

<sup>96</sup> A third set of Regulations, on the derivative action mechanism inserted into the 2006 Company Law at Articles 54, 119 & 152, is expected soon.

<sup>97</sup> ZUIGAO RENMIN FAYUAN GUANYÜ SHENLI ZHENGQUAN SHICHANG YIN XUJIACHENSHU YINFA DE MINSHI PEICHANG ANJIAN DE RUOGAN GUIDING [SUPREME PEOPLE'S COURT SEVERAL REGULATIONS REGARDING CIVIL COMPENSATION CASES ARISING FROM FALSE DISCLOSURE IN THE SECURITIES MARKETS], Jan. 9, 2003, FA SHI No. 2, CLC, *supra* note 5, at 5-25 – 5-29 [hereinafter MISREPRESENTATION IN SECURITIES MARKETS REGULATIONS].

<sup>98</sup> The Supreme People's Court started work on Regulations on the Bankruptcy Law in October 2007. See Dou Yumei, *Qiye Pochanfa Sifa Jieyi Qicao Gongzuo Qidong* [Work Starts on Drafting a Judicial Interpretation for the Enterprise Bankruptcy Law], July 11, 2007, available at <http://chinacourt.org/html/article/200707/11/256034.shtml>. This does not mean that the Courts do not accept any bankruptcy cases, only that they have great difficulty in handling these cases to a conclusion.

other aspects of securities markets fraud, such as stock manipulation or insider trading.<sup>99</sup> Similarly, the 2<sup>nd</sup> Judicial Regulations on the 2006 Company Law issued in May 2008 forbid the acceptance of shareholder petitions for dissolution of PRC companies based on factors outside of those listed in the statute.<sup>100</sup> In the third, liberalizing, category, are the parts of the same 2<sup>nd</sup> Judicial Regulations on the 2006 Company Law which provide for expanded justiciability of creditors' claims against firms in liquidation.<sup>101</sup> For the fourth category, Regulations which "prod" the People's Court into action or a re-start of adjudication work voluntarily abandoned, a good example is the continuing strife over settling a Regulation which might re-commence adjudication of creditors' actions on non-performing loans sold by commercial banks to asset management companies, and then on to third party purchasers of discounted bundles of such debt.<sup>102</sup> To date, the Supreme People's Court has managed to produce only a document which is

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<sup>99</sup> MISREPRESENTATION IN SECURITIES MARKETS REGULATIONS, *supra* note 97. The Supreme People's Court subsequently removed this restriction in May 2007, and has permitted actions on claims other than misrepresentation, including claims for insider trading and manipulation (but always subject to the prerequisite rule set forth in the 2003 Supreme Court Regulations). See *Zhengquan Minshi Peichang: Zhengjianhui Bu Cha, Fayuan Bu Shen* [Civil Lawsuits for Damages in Securities Cases: If the Securities Regulatory Commission Does Not Investigate, the Courts Will Not Try the Case], CAIJING, Sept. 11, 2007, available at <http://www.Caijing.com.cn/2007-09-11/100029938.html>.

<sup>100</sup> Examples of such non-permitted bases are claims arising from: frustration of shareholders' information rights, non-distribution of dividends, sustained company losses, failure to achieve a going concern or invalidation of the corporate business license. (By implication, it would seem that Chinese shareholders after 2006 sued for firm dissolution on precisely these grounds.)

<sup>101</sup> These expanded claims are: creditors' claims seeking People's Court confirmation of debts owed by a company subject to dissolution-liquidation, and creditors' claims asserting the joint and several liability of shareholders and controlling shareholders arising from their misfeasance or manipulation of residual assets in the dissolution and liquidation process. The most significant liberalizing Regulation of all *might have been* the Regulations finalized in Beijing a short time before adoption of the 2006 Company Law. In 2003 and prior to the 2005 amendments resulting in the 2006 Company Law, the Supreme People's Court had distributed for comment the very extensive "Regulations on Several Issues Regarding the Hearing of Corporate Law Disputes (Draft for Comments)" which anticipated large portions of the 2006 Company Law including corporate veil piercing, derivative actions, shareholders' information rights, fiduciary duties, liquidation procedures, invalidation of corporate resolutions, etc. If the Company Law had not been amended in late 2005, and this Comment Draft had been actually issued by the Supreme People's Court as a Regulation, then that Regulation would have provided the basis for a whole host of claims and procedures going far beyond the spare legal bases explicitly set forth in the 1994 Company Law, effectively changing the Company Law entirely by Supreme People's Court Regulation.

<sup>102</sup> Because of a 2004 report by the head of the Hubei Provincial Higher People's Court warning of "irregular activity" and the "loss of state assets" through such transfers of non-performing loans, the People's Courts simply stopped accepting, hearing or ruling on such cases in early 2005. In February of 2005, central departments under the State Council (including the Supreme People's Court, the commission overseeing state-owned assets, the

far weaker than a Regulation (or Explanation or Approving Response)<sup>103</sup> merely *urging* subordinate People's Courts to start accepting creditors' claims on such transferred non-performing loans.<sup>104</sup>

Significant controversy continues regarding the normative effect of Supreme People's Court pronouncements. In the view of many judicial officers and academics, these Supreme People's Court Regulations not only craft and make concrete the application of Laws promulgated by the National People's Congress, but are a condition precedent to application of a specific Law by any institution governed by the Supreme People's Court. Thus, many Chinese academics, lawyers and judges hold firmly to the idea that important provisions of the 2006 Company Law, such as corporate fiduciary duties, veil-piercing, or the derivative law suit mechanism, may not be employed or even invoked until Regulations specifically addressing the provision in question have been issued. The Supreme People's Court naturally supports this view as it assures competence and coherence in application of new Law, but also buttresses the

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Ministry of Finance, the China Banking Regulatory Commission and the People's Bank of China (China's central bank)) produced a draft proposal of considerations on the question, but only in April of 2006 did the Supreme People's Court produce a "comment draft" for the proposed Regulations. In October 2007, that draft was reported, over the strenuous objections of some of the key central players listed above, to the State Council for approval, which approval was never rendered because of the controversy between leading departments. By October of 2008, the Supreme People's Court was still unable to produce a final set of Regulations on the important question, and able only to muster "Important Meeting Minutes" (*huiyi gaiyao*) after a contentious and rather secretive meeting on Hainan Island attempting to address the State Council's concerns on the matter. See Zhang Yuzhe & Zhang Man, *Buliangzichan Chuzhe Xin Guiding Liangnan* [Two Difficulties for New Regulation of Non-performing Asset Arrangements], CAIJING, Nov. 24, 2008, at 60, 61 [hereinafter *Two Regulation Difficulties*].

<sup>103</sup> With the awkward title familiar from so many so-called normative documents in modern China, "Several Opinions on Judicial Protection and [Using] the Law in Service of Continuing to Develop the Nation's Financial Security and Overall Economic Coordination".

<sup>104</sup> See Ye Doudou, *Buliangzichan Zhuanrang Susong "Jie Dong"* [The "Unfreezing" of Litigation Relating to Transfer of Non-performing Assets], CAIJING, Dec. 8, 2008, at 28, available at <http://Caijing.com.cn/2008-12-04/110034693.html> [hereinafter *Unfreezing Litigation*]. This last example is both a good expression of how the People's Court bureaucracy works via Regulations and internal notices on substantive adjudication matters, but also an excellent demonstration of: (i) how the subordinate Courts react, on their own, in cases which touch on overtly political concerns (even where the rights and interests of the strongest international financial institutions are directly concerned—as many purchasers of bundles of discounted non-performing loans from the Chinese Asset Management Companies were foreign investment and commercial banks increasingly frustrated in their efforts to collect on the transferred debt); (ii) the normative authority of a Supreme People's Court pronouncement calling for the re-start of case acceptance and decision when encountering articulated, voluntary, subordinate-level refusal, and (iii) the ongoing resistance from local-level Courts even in the face of central-origin instruction and policy direction.

Court bureaucracy's central position and authority. This relation is seen in an utterance by an official at the No. 2 Civil Division of the Supreme People's Court just after the 1<sup>st</sup> Judicial Regulations on the new Company Law were issued in May 2006: "... after implementation of the "Company Law" [starting January 1, 2006], the litigation type cases the People's Courts will have to hear shall increase greatly, and many issues *will have to be the subject of judicial explanation* in accordance with legislated principles".<sup>105</sup>

Although Supreme People's Court Regulations, Explanations and Approving Responses play an important role, sub-national People's Court systems also issue their own "Opinions" on specific Laws.<sup>106</sup> For example, in June 2003 the Shanghai Higher People's Court issued its own internal<sup>107</sup> "Opinion of the Shanghai Higher People's Court on Handling Certain Issues Regarding Hearing Company Law Related Cases"<sup>108</sup> addressing the 1994 Company Law form, only the first part of which is directed to procedural rules and standards for the application of the Company Law.<sup>109</sup> The Opinion explicitly bars *Shanghai* People's Courts' from consideration of certain cases. Thus, with respect to shareholders' petitions seeking judicial invalidation of board or shareholders' resolutions the Shanghai People's Courts are instructed to "temporarily" *not* accept cases where the subject entity is a company limited by shares with listed capital.<sup>110</sup> The Shanghai Company Law Opinion also strongly counsels caution and conservatism in applying

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<sup>105</sup> *SPC Press Conference 2006*, *supra* note 61, at 4 (emphasis added).

<sup>106</sup> Such Court-system specific instructions/opinions are not unique to Shanghai. See for example in the Company Law sphere similar documents issued with respect to application of the 1994 Company Law by the Beijing Higher People's Court (February 9, 2004) and the Jiangsu Province Higher People's Court (June 3, 2003), collected at SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 236-48. Judges, scholars and lawyers in the PRC often allude to the high quality, "modernity" and coherence of the Jiangsu Province Opinion on the 1994 Company Law.

<sup>107</sup> *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 48.

<sup>108</sup> SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 231-36.

<sup>109</sup> The second and third parts review implementation problems "in recent years" and offer unified approaches to frequently-encountered difficulties.

<sup>110</sup> *Shanghai Company Law Opinion*, *supra* note 7, at part I, § B, para. 2. This instruction was reversed in conjunction with the 2006 Company Law, although pretty grudgingly. See *infra* notes 324 and 358 and accompanying text. See also *infra* notes 308 to 356 and accompanying text on the more generalized rejection of cases involving companies limited by shares cases and listed companies.



novel doctrines to corporate law disputes.<sup>111</sup> Yet the same Shanghai Company Law Opinion conversely works to expand the scope of the Shanghai Courts' adjudicatory powers, for instance by setting forth extremely detailed instructions on judicial veil-piercing<sup>112</sup> and derivative actions,<sup>113</sup> neither of which had any legal basis in the 1994 statute or any subsequent Supreme People's Court pronouncement.<sup>114</sup> Finally, the Shanghai Opinion on the 1994 Company Law highlights important values which must be vindicated in application of the same Law.<sup>115</sup>

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<sup>111</sup> The Shanghai Company Law Opinion not only forbids outright acceptance of certain kinds of cases, but also contains direct warnings against the People's Courts acting too aggressively in the use of novel doctrines. Thus, while the Opinion offers very detailed instructions on how to undertake veil-piercing adjudication, it also cautions the Shanghai Courts about moving too aggressively in acting to disregard the corporate form and assert direct shareholder liability in creditors' suits to pierce the corporate veil.

<sup>112</sup> For example: "In veil-piercing cases, when determining shareholder liability, the People's Court must carefully discover the facts so that certain kinds of defects in shareholder behavior do not become the basis for the disregard of limited liability protection. Thus, in cases where companies are initially undercapitalized but shareholders have increased capitalization, or in respect of project companies where in the course of operations such companies have been subsequently capitalized in excess of their declared registered capital (by retained earnings from the project), then this subsequent capitalization must be understood as adequate capitalization at the relevant time; Or, in respect of inquiries regarding the looting of corporate assets, an evaluation must be made of the appropriate level of assets for the company; In addition, [it should be understood that] the transfer of equity to another shareholder, or the contribution of shareholder equity to another company, do not have any impact on the assets of the company (even where the transfer has not been registered); Finally, where in the course of litigation the corporate form is disregarded, that judicial characterization does not result in *de jure* elimination of the corporate form status or dissolution by operation of law, but is only a question relative to whether or not shareholders shall bear unlimited liability, which should be determined on a case by case basis." See *Shanghai Company Law Opinion*, *supra* note 7, at part I, § D, para. 3.

<sup>113</sup> For example: "... the plaintiff must be a current shareholder, and the defendants should be the relevant controlling shareholder, senior management person(s) or transaction parties which have undertaken the inappropriate or harmful action; once the derivative suit has been initiated, the People's Court must notify the company that it is involved in a lawsuit as a 'third party'; Second, the People's Courts must determine whether the company's interests have suffered real harm, whether or not the defendants have engaged in inappropriate behavior which has given rise to a serious imbalance in the parties' respective rights and obligations, whether or not there is a causal relationship between the defendant's inappropriate action and the harm suffered by the company, where there are a number of defendants sued for a collective transaction whether some of the named defendants acted in good faith, and whether or not the company is controlled by the allegedly wrongful actor to the extent that the company cannot bring the action itself; Third, when the parties raise a settlement proposal in the course of the litigation, and the People's Court determines that the proposed settlement will harm the interests of other shareholders or the company, then the settlement should not be approved and the litigation should continue. Fourth, once the plaintiff's pleadings are established, the People's Court may order the unwinding of offending transactions, and may award damages for the company to be paid by those who are adjudicated to have undertaken the inappropriate action and other parties involved in the relevant transactions; in addition, the People's Court may award appropriate compensation for the plaintiff shareholders to be paid by the company." See *Shanghai Company Law Opinion*, *supra* note 7, at part I, § E, para. 2.

<sup>114</sup> The only colorable basis for the derivative action was an "Approving Response" from the Supreme People's Court in the mid-1990s, responding to an urgent request from the Jiangsu Province Higher People's Court, entitled "With Respect to External Economic Contract Disputes Arising at Chinese-foreign Equity Joint Ventures, and the Foreign Party that Controls the Joint Venture has a Conflict of Interest with the [Technology] Seller, The

Local-level People's Courts in fact do more. One senior Shanghai Higher People's Court official acknowledged to me that the Shanghai People's Court system issues what the official loosely called "judicial explanations" (*sifa jieshi*), sometimes publicly, most often internally. Perhaps most interesting from an institutional perspective is the official's view that such local-level instructions, while normatively not as authoritative as Supreme People's Court Regulations, are in reality far more determinative in the actual handling of cases at the non-central (*e.g.*, Shanghai Municipal) level.<sup>116</sup> The same Higher People's Court judge also stated that such local-level documents are in many cases issued before the national-level Supreme People's Court instructions see the light of day, and thereby gain authority by virtue of their prior existence and the relative void in central instruction. The phenomenon described by the Shanghai official seems well-accepted in the PRC, where many judges, scholars and even lawyers point to the quality and technical accomplishment of some local-level, preemptively-issued, judicial explanations—such as the highly-regarded Jiangsu Province Higher People's Court "Provisional Opinion" on application of the Company Law of June 3, 2003.<sup>117</sup> Overall, the use of local-level Court "Opinions" or other instructions to expand the authority and asserted competence of a

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Chinese Party Should In Whose Name Bring Suit in the People's Courts". See GONGSIFA XINXING YINAN ANLI PANJIE 114 (Beijing Higher People's Court ed., 2007) [hereinafter NEW COMPANY LAW ISSUES]. As the perfectly descriptive title indicates, the Supreme People's Court allowed derivative actions in a very limited circumstance: where the foreign partner in a Chinese-foreign equity joint venture—while also a technology licensor (or "seller") to the joint venture—exercised control over the venture (through its majority registered capital interest and resulting chairmanship of the board and power over the corporate seal or "chop") and blocked the corporate legal person from suing the foreign partner *qua* technology provider for non- or deficient performance, then the Chinese partner could bring suit "in the name of" the venture itself. The author knows from personal experience that this Approving Response was applied in an extremely strict manner, and did not provide a basis for derivative actions where the non-performing partner *cum* vendor in the Chinese-foreign joint venture context was Chinese as opposed to foreign, much less in the context of any other kind of enterprise legal person establishment like a "company".

<sup>115</sup> For instance, the Shanghai Company Law Opinion nicely emphasizes the PRC's entirely appropriate preoccupation with shareholder oppression, most often at the hands of controlling shareholders, via explicit warnings against Court approval of pressurized "settlements" in derivative lawsuits. Here, the Shanghai Higher People's Court effortlessly understands the pernicious structural defect at work in the lop-sided capital structure of controlled Chinese corporations, the very defect which makes the derivative suit mechanism so necessary. See *supra* note 113, and the excerpted language from "Third, when the parties..."

<sup>116</sup> Judge A, Shanghai Higher People's Court (Oct. 2008) (notes on file with the author).

<sup>117</sup> For the text of the Jiangsu Opinion, see SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 240-48.

specific People's Court systems shows two things. First, it shows non-central consideration and instruction for corporate law adjudication every bit as rich as Supreme People's Court directions. Second, it demonstrates how local-level People's Court bureaucracies do not wait for Supreme People's Court judicial Regulations on many apparently non-justiciable items. These pronouncements, and their demonstrated effectiveness, in turn provide a useful barometer of the bureaucratic autonomy exercised by the Shanghai People's Courts as a bureaucratic agency, even before that agency's Courts move onto specific adjudicatory tasks.

A final category of non-central government origin instruction distributed by and inside the People's Court systems, usually internally, pertains to general adjudication tasks and not the application of a specific Law or regulatory system under Law. For example, during the worldwide financial crisis commencing in the second half of 2008, when many of China's export-oriented producers and suppliers located in the Shanghai-Yangtze River Delta area experienced extreme financial difficulties, the Shanghai Higher People's Court issued an eleven-point document entitled "Several Opinions on an Active Approach to Economic Development During the Financial Crisis." That document exhorted the Shanghai People's Courts to conform to national social policy, and exercise heightened sensitivity to the impact of decisions on distressed industries, allow reduction or elimination of litigation fees, protect the ability of distressed litigants to file their claims equally under law (*i.e.*, exempting them from litigation fees and deposits), and emphasize speedy adjudication of distressed enterprises labor rights and compensation cases, and enforcement proceedings. A very micro-level identity of the same kind of instruction was seen on December 2, 2008 when a single Intermediate People's Court, the Shanghai No. 1 Intermediate People's Court, issued *its own* complementary ten-point document explaining how it would conform to the policy commands enunciated by the Higher People's

Court's eleven-point plan, including unified and accelerated financial crisis-related case acceptance, hearing and enforcement, a sensitivity to the capacity of enterprises to bear enforcement actions or asset attachment, and attention to what case law opinions identify as one of the highest values in PRC corporate law adjudication: finding a way for distressed enterprises with any future potential to keep operating even if technically in default of specific obligations or insolvent.<sup>118</sup> In these lower-level, non-Law specific, People's Court system pronouncements, opinions and notices, the PRC judiciary's function as a unified bureaucracy-administrative agency is clearer—one easily contrasted with an autonomous court system which hears and decides on specific cases based on applicable law and in formal disregard of national or regional policy concerns.

These various species of bureaucratic instruction are critical in evaluating the relative institutional autonomy of the People's Courts in the PRC. The mere existence of local-level "Opinions" shaping adjudication of cases for which there is no statutory authority or Supreme People's Court Regulation demonstrates significant normative autonomy for such local-level institutions. In these circumstances, the local-level People's Courts are in effect declaring (within the Court system and not publicly) that they will proceed to adjudicate claims which lack the legal or bureaucratic "basis" that usually issues from superior bureaucratic institutions or is contained in "Law." Moreover, any indication of the actual acceptance and handling of cases by the People's Court in the absence, or in contravention, of Supreme People's Court Regulations is very strong evidence of judicial autonomy.

This high degree of autonomy is precisely what seems to be at work in the Shanghai People's Courts' Company Law adjudication before 2006 and, with important qualification, beyond. Just as in respect of the application of orthodox corporate fiduciary duties by the

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<sup>118</sup> See *Accelerated Hearings*, *supra* note 9.

Chinese courts nationally,<sup>119</sup> there is evidence that the Shanghai People's Courts accept and dispose of corporate law claims even when the Company Law provides no legal basis for such case disposition, and/or there is no Supreme People's Court Regulation addressing the issue.<sup>120</sup>

Before 2006 and with the absence of explicitly-named corporate fiduciary duties of care and loyalty in statute, much less standards for evaluation of such duties or business judgment rule protection, the Shanghai People's Courts proved able to accept and handle fiduciary duties claims and doctrine, both in divining and directing remedies for breach of corporate fiduciary duties generally<sup>121</sup> and competently explicating a fiduciary's duty of care.<sup>122</sup> In one pre-2005

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<sup>119</sup> See *Doctrine That Dared Not*, *supra* note 20.

<sup>120</sup> This evidence is confirmation of the implications offered by the Shanghai Company Law Opinion, which addresses, and counsels acceptance by the Shanghai People's Courts of, actions at a time where there was no *national* or Supreme People's Court-issued Regulations (for instance on derivative actions).

<sup>121</sup> The Shanghai Courts do this in many cases where there is also a breach of contract in evidence, which less autonomous judicial institutions might have happily relied upon before invoking more controversial notions of corporate fiduciary duties. For the application of corporate fiduciary duties before 2005, *see* Shanghai X. Elec. Co. v. Mr. A, et al. 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 114-17 (Shanghai No. 2 Interm. People's Ct., 2003), (showing that a Japanese director of a Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC-invested limited liability company because of Japanese partner's sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director's personal account without joint venture board approval or joint venture investor (shareholder) approval); Shanghai Jingfa Enter. Dev. Co. v. Shanghai Haining Petroleum Prod. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 299-309 (Shanghai No. 2 Interm. People's Ct., 2003), (showing that in shareholder deadlock case, director representing one shareholder's interest who extracts funds to fund that shareholder's (and corporate vehicle's) business activities is in breach of fiduciary duties, even before the Company Law provides for the same), *aff'd*, Shanghai Higher People's Ct. (2003); Shanghai A. Co. v. Wang X, SELECTED COMPANY LAW CASES 96-98 (Shanghai Hongkou District People's Ct., 1995), (showing a shareholder *cum* corporate director who acted in violation of a shareholders' agreement expressed in a shareholder's resolution acted (i) beyond his corporate-contractual scope of authority and (ii) in violation of the obligation under Article 59 of the 1994 Company Law of "directors, supervisory board members and general managers to abide by the company articles of association, and faithfully [or "loyally"] perform their functions", in amending corporate articles of association and using corporate funds to establish a subsidiary company in the same business), *settled*, Shanghai No. 2 Interm. People's Ct. (1996).

<sup>122</sup> As the (civil law tradition's) "cautious and diligent management" of entrusted assets. *See* Guangxi Xineng Sci. and Tech. Co. Ltd. v. Guotai Sec. Co. Ltd, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 211-12 (Shanghai Higher People's Ct., 2003), (showing an assets management contract case—not a *corporate* fiduciaries or trust case—but where contract standard is divined to include this duty of care standard, the same standard as that described by the Shanghai Higher People's Court in its *post*-January 2006 discussion of application of the corporate law), *aff'd*, Supreme People's Ct. (2003). *See also* Shanghai Jingfa Enter. Dev. Co., Enter. Dev. Co. v. Shanghai Haining Petroleum Prod. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 303 (Shanghai No. 2 Interm. People's Ct., 2003), (showing that in a shareholder deadlock case, director representing one shareholder's interest who extracts funds to fund that shareholder's (and corporate vehicle's) business activities is in breach of "shareholder's duty of loyalty, and duty of due care of a good manager (*shanliang guanli*) of, and cautious attention (*qinshen zhuyi*) to company's property and interests"), *aff'd*, Shanghai Higher People's Ct. (2003); SHANGHAI HIGHER PEOPLE'S

case<sup>123</sup> providing evidence of substantial autonomy, the Board Vice Chairman and Factory Operations Director of a factory transformed into a limited liability company in August 1997 formed three competing companies in March 1999, November 2000 and (after his resignation of all positions at the original company) May 2001. The limited liability company sued for breach of duty of loyalty pursuant to Article 61 of the 1994 Company Law,<sup>124</sup> and damages calculated based on the wayward director/officer's unjust enrichment (not the harm suffered by the company).<sup>125</sup> The Shanghai Nanshi District People's Court and an unidentified appeals-level Intermediate People's Court seemed completely unrestrained in handling the fiduciary duties claims all the way through to appeal.<sup>126</sup>

After the adoption of the 2006 Company Law and explicit inclusion of corporate fiduciary duties at Articles 148 and 149, the Shanghai Higher People's Court likewise seems perfectly able to describe fiduciary standards which are to be employed by Shanghai judges even in the absence of Supreme People's Court Regulations on the application of such doctrines.<sup>127</sup> Similarly, even before

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COURT 2006, *supra* note 7, at 4 (strengthening the duty of care and duty of loyalty imposed on directors, supervisors and senior management).

<sup>123</sup> Shanghai Shenmao Dianci Factory v. Wang Longbao, 2006 HU YI ZHONG MIN SAN (SHANG) ZAI ZHONG ZI NO.1, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui District People's Ct., 2004), *aff'd*, Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2004), *overruled by*, Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/sweb/>.

<sup>124</sup> 1994 Company Law, *supra* note 4, at art. 61 (expressing the non-competition thread of duty of loyalty: "The directors and manager may not engage in the same type of business as the company, whether for their own account or that of others, nor may they engage in activities which are harmful to the interests of the company.").

<sup>125</sup> *Id.* "If a director or the manager engages in [the same type of] business or activities [as the company], the revenue so obtained [by the director or manager] shall belong to the company."

<sup>126</sup> If rather badly in the technical sense. The two Court levels rejected the plaintiff company's claim because (i) the first and second competing company establishments were "never operational," and (ii) the third competing company establishment was started *three months* after the defendant left the employ and board of the plaintiff company, and thus (in the Courts' view) outside of the period when the defendant owed a duty to the plaintiff. Further, these Shanghai People's Courts incorrectly rejected (in theory only, because they have found no breach) the notion of unjust enrichment stipulated in 1994 Company Law Article 61 in favor of a more traditional remedy of damages suffered by the party towards which the duty is owed.

<sup>127</sup> The Shanghai Higher People's Court document goes a step further in divining substantive standards, or the beginnings of such standards, for application of fiduciary duties law when the Company Law is silent on just such standards: "In addition, [the amended Company Law] strengthens the duties of loyalty and care of directors, supervisory board members, and senior management personnel. The amended Company Law places great emphasis on the two above-described [sets of] duties for directors, supervisory board members and senior management

2005 the Shanghai Courts<sup>128</sup> were apparently long in the business of corporate veil-piercing,<sup>129</sup> autonomous action ratified by the local Shanghai-level Opinion of June 2003.<sup>130</sup> This specific area

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personnel.... stressing that directors and senior management personnel etc. must strictly abide by the principle of good faith (*yanshou chengxin yuanze*), must take as their point of departure [in decision-making] the interests of the company, and should perform their jobs cautiously and diligently.” SHANGHAI HIGHER PEOPLE’S COURT 2006, *supra* note 7, at 4. Some of this is taken from the CSRC’s elaboration of fiduciary duties standards in CSRC regulation and CSRC-promulgated Guidance Articles of Association for Listed Companies, but—as in that regulation and standard form material applicable to securities-issuing companies—fails to describe a risk-encouraging, business judgment rule-protected, duty of care. *See Doctrine That Dared Not*, *supra* note 20.

<sup>128</sup> With many other PRC People’s Court nationally, see GONGSI SHENPAN SHIWU YÜ DIANXING ANLI PINGXI 142-54 (Beijing No. 1 Intermediate People’s Court No. 4 Civil Division ed., 2005) [hereinafter ADJUDICATING COMPANY LAW CASES], and for Shanghai-based plaintiffs. For an example of a Shanghai plaintiff in a non-Shanghai People’s Court trying to pierce the corporate veil, *see* China East Airlines Co. Ltd. Xiamen Enter. Dep’t v. Xiamen Mun. Renshan Airlines Ticket Agency Co., XIN GONGSIFA ANLI PINGXI 65-88 (Wang Xiaochuan, ed., 2006) [hereinafter NEW COMPANY LAW CASES] (Xiamen People’s Cts., 2002). This is an especially egregious case, where the Xiamen People’s Court notes a whole series of share transfers and serial corporate establishments designed to avoid creditor obligations, as well as evidence of undercapitalization, bad faith, etc., and states that regardless of what statute allows, the defendant controlling shareholder simply cannot be allowed to injure the lawful rights of good faith creditors. Accordingly, and on the basis of “fairness, justice, and good faith” described in Article 4 of the General Principles of the Civil Law, the defendant controlling shareholder is adjudicated as having direct liability to corporate creditors. This use of Article 4 of the General Principles of the Civil Law is noted *infra* in the section describing the Shanghai People’s Court own equity court-style adjudication practices which seek to provide justice and fair outcomes for PRC corporate case litigants.

<sup>129</sup> *See* Fan Jinxing v. Fu Chenghua, 2004 MIN MIN ER (SHANG) ZAI CHU ZI NO. 5 (Minghang Dist. People’s Ct. (No. 2 Civ. Div.), 2004), (showing the corporate veil of guarantor pierced to investors who have falsified capitalization of guarantor) *available at* <http://www.hshfy.sh.cn/fyitw/sweb/>; Shanghai Sitong Power Equip. Co. v. Fujian Zhongli Real Estate, 2000 HU YI ZHONG JING CHU ZI NO. 163 (Shanghai No. 1 Interm. People’s Ct., 2000), (recognizing the possibility of piercing the corporate veil, but refuses to pierce to the Japanese natural person behind a debtor wholly foreign owned enterprise (“WFOE”), because the original loan contract is illegal and without effect, and the natural person defendant has no investment or equity in the corporate defendant), *available at* <http://www.lawyee.net>; Shanghai Bund City Real Estate Comprehensive Dev. Co. v. Zhu Haimao, 2006 HU ER ZHONG MIN SAN (SHANG) ZHONG ZI NO. 461 (Shanghai Jiading Dist. People’s Ct., 2004), (ruling on a December 18, 2003 corporate veil piercing by the Shanghai Hongkou District People’s Court (2002 HONG ZHI ZI NO. 3301) because shareholders of company in existence from 1995 to 2003 have either depleted capital or not fully capitalized it; that initial veil piercing in favor of creditor reversed by Intermediate People’s Court because of evidentiary questions about who is a shareholder, and whether the shareholders’ held themselves out as actually capitalizing the company), *reh’g granted*, Shanghai Jiading Dist. People’s Ct. (2005), *rev’d*, Shanghai No. 2 Interm. People’s Ct. (No. 3 Civ. Div.) (2006), *remanded to*, Shanghai Jiading Dist. People’s Ct. (2006), *appeal filed*, Shanghai No. 2 Interm. People’s Ct. (2006), *available at* <http://www.hshfy.sh.cn/fyitw/gweb/>; Shanghai Bonded Prod. Materials Mkt. China Commc’n Prod. Exch. Ctr. v. Shanghai Baoan Enter. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 278-86 (Shanghai Pudong New District Peoples Ct., 2003), (recognizing liability of former investors in joint operation (not corporate) guarantor) *aff’d* Shanghai No. 1 Interm. People’s Ct. (2003); Xishan City Chemical Prod. Mfg. Co. v. Shanghai Aoshi Enter. Co., NEW COMPANY LAW CASES 293-99 (an unidentified Shanghai Dist. People’s Ct., 2000), (permitting the creditor to pierce the corporate veil of a limited liability company to assess joint and several liability on several shareholders, including initial promoters who had fraudulently undercapitalized the company and their subsequent transferees, for overdue payment of RMB 3.0 million yuan, but liability of defendant shareholders to third party creditor is on appeal limited to the difference between actual capitalization and subscribed-for capitalization; in the case, even the state Audit Bureau that licensed the accounting firm which certified the original non-contributions has liability to the extent that the contributions from defendant shareholders are inadequate to satisfy awarded damage), *aff’d*, a Shanghai Interm. People’s Ct. (2000); Shanghai Guanghua Animal Feed Co. v. Shanghai Paer Gen. Co., 2000 HU ER ZHONG JING ZHONG ZI NO. 1209 (Shanghai Yangpu Dist. People’s Ct., 2000), (piercing corporate veil to assert liability of non-contract party because of

of autonomous action by the Shanghai People's Courts is definitively confirmed in a Shanghai Higher People's Court 2006 policy statement which praises the new Company Law's explicit addition of a corporate veil-piercing mechanism as statutory ratification of doctrine already "implemented for many years".<sup>131</sup>

There is also evidence that the Shanghai Courts applied the veil-piercing doctrine robustly. One 2000 case shows two levels of the Shanghai judiciary supporting a very aggressive corporate-veil piercing remedy, through to the shareholders at the time of suit but also to *former* shareholders who had some time before transferred their shares to good faith purchasers.<sup>132</sup> In a second case decided in 2003, the Shanghai Higher People's Court acted not only autonomously but with some political courage by allowing piercing on a sensitive land condemnation and relocation case through to a *government* department which controlled the hollow corporate form established to sign the condemnation compensation contract the plaintiff land occupiers wished to enforce.<sup>133</sup> Regardless of the Shanghai People's Courts' lack of technical competence, more noteworthy is how they acted without authorization in statute, without any instruction from the Supreme People's Court under formal Regulation, and without any other indication of the all-important "legal basis." The Shanghai Higher People's Court

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common Legal Representative and shared premises), *rev'd*, Shanghai No. 2 Interm. People's Ct. (2000), available at <http://www.lawyee.net/>.

<sup>130</sup> The Shanghai Company Law Opinion explicitly allowed Shanghai People's Courts to rule whether or not corporate investors were obligated to recapitalize companies when faced with claims from tort or contract creditors, or simply be deprived of limited liability protection (regardless of the corporate form established) with respect to such creditors. SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 9.

<sup>131</sup> *Id.* at 6-7.

<sup>132</sup> Those original shareholders were determined by the Courts to have acted fraudulently by falsely capitalizing (or not capitalizing) the company at the time of their initial investments. *See* Xishan City Chemical Prod. Mfg. Co. v. Shanghai Aoshi Enter. Co., NEW COMPANY LAW CASES 304 (discussing false capitalization and stating that, because the original shareholders engaged in false capitalization and "violated the principle of good faith (*chengxin yuanze*)," they should also be liable for the company's obligations).

<sup>133</sup> Shanghai Kangpaisi Enter. Gen. Co. v. Shanghai Municipal Admin. of Indus. and Com. Huangpu Dist. Branch, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 349-56 (Shanghai No. 2 Interm. People's Ct., 2001), *aff'd*, Shanghai Higher People's Ct. (2003).



ruefully recognizes this high degree of autonomy (and the prevalence of the abuse it was meant to check) when celebrating the 2006 Company Law veil-piercing mechanism:

Unfortunately China's 1994 Company Law did not include a veil-piercing mechanism. In reality, the abuse of corporate limited liability by shareholders, sham capital investment, looting of corporate assets, diversion of company profits, the use of enterprise corporatization to create empty shells, and harm to the interests of creditors, etc. occur regularly in China's economic life, and easily result in relatively large cases where losses could not be compensated. In many cases, and although approaching the problem in good faith, much of China's judiciary used, introduced and employed the principles and spirit of a veil piercing mechanism to disregard the corporate form [but] without any legal basis whatsoever.<sup>134</sup>

As noted by both the PRC State Council and the National People's Congress at the time of passage of the 2006 Company Law<sup>135</sup> and the Shanghai Higher People's Court in a 2006 policy statement<sup>136</sup> one of the major policy aims behind the amended Company Law of 2006 was enhanced protection of third party creditors. It should come as no surprise then that the Shanghai People's Courts continued to use the veil-piercing doctrine after January 1, 2006, only with the slightly stronger legal basis provided by a new statutory provision (albeit with continued lack of specific authorizing Regulations).<sup>137</sup>

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<sup>134</sup> SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 7.

<sup>135</sup> LAO *Company Law Explanation*, *supra* note 19.

<sup>136</sup> SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7.

<sup>137</sup> One example of veil-piercing from 2007 demonstrates this, and is incidentally another elaboration of political independence by the Shanghai People's Courts because the piercing reaches to a centrally-funded SOE in Beijing. See *Shanghai Huaxin Elec. Wire and Cable Co. v. China Tietong Group Co.*, 2007 HU GAO MIN ER (SHANG) ZHONG ZI NO. 145 (Shanghai No. 2 Interm. People's Ct. (No. 4 Civ. Div.), 2007) (RMB 32 million yuan creditor pierces to the Beijing-based SOE parent of a Shanghai limited liability company debtor where the parent has undercapitalized the debtor by RMB 38 million yuan, specifically upholding the assertion of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law), *aff'd*, Shanghai Higher People's Ct. (2007), available at <http://www.hshfy.sh.cn/fyitw/gweb/>. A second 2007 proceeding, a criminal prosecution, shows both the lower-level Shanghai People's Court and the Shanghai Higher People's Court on appeal engaging in classic corporate veil-piercing to fix criminal liability on an SOE cadre/manager guilty of diverting funds to a limited liability company established with his wife and several confederates, but operated and capitalized solely by the defendant cadre. See *PRC v. Xue Henghe*, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 447-52 (Shanghai Rail Transport Interm. People's Ct.), (diversion of assets from "enterprise department" subsidiary entity of SOE to defendant-dominated limited liability company is criminal diversion of state-owned assets by individual defendant), *aff'd*, Shanghai Higher People's Ct. (2007). In this case, it is perhaps somewhat disturbing how the People's Courts pierce the corporate veil without the benefit of Article 20 of the 2006 Company Law, and instead rely on the incoherent Article 4 of the 1994 Company Law, which *inter alia* provides that those who

It is also likely that the Shanghai People's Courts' allowed the equivalent of derivative lawsuits before the 2006 Company Law provided the explicit basis for such suits.<sup>138</sup> Only "likely" because there is ample evidence of such cases nationwide in the same period,<sup>139</sup> Shanghai judges proclaim their abundance,<sup>140</sup> and the Shanghai Company Law Opinion provides detailed application rules for such actions,<sup>141</sup> and yet there are only a few reported cases permitting derivative suits in Shanghai specifically before January 1, 2006.<sup>142</sup> In the period before that date, the existence of such cases once again demonstrates the autonomy of the PRC People's Courts because the acceptance and adjudication of such cases was not authorized in statute or by Supreme People's Court Regulation.<sup>143</sup> After adoption of the 2006 Company Law, the nationwide People's Courts continued to accept, or allowed the structuring of claims in

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capitalize corporate entities will enjoy profits, major decision-making power, and management rights in accordance with the proportion of their equity contribution.

<sup>138</sup> See *supra* note 114 and the description of the only thin basis for such litigation, an "Approving Response" from the Supreme People's Court in the mid-1990s, responding to an urgent request from the Jiangsu Province Higher People's Court, entitled "With Respect to External Economic Contract Disputes Arising at Chinese-foreign Equity Joint Ventures, and the Foreign Party that Controls the Joint Venture has a Conflict of Interest with the [Technology] Seller, the Chinese Party Should in Whose Name Bring Suit in the People's Courts," NEW COMPANY LAW ISSUES, *supra* note 114, at 114.

<sup>139</sup> See ADJUDICATING COMPANY LAW CASES, *supra* note 128, at 74-85 (derivative action by remaining directors against board chairman who refused to step down upon the termination of his term); *id.* at 172-83 (derivative action by foreign shareholder of Sino-German joint venture against Chinese partner which illegally occupied joint venture's property); *Doctrine That Dared Not*, *supra* note 20, at 237-42 ("Beijing Self-dealing Case"). Some of the cases noted may be Shanghai proceedings, although this collection of derivative suits does not identify the jurisdiction where the cases arise.

<sup>140</sup> Statements of Shanghai Higher People's Court judges at "Company Controversies and Judicial Remedies" Conference held at East China University of Politics and Law, Shanghai, PRC (Dec. 5, 2008) (notes on file with the author).

<sup>141</sup> See SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7.

<sup>142</sup> See, e.g., Shanghai Tap Water Co. v. Shanghai Huihuang Enter. Co., NEW COMPANY LAW ISSUES 111-16 (Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.), 1999), (two plaintiff shareholders can sue third defendant shareholder in limited liability company "in the name of" the limited liability company for non-perfected contribution of capital (land use rights) and misappropriation of corporate funds, even though defendant shareholder—through majority ownership, board chairmanship and appointment as company Legal Representative—seeks to block the limited liability company from acting as plaintiff against himself). This is a profound and interesting case, and would seem to indicate that the plaintiffs saw no remedy in suing on the "contract" which formed the limited liability company, because that would only provide a remedy for the non-perfected capital contribution claim, and not the corporate claim for misappropriation of corporate funds by the controlling shareholder defendant.

<sup>143</sup> Their existence also ties into the claims developed below regarding perceived common law and equity court-type adjudication, in that such cases see the implementation of a structural-procedural remedy supporting equitable justice and shareholders' claims against breaching fiduciaries, and thus a pathway to substantive remedies against opportunistic use of the company form. See *infra* notes 157 to 180 and accompanying text.

accordance with, the classical derivative action—only then, as in the case of veil-piercing, with explicit statutory authorization but the continued lack of Supreme Court Regulations (or in the case of Shanghai, pursuant to the conditions and remedies elaborated in the local-level Shanghai Company Law Opinion).<sup>144</sup>

Corporate fiduciary duties, veil-piercing and derivative suits are not the only areas where the Shanghai People's Courts exercised significant autonomy in the corporate law sphere. The data I reviewed shows that the People's Courts in Shanghai also worked in other similarly unauthorized areas, including: promoters liability,<sup>145</sup> judicially-directed dividend distributions,<sup>146</sup> ESOP-type “employee stock ownership meetings” (*zhigong chigu hui*) in Chinese corporate establishments,<sup>147</sup> and the contribution of human capital/personal services to corporate establishments as equity.<sup>148</sup>

Notwithstanding these real assertions of autonomy, the Shanghai People's Courts and the entire Chinese judiciary by their own judgment still have a long way to go in fully realizing the fruits of such tentative assertions of authority. The Shanghai Higher People's Court alludes to

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<sup>144</sup> This is the same for derivative suits in the People's Court nationally. *See, e.g.*, ANALYSIS OF NEW CASES, *supra* note 94 at 307-11 (Beijing case rejecting plaintiff's derivative action on the ground that plaintiff did not first make statutorily required demand on the board); *id.* at 329-33 (Beijing case permitting shareholder derivative action because the statutory demand requirement is excused); *id.* at 334-39 (Nanjing case holding there is “nothing improper” in a shareholder bringing action against the management to preserve his own shareholder rights).

<sup>145</sup> Before the PRC Company Law was amended to include specific provisions identifying such liability (2006 Company Law, *supra* note 5, art. 95). *See* Shanghai Yongqi Beauty and Hairdressing Ltd. v. Shanghai New Concepts Beauty and Hairdressing Ltd., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 265-69 (Shanghai Luwan Dist. People's Ct., 2003), (recognizing that a personal contract signed by promoter of company must be performed by subsequently-formed company especially where assets purchased under the contract are contributed into company as capital investment by individual), *appeal filed*, Shanghai No. 1 Interm. People's Ct. (2003).

<sup>146</sup> *See* Huang Ziyu v. Guan Feng, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 310-18 (Shanghai Pudong New Dist. People's Ct.), *aff'd*, Shanghai No. 1 Interm. People's Ct. (2003), discussed *infra* note 170; Co. A v. Co. B, SELECTED COMPANY LAW CASES 142-44 (Shanghai Huangpu Dist. People's Ct.), (holding for 25% shareholder who sues company under control of another minority shareholder for distribution of dividends per company Articles of Association), *aff'd*, Shanghai No. 1 Interm. People's Ct. (1997).

<sup>147</sup> Before a mechanism for the determination of direct stock ownership was defined (2006 Company Law, *supra* note 5, art. 33). *See* X. Fang v. Y. Info. Tech. Co., Ltd., 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 59-65 (Shanghai Yangpu Dist. People's Ct., 2005), (showing that ESOP provides employees only with dividends expectation, not “disposition” property rights with regard to the underlying stock).

<sup>148</sup> *See infra* notes 266 to 269 and accompanying text.

some of the other constraints at work in its evaluation of veil-piercing doctrine as applied in concrete adjudication tasks:

... China at the present time does not have specific or employable decision standards sufficient to [allow judges to] rule on disregard of the corporate form.... These standards must be based in a very high degree of freedom in adjudication given to judges in the course of their adjudication practice. What must be emphasized [here] is that—looking at China’s current environment—the conditions needed for determination of these standards are not yet ripe.<sup>149</sup>

A final barometer of this aspect of judicial autonomy—adjudication without Supreme People’s Court authorization or in contravention of what Supreme People’s Court Regulation permits—and specifically applicable to the period immediately after January 1, 2006, is the extent to which the Shanghai judiciary used the new Company Law and its expanded remedies on controversies where the underlying claims arose before the effective date of the new statute. This is relevant to consideration of the power of Supreme People’s Court authorization because the 1<sup>st</sup> Supreme People’s Court Regulations on the 2006 Company Law<sup>150</sup> were issued to direct the national People’s Courts on the appropriate handling of these straddling claims. The issue cannot be an easy one for the People’s Courts, as the 2006 Company Law contains not only substantive innovations (*e.g.*, fiduciary duty of care (*qinmian yiwu*)) but also procedural changes and associated remedies (*e.g.*, derivative actions). The Supreme People’s Court’s 1<sup>st</sup> Company Law Regulations addressing this question are somewhat opaque, and seem to leave the People’s Courts with a good deal of room to handle pre-2006 claims under post-January 1, 2006 norms. Certainly there is evidence of the Shanghai People’s Courts acting in accordance with a strict

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<sup>149</sup> SHANGHAI HIGHER PEOPLE’S COURT 2006, *supra* note 7, at 9-10. This lament echoes Frank Easterbrook of the U.S. 7<sup>th</sup> Circuit Court of Appeals writing about application of the same difficult doctrine and its negative effect on predictability: “Such an approach [Frederick J. Powell’s three-part test for veil piercing from 1931], requiring courts to balance many imponderables, all important, but none dispositive and frequently lacking a common metric to boot, is quite difficult to apply because it avoids formulating a real rule of decision. This keeps people in the dark about the legal consequences of their acts.” *Secor Serv. Sys., Inc. v. St. Joseph Bank & Trust Co.*, 855 F.2d 406, 414 (7th Cir. 1988).

<sup>150</sup> SPC COMPANY LAW REGULATIONS, *supra* note 94, at 3.

understanding of these bifurcated worlds. For instance, in 2006 the Shanghai Higher People's Court took a very firm line on this when it chastised the Shanghai No. 1 Intermediate People's Court for using 2006 Company Law provisions to adjudicate shareholders' rights of first refusal where the challenged transfer occurred before January 1, 2006.<sup>151</sup> That scolding from the Higher People's Court may have caused the No. 1 Intermediate People's Court itself to invoke the Supreme People's Court's 1<sup>st</sup> Regulations in another 2006 proceeding, where the Intermediate People's Court instructs the District level People's Court that dissident shareholders' challenges to allegedly defective shareholders' resolutions adopted before 2006 may only be construed under the 1994 Company Law.<sup>152</sup>

Notwithstanding these exhortations in individual cases, the Shanghai Higher People's Court's own data show something radically different, and in fact much more aggressive application of the 2006 Company Law to claims arising before January 1, 2006 and thus technically under the 1994 statute. In the Higher People's Court's consideration of Company Law adjudication in calendar year 2006,<sup>153</sup> the Court reports that for the 318 cases producing a judgment after a first hearing, 164 (51.57%) used the PRC Company Law in arriving at a judgment. In addition, of the 164 cases invoking the Company Law, 102 (62.20%) issued a final judgment on the basis of the 2006 Company Law while only 62 cases (37.80%) issued judgments using the pre-amendment 1994 Company Law. This was true even though fully 88.46% of the Company Law litigation arose from events and establishments that occurred *prior to January 1,*

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<sup>151</sup> Shanghai Huipu Zhiye Co. v. Ling Shuzhao, 2006 HU GAO MIN ER (SHANG) ZHONG ZI NO. 76, ANALYSIS OF NEW CASES 216 (Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.), 2005), (recognizing that transfer of shares in limited liability company still valid, and must be fully performed, and is not invalidated because non-selling shareholder's did not exercise rights of first refusal, or because of a separate (Tianjin) People's Court judgment blocking sale), *aff'd*, Shanghai Higher People's Ct. (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/gweb/>.

<sup>152</sup> Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 185 (Shanghai No. 1 Interm. People's Ct., 2006).

<sup>153</sup> *Shanghai Company Law Report*, *supra* note 8, at 37-51.

2006. This variance (only 21% of claims arose after 2006, yet 62% of the judgments use the post-2006 Company Law to arrive at a decision) provides a strong indication that the Shanghai People's Courts felt relatively unconstrained in aggressively implementing the new Company Law. This is an indication confirmed rhetorically in the same report by the Shanghai Higher People's Court, when the Court proudly alludes to one case where it applied the expanded legal rights bestowed in the 2006 Company Law, even though the subject claim arose before January 1, 2006 when only the much narrower rights granted in the 1994 law were available.<sup>154</sup>

There is one blemish in the otherwise rosy picture of increased autonomy sketched out above, and it arises in the post-January 1, 2006 world of corporate law adjudication. That blemish is identifiable because of the relative lack of certain kinds of cases in the Shanghai Courts after 2006 discussed *infra*,<sup>155</sup> and noted in an unreleased report commissioned by the Supreme People's Court on implementation of the new Company Law. It appears that even with a proper legal basis for claims under the corporate law, the People's Courts are in some cases bending over backwards not to accept or adjudicate such claims—even though they heard the same cases in prior years when there was no legal basis.<sup>156</sup> If this is true, and it is difficult to

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<sup>154</sup> The example the Court uses is the enforcement of broader information rights for shareholders against recalcitrant corporate insiders, even though such insiders were only bound to provide—and in fact did provide—the narrower scope of information under the 1994 Company Law. *Shanghai Company Law Report*, *supra* note 8, at 39.

<sup>155</sup> And distinct from the forbearance or instructed rejection of public company-companies limited by shares cases also discussed *infra*, such as the avoidance of corporate fiduciary duties claims.

<sup>156</sup> See Zhu Ciyun, Professor of Law, Tsinghua Univ. Law Sch., Remarks at East China University of Politics and Law Symposium: Corporate Law Forum 2008, Disregard of the Corporation and Liability to Third Parties in China's Corporate Law from a Corporate Governance Perspective, (Nov. 3, 2008) (on file with author) (citing an internal Supreme People's Court study contracted to law academics which indicated that China's People's Courts have shied away from accepting veil-piercing and derivative lawsuits after those same mechanisms were formally established in the 2006 Company Law, at least in comparison to the pre-January 1, 2006 period, when there was no "legal basis" for accepting such cases). One possible example of this dynamic is a case straddling 2004-06, *Shanghai Bund City Real Estate Comprehensive Dev. Co. v. Zhu Haimao*, 2006 HU ER ZHONG MIN SAN (SHANG) ZHONG ZI No. 461 (Shanghai No. 2 Interm. People's Ct., 2006), available at <http://www.hshfy.sh.cn/fyitw/gweb/>. In that case, an initial ruling by the Shanghai Hongkou District People's Court from March 2003 permitting corporate veil piercing is reversed by the Intermediate People's Court after January 1, 2006 because of highly technical evidentiary questions about who is and is not a shareholder, and whether the defendant shareholders held themselves out as actually capitalizing the company.

prove in the Shanghai survey with respect to case *acceptances* because it requires proof of a negative, then it appears that the expansion of legal bases for litigation in the 2006 Company Law may have created the possibly unintended consequence of further constraining People's Court action, but largely in the way of *self*-constraints (because no superior governmental body has issued instruction commanding non-acceptance of cases where there is now a legal basis).

B. *The People's Courts Act in "Equity" or in a Common Law Fashion*

A second demonstration of autonomy may be seen in the way Shanghai Courts act entirely on their own to develop law and procedure and create remedies in the interest of what they call "fairness," "rationality," "appropriateness," or to punish the breach of (commercial) "good faith." Thus, the Shanghai People's Courts act with creativity and power to affirm equitable procedures and legal claims to serve "justice," stretch the application of law (again to provide "justice"), dismiss form to privilege function, "make law" based upon their autonomous conception of who or what the statutory framework is designed to serve, devise non-statutory legal standards for application of corporate law doctrine, and create remedies out of whole cloth. When adjudicating in this way, the Shanghai People's Courts most often invoke the all-purpose (commercial) "good faith" provision in Article 4<sup>157</sup> of the 1986 General Principles of Civil Law (*minfa tongze*) ("GPCL")<sup>158</sup> as the broad basis for equitable resolution of corporate and property rights cases.<sup>159</sup> This posture is daring in the PRC, as Article 4 of the relatively outmoded GPCL

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<sup>157</sup> This is the Roman Law concept of commercial "good faith" translated from reformed German Law of the late nineteenth century (the *Bürgerliches Gesetzbuch* ("BGB")), to Japanese law at the start of the twentieth century (when Meiji Japan translated the *BGB* word for word and called it the Meiji Commercial Code), and then to Chinese law in the 1930s during Guomindang rule.

<sup>158</sup> CLC, *supra* note 5, at 1-111 – 1-123.

<sup>159</sup> For an invocation of the broad civil law "good faith and fair dealing" basis in Article 4 of the General Principles of Civil Law by the Shanghai People's Courts in deciding corporate law cases, see Shanghai Guanghua Animal Feed Co. v. Shanghai Paer Gen. Co., 2000 HU ER ZHONG JING ZHONG ZI NO. 1209 (Shanghai No. 2 Interm. People's Ct., 2000), (piercing corporate veil to make liable non-contract party sharing common Legal Representative and shared premises, on the basis of "good faith and fair dealing" (*chengshi xinyong*) and "principles of fairness and

is extremely commodious, and the GPCL is not the purpose-built statute anointed to govern corporate law matters.<sup>160</sup> Invocation of the GPCL and its Article 4 may be seen in two aggressive veil-piercing cases from 2000 and 2003. One has already been described above in the section on veil-piercing without statutory or Regulatory authorization, where liability is enforced not only against the ultimate shareholders at the time of suit, but also the original transferors to those defendants.<sup>161</sup> As the written opinion by the lower-level Pudong New District People's Court in the other, 2003, case makes clear, this far-reaching assignment of liability is justified because the transferring equity holders had depleted the capital of the direct guarantor, and had not in the first place made their full capital contributions to the guarantor but disposed of their equity interests to good faith purchasers under the false impression that the shares were fully-capitalized, and most critically:

... from the standpoint of principles of fairness (*gongping yuanze*), even though there was an agreement that liabilities [of the guarantor] would be transferred along with transfer of equity [in the guarantor], as the original shareholders who had not fully contributed their [subscribed for] capital to the guarantor, those [original shareholders] cannot because of the transfer of that defective equity be completely exempt from their responsibilities to [the guarantor entity]; thus,

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rationality" (*gongping heli de yuanze*)), available at <http://www.lawyee.net>; Shanghai Jingan Food & Beverage Serv. Co. v. Shanghai Foreign Econ. Serv. Co., SELECTED COMPANY LAW CASES 86-93 (Shanghai Jingan Dist. People's Ct., 1999), (court of first instance only, broad General Principles of Civil Law view cut back completely on appeal by Shanghai No. 2 Intermediate People's Court), *rev'd*, Shanghai No. 2 Intern. People's Ct. (2000); and for a veil-piercing case which arises not in the Shanghai People's Courts, but involves a very important Shanghai plaintiff, see China East. Airlines Co. Ltd. Xiamen Enter. Dep't v. Xiamen Mun. Renshan Airlines Ticket Agency Co., NEW COMPANY LAW CASES 65-68 (Xiamen People's Cts., 2002), (holding, on the basis of Article 4 of the General Principles of the Civil Law, the defendant controlling shareholder has liability to corporate creditors). Note this is a different basis for the provision in the GPCL used as the source for claims in tort—"rights" or "property" infringement.

<sup>160</sup> The GPCL was in fact promulgated almost a decade before the PRC's first Company Law.

<sup>161</sup> See Xishan City Chemical Prod. Mfg. Co. v. Shanghai Aoshi Enter. Co., NEW COMPANY LAW CASES 293-99 (Shanghai Dist. People's Ct., 2000), (trade creditor pierces corporate veil of limited liability company to assess joint and several liability of several shareholders, including initial promoters who have fraudulently undercapitalized the company and their subsequent transferees, for trade payable of RMB 2.9 million yuan, but liability of defendant shareholders to third party creditor is on appeal limited to difference between actual capitalization and subscribed-for capitalization; in this case, even the state Audit Bureau which licenses the accounting firm that certified the original non-contributions has contribution liability), *aff'd*, Intern. People's Ct. (2000). See also Shanghai Bonded Prod. Materials Mkt. China Commc'n Prod. Exch. Ctr. v. Shanghai Baoan Enter. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 278-86 (Shanghai Pudong New Dist. Peoples Ct.), *aff'd* Shanghai No. 1 Intern. People's Ct. (2003).



where the transferee shareholders cannot meet the obligations of the [guarantor] company, then these two [original] shareholders still have liability to make up the guaranty obligations.<sup>162</sup>

This application of law can be derided as bad, or incompetent,<sup>163</sup> but it is nonetheless an impressive demonstration of one basic level Shanghai People's Court over-riding corporate and contract law norms to serve "the principles of fairness." The same orientation can be seen in another 2003 case where the Shanghai No. 2 Intermediate People's Court—with no basis in Law or judicial Regulation—ordered the "put" of equity by complaining shareholders back to company promoters who acted opportunistically and possibly fraudulently.<sup>164</sup> As that Court said in evaluating the plaintiff shareholders' suit for relief (and the ordered put), the put proposal is "fair, rational and feasible" (*gongping, heli he kexing*).<sup>165</sup> In a 2006 example straddling the effectiveness of the 1994 and 2006 Company Laws, the Shanghai No. 1 Intermediate People's Court wrote forthrightly that, in addition to what the statute commands, the court must also consider the "appropriateness" (*zhengdangxing*) and "rationality" (*helixing*) of a remedy as significant as dissolution.<sup>166</sup>

As discussed above, the Shanghai Courts use creative adjudication to fashion justice-delivering procedural remedies in the form of derivative lawsuits, which were implemented

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<sup>162</sup> Shanghai Bonded Prod. Materials Mkt. China Comm'n Prod. Exch. Ctr. v. Shanghai Baoan Enter. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 282 (Shanghai Pudong New District Peoples Ct., 2003), (recognizing liability of former investors in joint operation (not corporate) guarantor) *aff'd* Shanghai No. 1 Interm. People's Ct. (2003).

<sup>163</sup> Construed correctly under contract law principles, the transferee shareholders have a right in contract against the transferor shareholders, but only after paying out the guarantee made by the legal person guarantor they are invested in.

<sup>164</sup> Shanghai Jingfa Enter. Dev. Co. v. Shanghai Haining Petroleum Prod. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 299-309 (Shanghai No. 2 Interm. People's Ct., 2003), (holding court-ordered buyout of complaining shareholders is the "only remedy" and an "appropriate request" (on the part of plaintiffs) in light of shareholder deadlock and the failure of private ordering), *aff'd*, Shanghai Higher People's Ct. (2003).

<sup>165</sup> *Id.* at 304.

<sup>166</sup> Addressed below in the discussion of *lack of autonomy* (identified deference to national economic and social policy): Tang Chunxiao v. Zhou Huizhong, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 143 (Shanghai No.1 Interm. People's Ct., 2006), (rejecting the plaintiff's request for the dissolution of the corporation).

without statutory or bureaucratic authorization.<sup>167</sup> Equally indicative is the way the Shanghai People's Courts make frequent use of equitable principles to skillfully invoke "fairness" and privilege function over form.<sup>168</sup> See how the Shanghai Courts handle the prickly question of judicially-directed profit distributions in flat contravention of statute (before 2006), contract or conforming resolution where (i) the company is taken hostage by one shareholder-director,<sup>169</sup> and (ii) even where the oppressed plaintiff has not properly contracted for the privilege or taken up its statutory rights.<sup>170</sup> For an example of the latter situation, in 2003 the Pudong New District People's Court and the Shanghai No. 1 Intermediate People's Court ordered the distribution of dividends to a former shareholder who had not contracted for profits or managed to convene a shareholders' meeting to authorize such distribution. Three significant obstacles would seem to

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<sup>167</sup> See *supra* notes 138 to 144 and accompanying text.

<sup>168</sup> See, e.g., Tang Chunxiao v. Zhou Huizhong, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 138-44 (Shanghai No.1 Interm. People's Ct., 2006) (ruling against plaintiff because of something akin to "unclean hands"); Shang A. v. Lü B., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 107-09 (unidentified Shanghai Interm. People's Ct., 2006), (holding that plaintiff, widow of original named capital provider in "equity cooperative" (*gufen hezuo*) entity, who becomes a hidden shareholder (*i.e.*, one whose interest is held in the defendant's name) in post-transformation limited liability company has the right to be listed as a named shareholder on the shareholder register of the post-transformation company, and vote at shareholders' meetings, etc., because this is the "fairest" way to handle the problem), *appeal dismissed*, Shanghai Changning Dist. People's Ct. (2006); Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 184, (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (reading into the Company Law a notice period which starts from the "receipt" of notice by shareholders, and not "distribution" of notice by parties convening the meeting); Shanghai Shenmao Dianci Factory v. Wang Longbao, 2006 HU YI ZHONG MIN SAN (SHANG) ZAI ZHONG ZI NO.1, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui District People's Ct., 2004), *aff'd*, Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2004), (Intermediate People's Court *first* (before over-ruling itself) sees forced buy-out of stock in "non-profit" stock cooperative upon plaintiff's leaving employ a breach of good faith and fair dealing, even though consistent with regulation and the Articles of Association), *overruled by*, Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/sweb/>.

<sup>169</sup> See Co. A v. Co. B, SELECTED COMPANY LAW CASES 142-44 (Shanghai Nanshi Dist. People's Ct., 1997), (25% shareholder sues company under control of another minority shareholder for distribution of dividends from distributable profits per company Articles of Association, but not distributed because control party wants to redirect earnings to cash-poor beer plant asset), *aff'd*, Shanghai No. 1 Interm. People's Ct. (1997). But note *contra* and more conservative approach in Guo Chaoxu v. Shanghai Saiyang Textile Sci. & Tech. Co., SELECTED COMPANY LAW CASES 260-65 (Shanghai No. 2 Interm. People's Ct., 2000), (refusing to order dividends distribution to 20% equity holder because, per the 1994 Company Law, this is a matter for a resolution of the shareholders' meeting,—at which the 80% shareholder is assured to vote against dividend distribution,—and such shareholders' resolutions can only be challenged in court where they are "in breach of law or administrative regulation, or infringe upon the lawful rights of shareholders").

<sup>170</sup> See Huang Ziyu v. Guan Feng, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 312 (Shanghai No. 1 Interm. People's Ct., 2003), (judicially-directed profit distribution, even though there was no specific stock transfer agreement between plaintiff and defendant, because a stock transfer agreement nevertheless deemed to exist as the parties made their intention clear in a shareholder resolution).

have blocked such judicially-commanded dividend distributions: formal adherence to the 1994 Company Law made unavailable such distribution (because no shareholders' meeting was convened), the complaining shareholder should have ensured his rights by contract, and the People's Court did not at that time have the statutory power to direct such dividend distributions.<sup>171</sup> Notwithstanding these recognized obstacles, and in the interest of vindicating the implied profit expectation making up a part of the shareholder's bundle of property rights, the two Courts deemed that expectation triumphant over a more formalistic approach to the problem. In effect, these two Courts said that the status of shareholder in the corporation trumps the exercise of specific shareholders' rights granted in statute or agreed in contract.<sup>172</sup>

The Shanghai judiciary also uses equity court or even common law-like reasoning to "make law." One 2006 example<sup>173</sup> shows the Shanghai No. 1 Intermediate People's Court using a sophisticated rationale to determine the date upon which a shareholder notice response period should start—from "receipt" and not "distribution" of the notice. The Court reasons that because the point of notice is actual notification to shareholders so they can exercise their statutory rights and the Court must take into consideration the differences in physical location of shareholders, the Company Law notice provision, as written, must be interpreted so as to advantage shareholders or at least not injure them.<sup>174</sup>

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<sup>171</sup> A power explicitly gained in the 2006 Company Law, *supra* note 5, at art. 75(1).

<sup>172</sup> The Shanghai Higher People's Court, in its commentary on the case, distinguishes between the "abstract" right to dividend distributions, and the "specific" right to the same—saying that the former triumphs over the latter in a situation where the corporate form itself acts to frustrate the ability to exercise the abstract right. *Huang Ziyu v. Guan Feng*, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 316 (Shanghai No. 1 Interm. People's Ct., 2003).

<sup>173</sup> See *Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd.*, ANALYSIS OF NEW CASES 187, (Shanghai Changning Dist. People's Ct. and Shanghai No. 1 Interm. People's Ct., 2006). Sadly, this judicial elaboration of the bald corporate law statute invalidates a special meeting and the entire lawsuit of a dissident shareholder group against a controlling shareholder/Legal Representative who has already been proven in breach of law and his corporate fiduciary duties.

<sup>174</sup> The Shanghai Court system has separately read into the Company Law a 30 day exercise (response) period for limited liability company shareholders' exercise of a right of first refusal on a notified and approved transfer, and a one year statute of limitations on un-notified transfers (from registration of the transfer). Nowhere do

The People's Courts in Shanghai also are adept at fashioning legal standards for application of the Company Law. For instance, with regard to implementation of new Article 183 (shareholders' dissolution suits) in the 2006 Company Law, the Shanghai Higher People's Court announced its own judicially-developed standards, or clarification as to what functions as a trigger for a viable dissolution claim ("no other remedies available" is valid, mere "injury to [plaintiff] shareholders" is not).<sup>175</sup> More autonomously, the Shanghai Higher People's Court confirmed doctrinal importations which do not appear anywhere in the statute, such as the standard which holds that the Courts will only dissolve companies pursuant to shareholder application when the board and shareholders' meeting are no longer able to function in overseeing operations or agree corporate resolutions.<sup>176</sup> A similar style of elaboration is at work when the Shanghai People's Courts overreach to apply legal standards slightly beyond what the Law allows—for instance in examining a challenged shareholders' resolution not only against Article 111 of the 1994 Company Law<sup>177</sup> but in light of whether the suspect resolution might implicate the more generalized "deprivation of [shareholders'] rights."<sup>178</sup>

The Shanghai Courts also fashion non-statutory remedies. For example, although Articles 200 and 201 of the 2006 Company Law provide a legal basis for the levy of fines on investors who do not capitalize a limited liability company or fully pay-up their shares, the 2006

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these provisions appear in the 2006 Company Law, but are instead entirely "judge-made" and apparently necessary because of the imperatives of "commercial transaction efficiency and the stability of legal relationships". *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 42.

<sup>175</sup> *Id.* at 45.

<sup>176</sup> This is one area that received specific doctrinal elaboration subsequently in the 2<sup>nd</sup> Judicial Regulations on the new Company Law issued in May of 2008. See SPC COMPANY LAW REGULATIONS, *supra* note 94, at 7-11 (these 2<sup>nd</sup> Regulations issued by the Supreme People's Court address how the judiciary should handle People's Court-directed firm dissolution, including the circumstances under which the People's Courts should hear such cases, and the procedures for the settlement of liabilities and assets of the dissolved corporation).

<sup>177</sup> Under the statute, only invalid if violative of a law, an administrative regulation or the Articles of Association.

<sup>178</sup> *Guo Chaoxu v. Shanghai Saiyang Textile Sci. & Tech. Co.*, 2000 HU ER ZHONG JING ZHONG ZI NO. 280, SELECTED COMPANY LAW CASES 260-65 (Shanghai Hongkou People's Dist. Ct., 1999), *aff'd*, Shanghai No. 2 Interm. People's Ct., (2000) (applying a standard which goes to "deprivation of shareholders' rights), *also available at* <http://www.lawyee.net/>.

Company Law does not provide a civil remedy for such breaches (particularly for third parties dealing with the investee company at arms-length). Accordingly, in 2006 the Shanghai People's Courts allowed such a breach of funding obligations to support a third party creditor's claim to pierce the corporate veil, and assessed joint and several responsibility for the liabilities of the company against the defaulting investor-shareholders. Similarly, Article 31 of the 2006 Company Law addresses only the joint and several liability of other shareholders to replenish in the event that a single shareholder's *in-kind* contributions are deficient or initially overvalued. Noting that the same problem can occur when a *cash*-contributing investor does not make its contributions in a timely way, the Shanghai People's Courts extended the joint and several liability of the other shareholders to replenish. The People's Courts of Shanghai also fashioned their own tough remedies for successful derivative actions, proclaiming the power to void challenged transactions or assess damages for the company against persons adjudicated to have acted improperly (the directors and officers pleaded as defendants in the derivative action) and even other persons involved in the same transactions.<sup>179</sup>

A final example in this line shows the almost passive-aggressive autonomy of Shanghai judicial officers on remedies issues, in which they are forced to decide a case in a highly formalistic manner, but instead openly push the litigants into re-pleading and in the direction of better alternative remedies. In a 2006 judicial dissolution case, the Xuhui District People's Court refused to order dissolution of a limited liability company, and further refused to consider *sua sponte* evident breaches of corporate fiduciary duties in the same case. The District People's Court then happily proceeded to remind the plaintiffs they can and should avail themselves of *other remedies*. As the Court said:

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<sup>179</sup> *Shanghai Higher People's Court No. 2 Civil Division 2007, supra note 8, at 45.*

... in addition, with respect to the seven plaintiffs' belief that the three defendants have engaged in inappropriate behavior, [plaintiffs] are completely able to protect their lawful rights through the exercise of the shareholders' rights bestowed upon them, such as information rights, compensation rights, etc.<sup>180</sup>

C. *The De Facto Partnership Problem and Autonomous Application of Substantive Law*

A third major demonstration of autonomy in Company Law adjudication is the highly expert application of law and non-statutory legal principles that are sourced in common law-like considerations, and that seemingly contradict formal substantive law. Between 1992 and 2008, this phenomenon is exemplified by both negative and affirmative action from the Shanghai People's Courts. In this period, they show a stubborn and correct *refusal* to apply substantive *corporate* law to entities established under the embrace of the Company Law but really organized as *partnerships* (or what Western business association law and doctrine distinguish as "close corporations"), and instead apply—seemingly out of thin air—universal *partnership* law principles to what are formally called corporations.<sup>181</sup>

A large amount of investment and commercial activity undertaken even in Reform-era China is through arrangements and vehicles that are neither corporate nor have anything much to do with the PRC Company Law, of whatever vintage.<sup>182</sup> Although purely domestic investment and capital aggregation has exploded in China over the past 15 years, much of that is based in contract (and often not even contract *law*), such as "agreements" (*xieyi*), "joint operation" (*lianying*), "cooperative (*hezuo*)" or non-legal person "partnership" (*hehuo*)" arrangements.

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<sup>180</sup> See Yang Lizhi et al. v. Cao Chengjie et al., 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 208, ANALYSIS OF NEW CASES 359 (Xuhui District People's Ct., 2006), (holding that "compensation rights" (*peichangquan*) can include remedies for breach of corporate fiduciary duties).

<sup>181</sup> This is merely one aspect of the very difficult hand dealt to the PRC People's Courts in the so-called corporate law cases, which includes the inability to apply the Company Law to large-scale companies limited by shares with a diffuse shareholder base (the whole reason for amendment of the Company Law). See discussion *infra* notes 308 to 356 and accompanying text.

<sup>182</sup> See Donald C. Clarke, *How Do We Know When an Enterprise Exists? Unanswerable Questions and Legal Polycentricity in China*, 19 COLUM. J. ASIAN L. 53, 61 (2005-06) (stating "there can be no doubt that courts and government agencies in China do grant *de facto* recognition to business organizations and other entities that have no solid statutory basis.").

Even when something resembling a business organization is established, and even if formal “enterprise legal person” status is conferred on the entity by registration with the appropriate bureau of the State Administration of Industry and Commerce, the resulting firm often has no legal basis in the PRC Company Law, the various foreign-invested enterprise (“FIE”) statutes and implementing regulations promulgated since the late 1970s, or the “Regulations of the PRC on Administration of Company Registration.”<sup>183</sup> Indeed, the enterprise legal person landscape in China today is populated by an unusual collection of business forms. Sometimes these entities have a prior legal basis, as is the case with “collectively-owned enterprises.” Sometimes they have a precarious legal basis, such as the entities based on local government-promulgated “limited partnership” statutes pre-dating and/or at variance with the PRC Partnership Enterprise Law. And often they have no legal basis whatsoever, as is the case for the “stock cooperative” (*gufen hezuo*) form,<sup>184</sup> “domestic equity limited liability joint venture companies” (*guonei hezi*

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<sup>183</sup> Promulgated by the PRC State Council on June 24, 1994, and amended by the State Council on December 18, 2005. These are not just enterprises formed under the 1986 “Law of the PRC on Industrial Enterprises Owned by All of the People” (widely known as the PRC’s “State-owned Enterprise Law,” adopted by the 1st Session of the Seventh National People’s Congress on April 13, 1988, and effective as of August 1, 1988), the 2000 “Law of the PRC on Individual Proprietorships” (adopted at the 11th Meeting of the Standing Committee of the Ninth National People’s Congress on August 30, 1999 and effective as of January 1, 2000), or the 1997 “Law of the PRC on Township Enterprises” (meant to replace a separate law and a good deal of regulations on so-called “collectively-owned enterprises” (*jiti suoyouzhiquye*), adopted at the 22nd Meeting of the Standing Committee of the Eighth National People’s Congress on October 29, 1996 and effective as of January 1, 1997). For the presence of a collective in the sample, see *Shanghai Jinzhu Agric. Trade & Commerce Co. v. Shanghai Weisirui Co.*, NEW COMPANY LAW ISSUES 279-82 (Shanghai No. 1 Interm. People’s Ct., 2000), (adjudicating a dispute over a purported equity transfer agreement with respect to interests in a “factory” converted into a collectively-owned enterprise).

<sup>184</sup> Alluded to by the Shanghai Higher People’s Court in its Company Law Opinion, SHANGHAI HIGHER PEOPLE’S COURT 2006, *supra* note 7, at 231-36, and discussed in several cases in the sample. For a post-2006 example, see *Shanghai Shenmao Dianci Factory v. Wang Longbao*, 2006 HU YI ZHONG MIN SAN (SHANG) ZAI ZHONG ZI NO.1, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui District People’s Ct., 2004), (forced buy-out of stock in “non-profit” stock cooperative upon Vice Chairman’s leaving employ pursuant to board regulations, shareholders’ resolution and Articles of Association not a violation of shareholders’ rights), *aff’d*, Shanghai No. 1 Interm. People’s Ct. (No. 3 Civ. Div.) (2004), *overruled by*, Shanghai No. 1 Interm. People’s Ct. (No. 3 Civ. Div.) (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/sweb/>, where the Court cites not the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry-level Commission on the Restructuring of the Economic System (“CRES”) and Shanghai “Provisional Measures” on stock cooperatives and collectives.

*youxian zeren gongsi*),<sup>185</sup> the “private single shareholder enterprise” (*siying duzi qiye*),<sup>186</sup> or the “enterprise groups” (*jitian*), which may or may not have independent legal personality or ownership of formal equity in their so-called “subsidiaries.” China has the additional problem of a very large number of corporate forms set up not by commercial actors, investors, or shareholders, but directly by government departments—not just the “wholly state owned company” *genus* of the limited liability company permitted under the 1994 and 2006 Company Laws,<sup>187</sup> but also direct establishments by very local-level governments.<sup>188</sup> Chinese opinion-writing judges and PRC scholars refer to all of these business association forms, both those formed by informal contract and those holdovers from the completely state-owned and controlled economy, as “issues left [to us] from history.” However, they are not merely of historical import; they are encountered constantly in modern-day corporate law and commercial disputes, and very often where informal or state-tied investment arrangements have ripened into a corporate or enterprise legal person establishments and been registered as such.

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<sup>185</sup> Alluded to in one Shanghai opinion reviewed by the Supreme People’s Court, *see* Zhang Qingzhao v. Zhang Wenhui, 55:1 RENMIN FAYUAN ANLI XUAN 234-41, 235 (Supreme People’s Court China Practical Jurisprudence Research Institute, ed., 2006) [hereinafter SUPREME PEOPLE’S COURT REPORTS] (Shanghai Baoshan Dist. People’s Ct., 2002), *aff’d* Shanghai No. 2 Interm. People’s Ct., 2004, another from 2000 by the Shanghai Higher People’s Court, Zhu Liqun v. Hong Bangyao, NEW COMPANY LAW ISSUES 194 (Shanghai Changning Dist. People’s Ct., 2000), *aff’d* unidentified Shanghai Interm. People’s Ct., (2000), and a 2008 case Ding Guangjian v. Yan Haibo, HU GAO MIN YI (MIN) ZHONG ZI NO. 49 (Shanghai Higher People’s Ct., No. 1 Civ. Div., 2008), available at <http://www.hshfy.sh.cn>. The reference is usually to a limited liability company with only PRC investors, and thus not a limited liability company with foreign investment (which would make the entity subject to the PRC’s FIE laws), but how one wishes the Courts would simply refer to “Chinese capital limited liability companies” (*zhongzi youxian zeren gongsi*) without introducing the FIE joint venture term of art “joint venture” (*hezi*).

<sup>186</sup> Referred to, and deemed subject to registration, by the Shanghai Higher People’s Court in Shanghai Huayuan Real Estate Dev. Co. v. Shanghai Shenji Food & Beverage Enter. Mgmt. Co., NEW COMPANY LAW ISSUES 152 (Shanghai Higher People’s Ct., No. 2 Civ. Div., 2002).

<sup>187</sup> *See* 1994 Company Law, *supra* note 4, at arts. 64-72; 2006 Company Law, *supra* note 5, at arts. 65-71.

<sup>188</sup> *See* Shanghai Kangpaisi Enter. Gen. Co. v. Shanghai Mun. Admin. of Indus. & Commerce Huangpu Dist. Branch, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 49-56 (Shanghai Higher People’s Ct., 2003), (adjudicating a case in which the defendant and contract party that was sued for performance of a condemnation and relocation agreement was the Huangpu District Office of the Shanghai Municipal Administration of Industry and Commerce).



Accordingly, any analysis of the application of the (formal) Company Law in the People's Courts cannot be limited to how the People's Courts handle issues which are neatly identified by some authoritative actor, or even the disputants themselves, as within the purview of the Company Law or corporate norms. Instead, analysis of contemporary China must focus on how informal (and often illegal) economic organizations, all very significant drivers of China's recent growth and global expansion, are shaped and affected by the formal legal system and institutions, even when a seemingly obvious mismatch between indigenous forms and "modern" legal structures exists.<sup>189</sup> In fact, the subjects of much interaction between the judicial system and the Company Law are entities which are not corporations but corporate-style partnerships, close corporations, or something akin to the Limited Liability Company or "LLC" form known in the United States.<sup>190</sup>

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<sup>189</sup> A good, and very specific, example of this mismatch is the linguistic oddity often seen when Chinese companies refer to their board of directors. Instead of using the statutory term "board of directors' meeting" (*dongshi hui*) (akin to the UK term for shareholders that is the "general shareholders' meeting"), many companies—even in public documents—call that central organ the "board of directors bureau" (*dongshi ju*). For example, see the public notice issued by the board of directors of the electronics concern "Gome" in November 2008 when the company chairman was detained on suspicion of stock manipulation, in which the board refers to itself as the "*dongshi ju*", at DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Nov. 24, 2008, at B9. This may seem obscure to non-Chinese speakers, or even Chinese speakers who have so internalized the truth of Chinese corporate governance they do not see the difference, but the use of the character "*ju*" (bureau) instead of "*hui*" (meeting) gives the organ the taste of a central policy directing body (perhaps acting on behalf of a controlling shareholder), not a body meant to represent the entire shareholders' meeting. Thus, the linguistic oddity might inform not only different assumptions, but also different applications of legal doctrine.

<sup>190</sup> See, e.g., Zhang Qingzhao v. Zhang Wenhui, SUPREME PEOPLE'S COURT REPORTS 234-41 (Shanghai Baoshan Dist. People's Ct., 2002, No. 2 Interm. People's Ct., 2004), (looking through apparent corporate establishment to impose general partnership rules); Shi Jianjia v. Shanghai Fuxing Mingfang Accountancy Firm Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 319-22 (Shanghai Luwan Dist. People's Ct., 2002), (holding that a limited liability company accountancy is in effect a corporate partnership based on the Articles of Association, with shareholders meeting as its highest authority, and when leaving the employ of the accountancy and thus disassociating himself, plaintiff must sell his interest to other continuing partners), *aff'd* Shanghai No. 1 Interm. People's Ct., 2003; China Textile Mach. Co. v. Shanghai Mach. Imp. Exp. (Group) Co., NEW COMPANY LAW CASES 239-43 (unidentified Shanghai Dist. and Interm. People's Cts., 2001), (entity established before 1994 Company Law on the basis of a "joint investment agreement", eventually with separate Articles of Association and "enterprise legal person" registration); Shanghai 100 Group Real Estate Co. v. Shanghai Aofeng Trade Dev. Group, NEW COMPANY LAW ISSUES 191-93 (Shanghai No. 1 Interm. People's Ct., 1997), (parties established a limited liability company which was really a loose general partnership focusing on a real estate project, revealed when one of the parties tried to transfer a square-meter portion of the real estate assets theoretically "under" (owned by) the partnership, rather than an equity interest in the limited liability company); Yu Xiaohui v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 178-87, (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate

This is not the place to describe the reasons for the hardy persistence of the small-bore partnership form in the PRC business landscape, except to note that the phenomenon strongly recalls the persistence of the same forms in late imperial and pre-1949 China.<sup>191</sup> It is closely tied to post-1978 economic reforms which saw initial privatization of smaller-scale SOEs and “collectively-owned enterprises”<sup>192</sup> into various forms of non-state and non-collective ownership, especially “stock cooperatives” (*gufen hezuo*) or “stock cooperative companies” (*gufen hezuo gongsi*)<sup>193</sup> with no legal basis whatsoever.<sup>194</sup> Nor is this the place for a long

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People’s Court, 2006), (subject firm is established as a “limited liability company” under the 1994 Company Law but—pursuant to the firm’s Articles of Association—has all the attributes of a limited liability partnership: *i.e.*, the entity has a board of directors, but the highest organ of authority in the entity is the shareholders’ meeting (which the board or a certain percentage of investors calls into session); voting rights tied to individual identity, not amount of equity contribution; shareholders’ have a non-compete obligation and thus a duty of loyalty to the entity and the other members; upon death, retirement or transfer to another job, members’ interests are redeemed (or “sold to the company” on a mandatory basis) for a return of capital which is an individual’s participation in net partnership assets; some shareholders’ have agency power for the entity, etc.); *Chen Zhijin v. Shanghai Kaikai Enter. Co., Ltd.*, 1998 HU ER ZHONG JING ZHONG ZI NO. 729 (Shanghai Jingan Dist. People’s Ct., 1998), (plaintiff’s “internal” (employee’s) shares in company limited by shares properly subject to mandatory buy-back upon plaintiff’s leaving employ of company because the entity is really a close partnership), *partially aff’d*, Shanghai No. 2 Interm. People’s Ct., (1998), *available at* <http://www.lawyee.net>.

<sup>191</sup> It is a strong echo of the persistence of private, customary, and traditional partnership (*hehuo*) formations in China through the end of Qing rule, the Beiyang Government, and Nationalist Party rule, notwithstanding four separate company statutes and company registration procedures (1904, 1914, 1929 and 1946), the lack of a statute actually authorizing partnerships, and the conferral of shareholder limited liability only for registered “companies”. See HISTORY OF CHINESE CORPORATE THOUGHT, *supra* note 39, at 36-37; MADELINE ZELIN, THE MERCHANTS OF ZIGONG: INDUSTRIAL ENTREPRENEURSHIP IN EARLY MODERN CHINA 51-58 (2005) (describing lease/partnership arrangements in the Sichuan salt industry); *id.* at 84-94 (describing how an efficient management organization helped promote expertise, centralize control in a large group, and facilitate vertical integration in salt conglomerates); Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN. L. REV. 1599, 1621 (2000) (suggesting that “clan corporations were also “true” corporate entities and ought to be viewed as predecessors of modern Chinese corporations.”).

<sup>192</sup> Thus not the large, line Ministry-run, SOE systems of productive and social assets which garnered so much world attention and the bulk of formal “corporatization” efforts.

<sup>193</sup> NICHOLAS LARDY, CHINA’S UNFINISHED ECONOMIC REVOLUTION 21-24 (1998).

<sup>194</sup> With respect to explicitly-named “collectives”, see *Shang A. v. Lü B.*, 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 107-09 (Shanghai Changning Dist. People’s Ct., 2006), (plaintiff/original named capital provider in “equity cooperative” (*gufen hezuo*) entity who becomes hidden shareholder (*i.e.*, share interest held in defendant’s name) in post-transformation limited liability company), *dismissed*, Interm. People’s Ct. not identified (2006); *Shanghai Shenmao Dianci Factory v. Wang Longbao*, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui Dist. People’s Ct., 2004), (forced buy-out of stock in “non-profit” stock cooperative upon Vice Chairman’s leaving employ pursuant to board regulations, shareholders’ resolution and Articles of Association is not a violation of shareholders’ rights, where the Court cites not the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry level CRES and Shanghai “Provisional Measures” on stock cooperatives and collectives), *aff’d*, Shanghai No. 1 Interm. People’s Ct. No. 3 Civ. Div. (2004), *rev’d on reh’g*, Shanghai No. 1 Interm. People’s Ct. No. 3 Civ. Div. (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/gweb/>.

exegesis on the fundamental differences between partnerships and corporate establishments, or the necessarily separate norms which govern them in a coherent manner.<sup>195</sup> Those differences touch on every major area of enterprise law, including fiduciary duties (both for orthodox corporate fiduciaries and shareholder-investors), the ease and justification of asserting liability against promoter-shareholders (veil-piercing), the relationship between management/employee (contract) status and ownership (property) rights, and the adaptability of the enterprise upon the defection of any owner-operator. The very obvious problem with the PRC Company Law and China's relatively new company system is that the formal "Company" Law makes little of these fine distinctions, potentially leaving the deeply-disadvantaged People's Courts in a position

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For entities that "grow out" of collectives, *see* Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 178-87 (Shanghai Changning Dist. People's Ct. and Shanghai No. 1 Interm. People's Ct., 2006), (transferring limited liability company into a collectively-owned enterprise, with uncertain application of internal governance mechanisms arising from corporate law over former collective participants). One authoritative Shanghai judge, the President of the Changning District People's Court, offered a somewhat circular explanation for the abundance of partnerships established as limited liability companies which explanation invokes such "stock cooperatives" (*gufen hezuo*). He stated in December 2008 that because such "stock cooperatives" continue to exist in such numbers in China, it is natural that a good number of disputes concerning their operation and internal governance enter the People's Courts (remarks on file with the author). This is only a partial explanation, because as this writing makes clear so much of the energy behind the application of partnership law principles in China is directed at close corporation-type business organizations formed long *after* the implementation of the 1994 Company Law, where there was no question of rogue "stock cooperative" establishments or transformation of collectives or small SOEs into anything other than companies.

<sup>195</sup> Partnerships are the expression of an intimate, non-owner-alienated, business association, where the relatively few partners will participate in the running of the business and have confidence in the trustworthiness and technical competence of their co-venturers—a confidence based on knowledge about the other partners, their past performance in business, their skill-sets, etc. That intimate association is recognized in the default partnership norms which distribute ownership and management authority equally to all of the partners, give full agency powers in regards to the partnership to each partner, and dictate that the partners share profits, and bear the burden of losses, equally. Contrast with the partnership or sole proprietorship the orthodox corporate forms where powers attendant to the ownership right are parceled out among directors (centralized management), officers (day-to-day operations and management) and the mere capital providers (and residual interest rights holders) the share-"owners"—which shareholders are alienated from management authority, have no agency powers with respect to the corporation, and have a right to distributed profits only in accordance with the equity investment represented by their share capital, all in exchange for limited liability protection. Yet one difference arising from the distinction is with respect to the costs of partnering (as contrasted with a corporate establishment): the peculiar *lack* of adaptability seen in the partnership establishment, where *per* the default rule all partners have to agree on significant matters and disassociation (often resulting from inability to agree) by one partner leads to the dissolution of the association, and pay-out to the partners (redemption via liquidation). Contrast the pure corporate form, where centralized management by the board of directors (requiring only a majority vote of the directors, and not unanimity) and their appointed management, and continuity of life of the entity, are undisturbed by the disagreement of even a significant proportion of shareholders or the departure of any mere "owner" via transfer of its share interest or—if permitted—by stock redemption.

where they cannot apply, or must mis-apply, “corporate” law doctrine to what are in fact limited liability “partnerships”.<sup>196</sup> As the Shanghai Higher People’s Court noted in 2003 when faced with this mismatch between legal form and enterprise reality,<sup>197</sup> in corporate law matters the courts simply have to be experts in construing the rights and obligations relevant to the many business forms in play, whether or not the Courts have a legal or doctrinal basis.

Thus, it is a significant demonstration not only of judicial autonomy but also of real competence to see the Shanghai People’s Courts refuse to apply formal corporate law to so-called “corporate” establishments and instead apply decision principles that conform to the reality underlying Chinese business organization and participant expectations. In one well-handled 2004 case, the Shanghai Baoshan District People’s Court (upheld by the Shanghai No. 2 Intermediate People’s Court) looked through a *de jure* “corporate” establishment to understand a *de facto* “partnership” and ruled on the parties’ rights accordingly. It did so not in conformity with the flawed PRC Partnership Enterprise Law but instead with universal partnership principles.<sup>198</sup> In this very impressive work, the District-level People’s Court boldly disregarded the form of corporate establishment (including a “Shareholders Agreement” between the

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<sup>196</sup> This problem leads many analysts to think that China’s courts should not be applying the Company Law—which seeks to cover both closely-held corporate partnerships (or “limited liability companies” (*youxian zeren gongsi*)) and large, often publicly-held, companies limited by shares (*gufen youxian gongsi*)—to such close corporate partnerships, at least not with the formal tools they are given for their larger, public, cousins. The obvious, but presently impossible, remedies to this problem are (i) a new set of statutes which apply specifically and separately to partnerships, LLC-type entities, close corporations (corporate partnerships), and orthodox joint stock corporations, etc., or (ii) People’s Court-led development of different doctrine which can be applied to different forms. At the present time, neither of these remedies is realistic, with China having only recently amended its Company Law, the Supreme People’s Court working hard to compose Regulations for implementation of the 2006 Company Law, and the People’s Courts not part of a system which would allow them to develop nationally-binding doctrine through cases opinions even if they possessed the requisite competence.

<sup>197</sup> Alluding to the difficulties encountered in dealing with “stock cooperative” (*gufen hezuo*) entities under the Company Law. *Shanghai Company Law Opinion, supra* note 7, at 231.

<sup>198</sup> Zhang Qingzhao v. Zhang Wenhui, SUPREME PEOPLE’S COURT REPORTS 234-41 (Shanghai Baoshan Dist. People’s Ct., 2002), (formal corporate establishment to be disregarded, and investors to be seen as general partners, with liquidation and distribution rights determined accordingly), *aff’d* Shanghai No. 2 Interm. People’s Ct. (2004). The Shanghai No. 2 Intermediate People’s Court opinion is summarized at length in the attached Case Reports Appendix.

investors) to rule that the entity is in fact a kind of general partnership and order equal *partner* distributions of the residual assets (rather than different proportions of the residual assets determined by the investors' notional "equity" investment).

The same smart application of law can be identified after January 1, 2006. For instance, for calendar year 2006 the Shanghai Higher People's Court reported a large number of cases in which company Articles of Association provide for expulsion of shareholders by the shareholders' meeting upon the occurrence of certain events, including infringement upon the rights of other shareholders, failure to fully pay-in capital, withdrawal or termination of human capital contributions, and the like. The 2006 Company Law countenances no such possibility, as is correct under corporate law doctrine. The Higher People's Court reported much litigation arising from this contradiction, where the expelled shareholder says he or she simply cannot have his or her status as a shareholder extinguished (absent redemption of his or her share interest at the initiative of the shareholder). The respondent company commonly answers by portraying the Articles of Association as the shareholders' agreement and the full contractual expression of almost sacred "private ordering," so that when one contract party fails to abide by its obligations the other contract parties can exercise the remedies set forth in the contract (expulsion from the company). The Higher People's Court supported the latter jurisprudence in explicit terms because the result protects the power of "private ordering"<sup>199</sup> and "freedom of contract" in China's new semi-marketized economy.<sup>200</sup> Yet, what the Shanghai Higher People's Court was

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<sup>199</sup> See *infra* notes 205 to 225 and accompanying text.

<sup>200</sup> And under the condition that the expulsion mechanism does not contravene any mandatory rule of law, or harm the interests of creditors, see *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 46-47. See how the Shanghai Courts achieve the same emphasis in *Shanghai Yingdafang Serv. Co. v. Shanghai Yingdafang Zhangjiang Serv. Co. et al.*, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 190-95 (Pudong New Dist. People's Ct., 2005), *aff'd* Shanghai No.1 Interm. People's Ct. (2005), (summarized in the Case Reports Appendix); *Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd.*, ANALYSIS OF NEW CASES 178-87 (Shanghai Changning Dist. People's Ct., 2006), *aff'd* Shanghai No. 1 Interm. People's Ct. (2006), (a limited liability company which has all the properties of a partnership).

actually doing is something far more profound than a hymn to self-ordering: it was exercising a high degree of autonomy (and not a little “legal realism”) in supporting application of company law in conformity with the underlying identity of China’s firms, or “partnerships.” This may be a bit of a travesty in corporate law terms but shows a technical skill and autonomy not generally associated with the Chinese People’s Courts in their history.

A related instance of autonomous and commendable misapplication of the law is one case from the mid-1990s in which the Shanghai Higher People’s Court—in an initial hearing and then re-hearing—bent over backwards *not* to invalidate a share transfer agreement between the shareholders of a two-shareholder entity which would have resulted in a single-shareholder limited liability company, something not permitted under the 1994 Company Law.<sup>201</sup> In a remarkable opinion, the Higher People’s Court offered various remedies to the technical problem at issue—the legal impossibility of a single shareholder company—with helpful suggestions, one of which is plainly illegal. The Court blithely suggested that the resulting sole shareholder can (i) actively find another shareholder, (ii) change the company into an unlimited liability entity, (iii) liquidate the company, or (iv) continue to operate the company as a single shareholder company. As the Shanghai Higher People’s Court, the apex of the Shanghai judicial system, wrote with some degree of understatement, “the three first ideas are legal, and the fourth idea *has some degree of illegality.*”<sup>202</sup> The Shanghai Court then went even further afield with the assurance that external creditors of a single shareholder company will be protected because they can “avail themselves of the [protective] remedy that is disregard of the corporate form.” This is equally odd jurisprudence because, at the time, corporate veil-piercing had no formal legal basis

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<sup>201</sup> Shanghai Huayuan Real Estate Dev. Co. v. Shanghai Shenji Food and Beverage Enter. Mgmt. Co., NEW COMPANY LAW ISSUES 148-52 (Shanghai Higher People’s Ct., No. 2 Civ. Div., 2002), (shareholders’ agreement which will result in a single shareholder limited liability company is legal and binding, and local bureau of industry and commerce should register resulting entity).

<sup>202</sup> *Id.* at 151 (emphasis added).

(statutory or Regulatory). The Court then came to a final, dizzying, turn, by arguing in favor of spontaneously-formed single shareholder companies<sup>203</sup> as a necessary legal-structural remedy for shareholder-deadlocked companies because the other remedy in corporate law—a shareholder's suit to ask for judicial dissolution of the entity—“*has no legal basis under the Company Law.*” In the space of a few lines in one opinion, the Higher People's Court has counseled “some degree of illegality,” provided assurances to creditors based on a mechanism which the People's Courts are not authorized to apply, and then argued again in favor of the admitted illegality because the only other legal claim is unauthorized. Yet, this exercise of extreme autonomy has a praiseworthy aspect when compared with the many post-2006 cases demonstrating hostility to judicially-directed deadlock resolution.<sup>204</sup> The remedy suggested in this decision, which slides up against (and over?) the line of illegality and doctrinal incoherence, is a rational technique allowing two warring shareholders to re-deploy their capital investment to better productive uses and escape the straightjacket of a badly-drafted 1994 Company Law.

#### D. *Protecting Firm Autonomy and Private Ordering*

Fourth, the Shanghai Courts express their autonomy by acting as the guardian of corporate and commercial autonomy itself. In recent years each of the State Council, the National People's Congress<sup>205</sup> and the Shanghai Higher People's Court<sup>206</sup> has pointed to the enabling of this function as a key policy aim behind the 2006 Company Law amendments. Thus, China's law drafters apparently hoped that the new Company Law would protect the autonomy

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<sup>203</sup> The problem under the 1994 Company Law was that even limited liability companies required two initial promoters. The Shanghai Higher People's Court is saying here that it will permit companies which are established with the requisite two shareholders but spontaneously become single shareholder entities with post-establishment transfer of all shares into the hands of one shareholder.

<sup>204</sup> And the overwhelming concern with what the Shanghai People's Courts call “market stability” and entity preservation at all costs. See *infra* notes 233 to 245 and accompanying text.

<sup>205</sup> *LAO Company Law Explanation*, *supra* note 19.

<sup>206</sup> *Shanghai Company Law Opinion*, *supra* note 7, at 5.

of corporate legal persons and also the parties who form and operate them, a position in direct contrast to the legal positivist “business regulation” philosophy underpinning both the 1994 Company Law and much of China’s substantive law and regulation produced from the start of the Reform era. This idea is most often exemplified in opinion rhetoric and case outcomes which uphold the idea of “market autonomy” against state power/regulation, and the equally sustained support for “private ordering” and “self-regulation” versus mandatory business regulation.

This orientation seems to have been in effect even before the 2005 amendments.<sup>207</sup> A 2004 case presenting a situation all too common in Chinese corporate dealings—the frustration of corporate decision-making by failure of a board chairman (and Legal Representative (*fading daibiaoren*)) to convene a shareholders’ or board meeting—is lost by plaintiffs because the Shanghai Luwan District People’s Court privileged the entity’s Articles of Association<sup>208</sup> (which give the board chairman in question the exclusive authority to convene such meetings), despite clear evidence that the same chairman was protecting the shareholding group he represented against the other shareholders in the company and in clear breach of his/their corporate fiduciary duties to the company.<sup>209</sup> The Court issued a mini-sermon on the virtues of strict deference to private arrangements such as Articles of Association over “public authority” (*i.e.*, bedrock corporate law principles applied by judicial institutions):

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<sup>207</sup> But not uniformly. *See, e.g.*, Co. A v. Co. B, SELECTED COMPANY LAW CASES 142-44 (Shanghai Nanshi Dist. People’s Ct., 1997), (25% shareholder sues company under control of another minority shareholder for distribution of dividends from profits *per* company Articles of Association, but not distributed because control party wants to redirect earnings to cash-poor beer plant asset), *aff’d*, Shanghai No. 1 Interm. People’s Ct. (1997). In that case, on appeal the defendant argued that the plaintiff shareholder should not be able to sue the company for failure to distribute dividends because the problem should have been resolved at the shareholders’ meeting or board meeting level, and only if the resulting resolutions in some way infringed upon the lawful rights of the plaintiff shareholder could the plaintiff sue under Article 111 of the 1994 Company Law. The Shanghai No. 1 Intermediate People’s Court rejected this solid statutory argument, and ordered the distribution of dividends with interest in line with the plaintiff’s inherent right (also described in the Articles of Association) to 25% of after tax profits.

<sup>208</sup> Based, however, on the formal articles of the 1994 Company Law which direct the same.

<sup>209</sup> See the same result in X. Fang v. Y. Information Tech. Co., Ltd., 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 59-65 (Shanghai Yangpu Dist. People’s Ct., 2005).



This case demonstrates another issue, the connection between public authority (*gongquanli*) and internal corporate governance. The main bases for the Court's decision [in this case]... are the effectiveness of the Articles of Association and the shareholders resolutions. Corporate law invests great authority in corporate Articles of Association and the shareholders' meeting, which is an expression of the principle of self-regulation [autonomy] of corporate legal persons. [There is] [o]ne important pre-condition however, and that is that no mandatory prohibition of law is contravened. [Thus,] even if there are aspects that are not completely rational, we will in the end let them be self-resolved by shareholder resolution in accordance with the company's own development process, the increasing understanding between the shareholders, and the progressive perfecting of the Articles of Association. The public authority must not impose judgments directing that [shareholders'] resolutions produced by legally-conforming procedures be [changed] this way or that way, and must not exceed its power by interfering in a company self-governance scheme or its ability to make decisions regarding its own internal affairs (assuming that they comply with law).<sup>210</sup>

The *Yingdafang* case from 2005, which is briefed in the Case Reports Appendix, also shows a perhaps wrongly-decided case where self-ordering—as expressed in company Articles of Association—completely swallows the quasi-immutable statutory/legal norms of fiduciary duty of loyalty.<sup>211</sup>

The orientation of the Shanghai courts as guardian of corporate autonomy is stronger after 2006. In its 2007 analysis of more than 750 Company Law-related opinions rendered in 2006, the Shanghai Higher People's Court confirms one side of the achieved result, asserting the “exhaustion of internal remedies” as one of the principles perceived at work in post-January 1,

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<sup>210</sup> X. Jiyin Chip Co. et al. v. Y. Group Co., Ltd., 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 75 (Shanghai Luwan Dist. People's Ct., 2001). This rhetorical position is countered by the result from the Shanghai No. 1 Intermediate People's Court in the A. Inv. Dev. Co. v. Wang case alluded to below, *infra* note 214, where the Court has to choose between a fraudulent, albeit privately-ordered, stock transfer contract (and the interests of a good faith purchaser), on one side, and the preemptive rights bestowed on existing shareholders in the Company Law, on the other—coming down firmly on the side of the Company Law, probably because of the presence of fraud in the underlying transfer contract.

<sup>211</sup> Shanghai Yingdafang Serv. Co. v. Shanghai Yingdafang Zhangjiang Serv. Co., 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 190-95 (Pudong New Dist. People's Ct. and Shanghai No.1 Interm. People's Ct., 2005). See also Guo Shaoqu v. Shanghai Saiyang Textile Sci. and Tech. Co., 2000 HU ER ZHONG JING ZHONG ZI NO. 280, SELECTED COMPANY LAW CASES 260-65 (Shanghai Hongkou People's Dist. Ct., 1999) (People's Courts refuse to order dividend distribution to 20% equity holder because, per the 1994 Company Law, this is a matter for a shareholders' meeting resolution (which 80% shareholder is assured of passing against dividend distribution) and such shareholders' resolutions can only be challenged in court where they are “in breach of law or administrative regulation, or infringe upon the lawful rights of shareholders”), *aff'd*, Shanghai No. 2 Interm. People's Ct. (2000), also available at <http://www.lawyeer.net>.

2006 corporate law jurisprudence.<sup>212</sup> This assertion means that parties involved in corporate disputes were encouraged and permitted to take full advantage first of internal (*i.e.*, intra-shareholder) remedies before having recourse to procedures and mechanisms directed by public institutions, such as derivative actions, or lawsuits seeking judicially-ordered equity transfers or dividend distribution.<sup>213</sup> Confirmation of this new dogma appears in the Shanghai No. 1 Intermediate People's Court 2007 commentary on a pre-2006 Company Law case,<sup>214</sup> in which the adjudicating Court is deemed to have chosen "incorrectly" between protection of the existing shareholders' right of first refusal on transfer, on one side, and the rights of a good faith third party stock transferee under a fraudulently "shareholder-approved" transfer agreement, on the other. The People's Court's post-January 1, 2006 commentary on the case makes clear the extent to which judges working in the Shanghai system are to prioritize private ordering over the statutory framework:

First and foremost, the thing we must clarify is this: the jurisprudential logic underlying the giving of priority to the shareholders' preemptive rights of purchase over the [good faith] purchase rights of the transferee is absolutely not because the former right is in statute, and the latter is merely a contract right. This is because statutory rights are not always superior to contract rights—in fact, it is just the opposite. Approaching it systemically, and adhering to the orientation which protects private ordering, regulation of the market requires that the formulation of law fully respects the freedom to contract, so as to encourage successful transactions.... The amendments resulting in the 2006 Company Law

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<sup>212</sup> Those other two principles identified are: (i) priority to commercial law (*shang fa*) over civil law (*minfa*) in adjudicating corporate law cases (*see infra* notes 301 to 303 and accompanying text for the meaning of this idea in the PRC context); and (ii) distinguishing between internal (governance) and external (third party) corporate interactions.

<sup>213</sup> For a post-2006 expression of what the Shanghai Higher People's Court deems a new line, *see* Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 185 (Shanghai Changning Dist. People's Ct. 2006), (striking down contested shareholder resolutions passed at dissident special shareholders' meeting because they were defective under a strict reading of the company's Articles of Association, which are given priority over the corporate law), *aff'd*, Shanghai No. 1 Interm. People's Ct. (2006).

<sup>214</sup> *See* A. Inv. Dev. Co. v. Wang, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 106-09 (Shanghai No. 1 Interm. People's Ct., on appeal, 2003), (shareholder resolution approving transfer of 83% of company stock by one shareholder without exercise of preemptive rights by other shareholders pursuant to Article 35 of the 1994 Company Law is forged for beneficiary of rights by application of forged seal for the beneficiary; the higher Court then invalidates the original transfer contract to a third party, giving the Company Law preemptive right precedence over the falsely-approved contract).

with respect to issues regarding transfer of shares in limited liability companies especially emphasize: “Where the Articles of Association make other stipulations on share transfers, those other stipulations shall govern.” There is significant meaning in this.<sup>215</sup>

This is a remarkable view of state-issued norms in the context of recent Chinese history, and certainly a departure from the view of Chinese law even through the 1990s. The same orientation is seen in other post-January 1, 2006 Shanghai Company Law cases. A case decided on appeal in 2006 shows heavy privileging of apparent self-ordering via Articles of Association and entity “regulations” approved by the board, where the result is to disenfranchise someone clearly a shareholder.<sup>216</sup> A late 2006 case arising in Shanghai’s Changning District shows the extraordinary weight placed on a company’s partnership agreement-like Articles of Association, as an expression of “private ordering”, which triumphs absolutely over the larger default provisions or corporate law doctrines of the Company Law such as fiduciary duties. In that case, even with public identification of (and administrative punishment for) breach of corporate fiduciary duties and fraud by a controlling shareholder/Legal Representative, resolutions passed by a dissident shareholders special meeting were ruled invalid because the dissident meeting was not convened, and the voting at the meeting was not effected, in technical conformity with the agreed Articles of Association.<sup>217</sup> Finally, a 2007 Intermediate People’s Court<sup>218</sup> went so far

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<sup>215</sup> *Id.* at 111.

<sup>216</sup> Shanghai Shenmao Dianci Factory v. Wang Longbao, 2006 HU YI ZHONG MIN SAN (SHANG) ZAI ZHONG ZI NO.1, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui Dist. People’s Ct., 2004), (forcing buy-out of stock in “non-profit” stock cooperative upon Vice Chairman’s leaving employ pursuant to board regulations, shareholders’ resolution and Articles of Association not a violation of shareholders’ rights), *aff’d*, Shanghai No. 1 Interm. People’s Ct. (No. 3 Civ. Div.) (2004), *rev’d on reh’g*, Shanghai No. 1 Interm. People’s Ct. (No. 3 Civ Div.) (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/gweb/>. In this case, the defendant entity actually pleaded that assertion of “law” over the agreements in the board “regulations” and the Articles of Association amounted to “state interference.”

<sup>217</sup> The defects are very, very, arcane, and related to meeting notice, and the status of individuals who have died, redeemed their equity, or transferred their equity to third parties. *See* Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 187 (Shanghai No. 1 Interm. People’s Ct., 2006)..

<sup>218</sup> In Sun X. v. Li Y., described in *Fayuan Nengfo Shouli Gudong Qingqiu Queran Gudonghui Jueyi Youxiao de Susong* [Should the People’s Courts Accept Shareholders’ Suits Seeking Confirmation of Validity of Shareholders’ Resolutions?] in “GONGSI JIUFEN YU GONGSIFA JIUJI” YANTAOHUI – LUNWENJI, 28-29 [hereinafter

rhetorically as to see off its own role—*judicial* intervention—with the ringing admonition “the People’s Courts should not use the coercive power of the state to interfere with matters within the scope of a company’s self-governance.”<sup>219</sup>

There is one final angle from which to divine the approach of the Shanghai judiciary to the relative autonomy of firms as against the state, or state business regulation. In this regard, the Courts act as cheerleaders for the transformation of business entities run as political departments to autonomous business enterprises aggregating property rights of investors. An April 2006 opinion addressing one of many judicial dissolution cases on the Shanghai People’s Courts’ docket refused to grant shareholder plaintiffs the dissolution remedy, but took the opportunity in scolding *dicta* to lecture defendant directors of the limited liability company entity for their obvious failure to understand that they are no longer *political* cadres operating a collectively-owned enterprise, but really *shareholders* and corporate *directors* who have a radically different relationship to their co-investors (the former worker-participants in a collectively-owned enterprise):

But, the People’s Court has also noticed that the three defendants, as directors of the company, have not really made the transition from their former role as leaders (*lingdao jiaosi*) of a collectively-owned enterprise to that of shareholders in a limited liability company. For instance, in calling shareholders’ meetings they have not conformed to their notification obligations, have failed in bringing about discussion of corporate operating policies, and ignored the other related rights of the seven plaintiffs. In addition, in managing corporate finances, there seems to be in evidence action which includes the transfer of corporate funds into personal accounts and the holding out of corporate vehicles as personal assets. And, the expenditures by the company have not been handled transparently, etc. The above-described actions by the defendants have certainly brought about the lack

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COMPANY CONTROVERSIES] (Shanghai Higher People’s Court No. 2 Civil Division and East China University of Politics and Law, eds., 2008) (Dist. People’s Ct. not identified), *appeal filed* Shanghai No. 2 Interm. People’s Ct. (No. 3 Civ. Div.) (2007 or 2008). This is the same case invoked as a demonstration of judicial “conservatism,” *see infra* text accompanying notes 247 to 251.

<sup>219</sup> *Id.* at 28.

of trust by the plaintiffs, which has resulted in the disagreement [between shareholders].<sup>220</sup>

This statement is a wonderful articulation by a Shanghai People's Court—not a legislator, regulator or government official—of the new status, obligations and rights of the natural persons transformed from agents of the state into the subjects of corporate law who are fiduciaries for firm owners.<sup>221</sup>

Conversely, if the Shanghai Courts are in the business of protecting firm autonomy, and urging former political actors to participate in the new system as commercial actors (under law), they also function to disallow political actors the use of corporatization and the law as a shield. In a 2007 case, the lower-level People's Court and the Shanghai Higher People's Court dismissed two defenses: one that sought to distinguish SOE-subsidary “enterprise department” action from the interests of the SOE itself, and another that sought to protect a corrupt cadre from prosecution because he had diverted funds to a “commercial” limited liability company he promoted and controlled absolutely.<sup>222</sup> A similar case, also from 2007, summarily dismissed a criminal defendant's assertions that his corporate misfeasance (false accounts to boost manager bonuses, etc.) and breach of corporate law and regulation were unrelated to the crime of “private misappropriation of public assets” because they were the internal affairs of a corporate entity

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<sup>220</sup> Yang Lizhi v. Cao Chengjie, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 208, ANALYSIS OF NEW CASES 356-59 (Xuhui Dist. People's Ct., 2006).

<sup>221</sup> And the real requirements for effectuation of the decade-long effort to “separate enterprise from administration” (*zhengqi fenkai*) under the Company Law in Reform-era China.

<sup>222</sup> See PRC v. Xue Henghe, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 447-52 (Shanghai Rail Transp. Interm. People's Ct., 2007), (affirming that, under the principle “he who invests has property ownership rights” (*shei touzi shei yongyou chanquan*), the SOE subsidiary “enterprise department” is “owned” (and governs assets belonging to) the SOE, even when administered independently; the corporation set up to receive diversion of assets from the same “enterprise department” is pierced because the corporation is entirely controlled by, and gives benefits to, the criminal defendant), *aff'd*, Shanghai Higher People's Ct. (2007).

(albeit a registered SOE).<sup>223</sup> The Court had none of this theory, and sentenced the defendant to several years in prison and return of diverted income.<sup>224</sup>

In sum, the Shanghai People's Courts are simultaneously exercising increased autonomy in supporting the newly-enabled private ordering of firms that operate in China's quasi-market economy and in frustrating the use of such new firms as shields for corrupt state cadre activity.<sup>225</sup>

### *E. Exercise of Judicial Power*

A fifth aspect of institutional autonomy demonstrated in Shanghai is the willingness of Courts to void or rearrange private arrangements, and exercise significant regulatory power. The Shanghai People's Courts demonstrated these powers very well even before 2006, in cases in which they:

- liberally declared void *ab initio* share transfer agreements (and associated purchase obligations) which had not seen waiver of non-selling shareholders' rights of first refusal;<sup>226</sup>
- ordered, with great assurance, the buy-out of unhappy shareholders where there was strong evidence of opportunistic or even fraudulent behavior by promoter shareholders;<sup>227</sup>

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<sup>223</sup> PRC v. Wang Haiqing, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 437-42 (Shanghai Hongkou Dist. People's Ct., 2007).

<sup>224</sup> This is consistent with the same sensitivity and approach taken in a 2001 criminal case, where the establishment of a new, private enterprise by an SOE manager designed to skim transfer value from the SOE's sourcing transactions is a violation of the Criminal Law's prohibition against "illegally engaging in the same business" (as an SOE where the criminal defendant is posted): *see* PRC v. Shen XY, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 260-64 (Shanghai Higher People's Ct., 2001).

<sup>225</sup> With respect to the affirmative protection of private ordering, there may be a less sanguine view of this adjudicatory orientation. As noted below, the Shanghai People's Courts may be using the enforcement of so-called private ordering to avoid employing their full powers to vindicate more abstract and de-stabilizing corporate law principles, like fiduciary duties. This phenomenon is addressed below in the separate discussion of the identified constraints on autonomy of the Shanghai Courts. *See infra* notes 284 to 307 and accompanying text.

<sup>226</sup> *See* Zhu Liqun v. Hong Bangyao, NEW COMPANY LAW ISSUES 194-97 (Shanghai Changning Dist. People's Ct., 2000), (declaring void a share transfer agreement involving equity in limited liability company because approval of transfer not obtained from "all" shareholders), *aff'd*, Shanghai Interm. People's Ct. (2000); Wu Yazhong v. Shanghai Xi Bin Clothes Mfg. Co., NEW COMPANY LAW ISSUES 203-05 (Shanghai Fengxian Dist. People's Ct., 2000), (share transfer agreement involving registered capital interests in Chinese-foreign equity joint venture void because approval for proposed transfer not sought from other participants (or their board appointees) pursuant to statute, the joint venture contract and articles of association, and the examination and approval authority governing such foreign invested enterprises), *aff'd*, Shanghai Interm. People's Ct. (2000).

<sup>227</sup> Shanghai Jingfa Enter. Dev. Co. v. Shanghai Haining Petroleum Prod. Co., 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 299, 303 (Shanghai No. 2 People's Ct., 2003), (where judicial buyout of complaining

- ordered corporate actors to conform to their legal obligations in certain circumstances—in one case so as to protect and elaborate the full range of property rights (transferability, right to profits, and voting rights) where a capital provider's contribution had not been recognized by the investee company and the People's Courts ordered the defendant corporations to undertake their registration obligations;<sup>228</sup>
- adjudicated legal person entities as tortfeasors for the actions of their officers and employees;<sup>229</sup> and
- assessed criminal liability against control parties and key employees.<sup>230</sup>

In fact, the Shanghai Courts on occasion seem too powerful in corporate adjudication. In a 2006 case, the People's Courts criminalized an enthusiastic pursuit of the financial/advisory/asset management business (which is construed as the “public offering” of units in an investment fund in breach of the PRC securities regulatory regime).<sup>231</sup> In a 2007 example, the People's Courts effectively criminalized what looks like a simple *ultra vires* defect by defendants who had set up

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shareholders is the “only remedy” and an “appropriate request” on the part of plaintiffs in light of shareholder deadlock and the failure of private ordering) *aff'd*, Shanghai Higher People's Ct. (2003).

<sup>228</sup> Shang A. v. Lu B., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 107-09 (Shanghai Changning Dist. People's Ct., 2006), (plaintiff/originally-named capital provider in “equity cooperative” (*gufen hezuo*) entity who becomes hidden shareholder (i.e., share interest held in defendant's name) in post-transformation limited liability company has right to be listed as a name shareholder on the shareholder register of the post-transformation company, and vote at shareholders' meetings, etc., unless such recognition violates a mandatory rule), *appeal dismissed*, unidentified Interm. People's Ct. (2006).

<sup>229</sup> Wang A. v. Shanghai B. Pub. Transp. Co., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 7-10 (Shanghai Luwan Dist. People's Ct., 2006), *aff'd and appeal denied*, Interm. People's Ct. (2006).

<sup>230</sup> See PRC v. Yang Demao, NEW COMPANY LAW CASES 460-65 (Shanghai Luwan District People's Court, 2003), (deeming preferential transfers by controlling shareholders out of company approaching liquidation either to loot company in breach of duties, or remove assets from creditors' claims, as basis for the crime of “harmfully impeding liquidation”), *aff'd*, Shanghai No. 1 Interm. People's Ct. (2003); PRC v. A. Internet Co., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 305-09 (Shanghai Pudong Dist. People's Ct., 2006), (corporate legal person criminally liable under PRC Criminal Law Article 366 crime of “unit (legal person) distribution of pornography for profit”, and same for those corporate officers and employees “having direct management responsibility” or who are “directly responsible”), *aff'd and appeal denied*, Interm. People's Ct. (2006); PRC v. Shanghai X. Real Estate Jingji Brokerage Ltd., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 334-37 (Shanghai Xuhui Dist. People's Ct., 2006), (limited liability company which has engaged in fraudulent real estate contracting and transactions assessed criminal liability), *aff'd and appeal denied*, unidentified Interm. People's Ct. (2006); PRC v. X. Sec. Ltd., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 340-45 (unidentified Shanghai Dist. People's Ct.), (securities company building government-approved financial advisory and asset management business collects investment funds from a very broad public against promises of high “interest” return, and thus is engaged in illegal public offering of securities, commercial banking, etc., both company and executives and employees directly responsible have criminal liability), *appeal denied*, Shanghai No. 2 Intermediate People's Court (2006).

<sup>231</sup> PRC v. X Sec. Ltd., 2006 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 340 (unidentified Shanghai Dist. People's Ct., *aff'd and appeal denied*, Shanghai No. 2 Interm. People's Ct. (2006).

an unregistered equity trading business (dealing in unlisted stock).<sup>232</sup> All of these outcomes demonstrate a Shanghai judiciary which acts not only with autonomy but a good degree of self-confidence and raw institutional power in application of law as business regulation.

#### IV. AUTONOMY CONSTRAINTS

In contrast with the demonstrations of significant judicial autonomy reviewed above, the Shanghai People's Courts between 1992 and 2008 also faced serious constraints on that same hard-won autonomy in corporate law adjudication, three in particular: (a) deference by the Courts to national social or economic policy and in contravention of what the Law commands or permits; (b) a multi-headed conservatism in implementation of the Company Law (including the seemingly toxic corporate fiduciary duties doctrine); and (c) the rejection (instructed or voluntary) of public company cases or cases involving companies limited by shares and thus non-application of the Company Law to those firms or their shareholders.

##### A. *Application of the Law to Support Public Policy in Contravention of Law*

In 2007 the Shanghai Higher People's Court praised newly-inserted clauses of the Company Law designed to unblock deadlocked companies,<sup>233</sup> in particular a new Article 183 which allows shareholders to petition for firm dissolution. In its focus on new Article 183 however, the Higher People's Court raised a concern which exemplifies a first constraint working on the autonomy of the Shanghai Courts. Explicitly alluding to the importance of continued firm existence and operation for growth, employment, and social welfare, the Higher

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<sup>232</sup> PRC v. Fang Kun, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 419-26 (Shanghai Pudong New Dist. People's Ct., 2007), (stating that trading in unlisted securities, including acting as agent-underwriter in public offerings, without CSRC approval and registration to engage in the securities business, constitutes the crime of "illegal business operations"), *aff'd*, Shanghai No. 1 Interim. People's Ct. (2007).

<sup>233</sup> For instance: greater ease in convening meetings, clearer legal person representation and agency principles, and better procedures for producing a vote on board and shareholder resolutions.



People's Court worried that new Article 183 would force it to order firm dissolution in the event of deadlock, and lamented the apparent inability to instruct other less socially-costly remedies.<sup>234</sup> The concern of the Higher People's Court in this regard is echoed in the values *cum* doctrinal choice by a Shanghai Intermediate People's Court in the 2006 *Tang Chunxiao* judicial dissolution case<sup>235</sup> briefed in the Case Reports Appendix—one which shows PRC People's Courts consciously deferring to national social and economic policy rather than implementing formal corporate law or doctrine.<sup>236</sup> It is the same values choice confirmed directly by the Chief Judge of the Shanghai Higher People's Court No. 2 Civil Division in December 2008 when discussing the Shanghai Courts' hesitancy in accepting and allowing dissolution-liquidation pleadings.<sup>237</sup> In the *Tang Chunxiao* case, the Shanghai No. 1 Intermediate People's Court rejected the plaintiff's suit for judicial dissolution of a thoroughly deadlocked company, even though the underlying real estate project had been shuttered for more than a year because of the inability of the two shareholders to agree. The expanded reasoning behind the simple judgment is most important to note here, as the Court is loathe to order the dissolution of a corporate legal person because it would “necessarily impact in different degrees [on] market order and

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<sup>234</sup> Such as ordered settlement negotiations, settlement after trusteeship, auction and buy-out by existing shareholders, or judicially-ordered acquisition. See SHANGHAI HIGHER PEOPLE'S COURT 2006, *supra* note 7, at 11-12.

<sup>235</sup> *Tang Chunxiao v. Zhou Huizhong*, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 138-44 (Shanghai No. 1 Interm. People's Ct., 2006), (case decided before the 2<sup>nd</sup> Judicial Regulations on the 2006 Company Law applicable to shareholders' suits for dissolution were issued).

<sup>236</sup> It is the same doctrinal approach adopted two years later in the 2<sup>nd</sup> Supreme People's Court Judicial Regulations on Application of the 2006 Company Law, see *Zuigao Renmin Fayuan Guanyu Shiyong “Zhonghua Renmin Gongheguo Gongsifa” Ruogan Wenti de Guiding (Er)* [Supreme People's Court Regulations (2<sup>nd</sup>) on Several Issues Related to Application of the “Company Law of the PRC”], 2008 FA SHI No. 6, issued May 12, 2008, SPC COMPANY LAW REGULATIONS, *supra* note 94, at 7-11, art. 5, which for petitions under Article 183 directs the People's Courts first to “emphasize” (*zhuzhong*) mediation, and then pushes the People's Courts to support an agreed buyout among the shareholders, reduction of capital and exit of one or more partners, or any method which is not in contravention of mandatory law or administrative regulation, all in order to serve the priority of keeping the company in existence. As such, the *Tang Chunxiao* case may show an example where lower-level People's Court adjudication shaped Supreme People's Court Regulation, and not the other way around.

<sup>237</sup> Remarks of Shanghai Higher People's Court No. 2 Civil Division Chief Judge, Dec. 5, 2008 (“... we strive to keep the company in existence, we have to think about creditors, the social responsibility of the corporate person, and the fate of the employees...”) (notes on file with author).

stability”.<sup>238</sup> Another 2006 judgment, in which shareholders of a limited liability company (converted from a collectively-owned enterprise) also sought judicial dissolution, evidences a similar approach by the Shanghai Xuhui District People’s Court.<sup>239</sup> In that case, a petition seeking judicial dissolution was also refused because it was explicitly deemed a market-disrupting remedy, and it would have altered arrangements for continued payment of salary to laid-off workers. The Shanghai Higher People’s Court in its commentary on this case again lauds the result because of the negative impacts on “market stability” arising from firm dissolution and the attendant judicial and social costs.<sup>240</sup>

This extra-legal, poly-centric, orientation was publicly proclaimed in late 2008 in the Shanghai Higher People’s Court’s eleven-point document entitled “Several Opinions on an Active Approach to Economic Development During the Financial Crisis” and the Shanghai No. 1 Intermediate People’s Court’s own ten-point document.<sup>241</sup> Each of these bureaucratic pronouncements directed the People’s Courts in Shanghai to serve the highest non-legal value in company law adjudication: finding a way for distressed enterprises to continue operating even if technically in default of their obligations or insolvent.<sup>242</sup> Regardless of the cause of this pronounced orientation, or the policy advisability of what is urged, the effect is clear:

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<sup>238</sup> Tang Chunxiao v. Zhou Huizhong, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 143 (Shanghai No. 1 Interm. People’s Ct., 2006).

<sup>239</sup> See Yang Lizhi v. Cao Chengjie, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 205-10, ANALYSIS OF NEW CASES 356-59 (Xuhui Dist. People’s Ct., 2006), (plaintiffs’ application does not meet the high standard set forth in 2006 Company Law, Art. 183; in addition, plaintiff shareholders are encouraged to plead against defendant directors’ apparent breaches of corporate fiduciary duties).

<sup>240</sup> *Id.* at 209. This result is not necessarily “bad” or “unjust” (as courts in the West are seeing in the proposed non-application of bankruptcy law or non-exercise against secured property for debtors in difficulty after the 2008-9 Financial Crisis), but only a clear example of PRC judicial institutions refusing to do what they are supposed to do under a strict reading of the law. Each of these 2006 results is unsatisfactory to the economist or the lawyer. From the economist’s standpoint, the redeployment of capital out of a deadlocked firm is something to be encouraged. The strict lawyer’s approach would counsel that if the statutory standards for judicial dissolution are met, then the judiciary should grant the dissolution relief described in the law. Yet each of the Shanghai People’s Courts involved in the cases cited here resist either of those approaches to privilege other, extra-legal and policy-oriented, aims, e.g. continued firm existence and continued payments to previously laid-off workers.

<sup>241</sup> See *supra* note 118 and accompanying text.

<sup>242</sup> *Accelerated Hearings, supra* note 9.

diminution of judicial institution autonomy in the application of the law to vindicate private economic rights and arrangements. The 2007 command of the Shanghai Higher People's Court that Shanghai Courts "temporarily" not accept the invitation in Article 184 of the 2006 Company Law to oversee the establishment of firm liquidation committees, and the general non-utilization of the PRC Bankruptcy Law without a Supreme People's Court Regulation authorizing application of that Law,<sup>243</sup> are animated by the same worries behind the specific judgments and bureaucratic instructions above:<sup>244</sup> a desire to stymie liquidation and termination of the firm, job losses, and other social costs.<sup>245</sup>

### B. "Conservative" Adjudication

The Shanghai People's Courts are conservative, and the degree of conservatism appears to increase after 2006 and promulgation of the new Company Law. This so-called conservative orientation for the Shanghai judiciary consists of action, or inaction, which indicates a turn against the full exercise of autonomy granted in law or implied by the Courts' institutional position. Importantly, this action or inaction is not necessarily the result of political pressure, or

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<sup>243</sup> See *supra* note 98 and *infra* note 270 and accompanying text.

<sup>244</sup> The Higher Court's justification focuses on competence, not autonomy, in that the Shanghai Courts "lack liquidation rules, and the Court's affirmation of effective liquidation lacks a legal basis (*fali yijü*)". *Shanghai Company Law Report*, *supra* note 8, at 45.

<sup>245</sup> There is no reason to think that the Shanghai People's Courts *cannot* act in the fully autonomous way posited above. Contrast the two 2006 outcomes described here with the result in a pre-2006 Company Law case (decided under the 1994 Company Law which had no provision allowing shareholder suits for judicial dissolution): *Shanghai Jingfa Enter. Dev. Co. v. Shanghai Haining Petroleum Prod. Co.*, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 299-309 (Shanghai No. 2 People's Ct., 2003), *aff'd*, Shanghai Higher People's Ct. (2003). In that case the Shanghai No. 2 Intermediate People's Court orders the "put" of equity interests owned by complaining shareholders to the other (breaching) shareholders so the company may "continue normal operations" and continue to "maintain utilization of the company's accumulated value". *Id.* at 304. However, the court also implicitly allows redeployment of capital by the complaining shareholders to continuing and better productive uses. The judicial rhetoric about "market stability" and "continued use of productive assets" in this case is roughly the same, but the 2003 Court feels emboldened to fashion continued firm existence via its own, implicitly far more efficient, remedy—a remedy which speaks to the significant power and autonomy of the Court itself.

resource or competence constraints,<sup>246</sup> but is very often an expression of studied Court avoidance of granted institutional powers.

A recent case reported by a sitting judge of the No. 2 Intermediate People's Court No. 3 Civil Division demonstrates the conservative adjudicatory style.<sup>247</sup> Plaintiff Sun and Defendants Li and Shi acted as promoters in the formation of a limited liability company, the Shixin Company. Defendant Li was originally named Legal Representative of the company. In October 2006, the company convened a shareholders' meeting at which each of the three shareholders of the company signed the meeting registry. The shareholders at the meeting considered and voted on a resolution addressing (i) the removal of Defendant Li from all positions at the company, (ii) the validity of an agreement executed in September of 2006 with Plaintiff Sun, and (iii) the withdrawal of the company's suit against Plaintiff Sun, with all litigation costs to be borne by Defendant Li.<sup>248</sup> Both Plaintiff Sun and Defendant Shi signed the shareholders' resolution, but Defendant Li refused. Defendant Li rejected the validity of the shareholders' resolution, but did not bring suit as permitted under the 2006 Company Law seeking to invalidate or declare the resolution *ineffective*. Plaintiff Sun, however, did bring suit before the Shanghai People's Courts asking that the resolution be declared *effective*. The trial court, probably a District-level Shanghai People's Court, rejected Sun's lawsuit that sought a declaration of effectiveness for two reasons. First, it was rejected for what the Court called a

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<sup>246</sup> In public statements, several Shanghai People's Court judges noted obvious resource and competence constraints operating on their performing as proposed under the 2006 Company Law or other major statutory formulations, such as in liquidation proceedings under the Company Law or bankruptcy proceedings (reorganization or liquidation) under the new PRC Bankruptcy Law (Dec. 5, 2008) (on file with author).

<sup>247</sup> The case is Sun X. v. Li Y., *Fayuan Nengfo Shouli Gudong Qingqiu Queran Gudonghui Jueyi Youxiao de Susong [Should the People's Courts Accept Shareholders' Suits Seeking Confirmation of Validity of Shareholders' Resolutions?]*, in COMPANY CONTROVERSIES 28-29 (Dist. People's Court not identified), *appeal filed*, Shanghai No. 2 Interm. People's Ct. (No. 3 Civil Division) (2007 or 2008).

<sup>248</sup> Although never stated explicitly in the Intermediate People's Court's judge's recitation of the facts, it would seem that the underlying dispute revolved around the ouster of Defendant Li from a leading position in the company, in favor of Plaintiff Sun, with Sun directing the company to withdraw its lawsuit against Sun (presumably after he or she gained control of the company pursuant to the September 2006 agreement).

“procedural” defect: the 2006 Company Law and the company’s Articles of Association mandate that shareholders’ meetings should be reduced to meeting minutes. Because the disputed resolution was not reduced to any form in the shareholders’ meeting minutes, it was deemed defective. Second, the lower-level Court identified an evidentiary problem: in a situation where one shareholder does not recognize a resolution and the only evidence offered to the Court is the actual resolution signed by just two of three shareholders, it is difficult, the Court said, to determine whether the shareholders’ meeting actually passed the resolution.<sup>249</sup> Therefore, said the Court, pursuant to Article 11 of the 2006 Company Law (which speaks to the binding effect of company Articles of Association) the plaintiff’s suit should be rejected. Plaintiff Sun appealed to an unnamed Intermediate People’s Court, likely the Shanghai No. 2 Intermediate People’s Court where the judge reporting the case sits. The appeals-level Intermediate People’s Court also rejected the plaintiff’s suit for a declaration of effectiveness, but on radically different grounds, declaring irrelevant the bases invoked by the District-level People’s Court. The Intermediate People’s Court focused on Article 22 of the 2006 Company Law, that provision of the new statute which allows shareholders’ suits to challenge the validity of shareholders’ meeting resolutions because the resolution substantively violates law, regulation or the company Articles of Association, or the convening of the meeting or voting procedures violate law, regulation or the company’s Articles of Association. As the Court noted, Article 22 of the new Company Law bestows upon shareholders injured by a defective or illegal resolution the right to sue for a specific remedy to protect their rights. However, the Court continued, if the injured shareholder does not bring suit under the 2006 Company Law to have the allegedly defective resolution declared ineffective, “the People’s Courts should not use the coercive power

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<sup>249</sup> The Court seems to be implying that shareholders’ resolutions should be passed unanimously, or in the alternative that all shareholders must be present and voting to establish a quorum.

of the state to interfere with matter within the scope of a company's self-governance."<sup>250</sup> In the instant case, concluded the Intermediate People's Court, the subject resolution is obviously harmful to the ousted shareholder, Defendant Li, yet he is not the person who has brought suit regarding the resolution. Instead, the suit seeking an affirmative declaration of *effectiveness* (not a negative declaration of *ineffectiveness*) had been brought by Plaintiff Sun, one of the beneficiaries of the contested resolution. Accordingly, the Court stated, Plaintiff Sun's lawsuit "by nature does not conform to the conditions set for the acceptance of civil lawsuits by the People's Courts, and in addition the suit lacks an appropriate [legal] basis (*xiangying de yijii*)".<sup>251</sup>

The case nicely demonstrates one aspect of the very conservative orientation of the Chinese People's Courts in accepting and hearing lawsuits on the 2006 Company Law. According to the analysis of the Intermediate People's Court judge reporting the case, the Court had a choice in its approach. A more autonomous judicial institution might have reasoned that the explicit legal basis for shareholders' suits challenging resolutions set out in the Company Law does not mean that related suits without the exact same legal basis are prohibited. Given the radically expanded justiciability of the 2006 Company Law, and in the absence of explicit legal bases for a large universe of legal claims, a more self-confident Court might not have thrown out the claim simply due to the lack of a very explicit legal basis for the action. Furthermore, the judge notes, basic logic dictates that if lawsuits which have the effect of declaring resolutions ineffective are permitted, then by the same token lawsuits seeking declarations of effectiveness should also be allowed. Finally, because there are so many disputes about the validity of shareholders' resolutions, Courts must exercise a role in declaring the resolution effective or non-effective (*i.e.*, there is no other state actor able to do this authoritatively).

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<sup>250</sup> Sun X. v. Li Y., COMPANY CONTROVERSIES 28 (Dist. People's Court not identified), *appeal filed*, Shanghai No. 2 Interm. People's Ct. (No. 3 Civil Division) (2007 or 2008).

<sup>251</sup> *Id.*

The conservative view is just the opposite: First, basic statutory interpretation holds that if, when the Company Law was amended, the PRC legislature chose not to provide an explicit legal basis for lawsuits seeking declarations of validity, then the legislature acted with some specific intent and did not want to provide for such a claim. Second, shareholder meeting and voting procedures should be undertaken pursuant to the firm's Articles of Association except if in violation of a mandatory article of law. Accordingly, the content of shareholders' resolutions should be decided, autonomously, by the company, and should only be disturbed if in violation of the company Articles of Association. Thus, unless a dissident shareholder lawsuit seeks to declare a resolution invalid, the People's Courts should not interfere with matters within the scope of company autonomy and self-ordering. Third, those shareholders who seek confirmation of validity have other remedies under the Company Law against the shareholders (or the company under control of those shareholders) not complying with the allegedly effective resolution—*e.g.*, a suit for damages. The Intermediate People's Court deciding this case adhered to a decidedly conservative view of the People's Courts institutional role in corporate law cases.

The indications of conservative application of the law, or constrained autonomy, are multi-faceted and include limitation on common law or equity court-style decision making, judicial construction of enabling rules as mandatory stipulations, strict formalism or non-application of the law in the absence of statutory or Regulatory authorization, and the non-application, or a ferocious struggle to avoid implementation, of corporate fiduciary duties doctrine.

- i. Limitation on Equity Court-like Decision Making

In many cases the Shanghai People's Courts limit the ability of litigants to take advantage of equity court-like elaboration or exceptions to statutory rules which remedy illegality or

opportunism. In so doing, they stand stubbornly behind the bargain that is a business association established as a “company” under the Company Law. One 2000 case<sup>252</sup> rejected a 20% shareholder’s suit for distribution of dividends from a two-person corporation when the 80% shareholder-dominated shareholders’ meeting had already resolved not to make any distributions. The reasoning was that the statutory standard for voiding a shareholders’ resolution under the 1994 Company Law is high, “breach of law or administrative regulation, or infringement upon the lawful rights of shareholders.” In the absence of any breach of positive law, or direct rights infringement, and with a properly-convened shareholders’ meeting resolving in the interest of the 80% majority shareholder, the plaintiff minority shareholder subject to oppression had no case. In this example, one of many, the Shanghai People’s Courts signaled to the participants in the corporate form that the judiciary will support inflexible aspects of the corporate law compact, and intervene only when a very high standard of breach/infringement is identified.

ii. Enabling to Mandatory

A second and perhaps related expression of conservatism is the tremendous affection shown by the Shanghai People’s Courts for the rules set forth in the Company Law. Here the Courts effectively take such rules from the *enabling* column and invest them with the character of *mandatory* rules which may not be contravened by private ordering. For example, one 1995 Shanghai case<sup>253</sup> reversed the appointment in a company limited by shares of three new directors to the board pursuant to a clause in the Articles of Association granting the board the power to do

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<sup>252</sup> Guo Chaoxu v. Shanghai Saiyang Textile Sci. and Tech. Co., 2000 HU ER ZHONG JING ZHONG ZI No. 280, SELECTED COMPANY LAW CASES 260-65 (Shanghai Hongkou People’s Dist. Ct., 1999), *aff’d*, Shanghai No. 2 Interm. People’s Ct., (2000), *also available at* <http://www.lawyee.net>.

<sup>253</sup> Zhang X. v. Shanghai A Co. Ltd., SELECTED COMPANY LAW CASES 229-31 (unidentified Shanghai Dist. People’s Ct., 1995), *appeal filed*, unidentified Shanghai Interm. People’s Ct. (1995).



just that. Both the People's Court of first instance and the Intermediate People's Court on appeal held that Articles of Association which purport to vest in the *board* the power to *appoint* directors were "illegal" (*weifa*) and invalid, because they were contrary to the 1994 Company Law provision vesting the power to *elect* directors solely in the *shareholders' meeting*. The two Courts held to this judgment in the face of quite reasonable pleadings by the defendant company that the offending Articles of Association clause was passed by the shareholders' general meeting, which the company asserted should be seen as a delegation of the shareholders' statutory powers to elect directors to the board. A later 2001 case similarly cast very serious doubt on the validity of a stand-alone shareholders' capitalization agreement which is different from the Articles of Association (also setting forth capitalization requirements), by ruling that the contractual capitalization plan would implicate one of the investors in a violation of the 1994 Company Law's prohibition on passive investment of more than 50% of "net assets."<sup>254</sup> That single fact poisoned the enforceability of the private-ordering agreement.

### iii. Strict Formalism or Non-application

A third expression of conservatism, embodied in the *Sun X.* case detailed at the start of this section,<sup>255</sup> is a strict formalism or case decisions determined by a Court's view that there exists no explicit "legal basis" for implied rights in *corporate* law. There are numerous examples of this kind of conservative adjudication. A 1998 opinion ruled that an agreement transferring beneficial ownership of 20% of a company's stock (and the expectation of annual dividends) is enforceable under *contract* law, notwithstanding the failure of the parties to make the transfer known or see to public registration of the share ownership change under *corporate*

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<sup>254</sup> Shanghai Minzu Music Instruments No. 2 Factory v. Shanghai Heli Trade Co., NEW COMPANY LAW CASES 45-49 (unidentified Shanghai People's Ct., 2001), (shareholders' agreement is thus void *ab initio*, and even if not void, then without effect as against the company and the world at large (which the Articles of Association are)).

<sup>255</sup> See *supra* notes 247 to 251 and accompanying text.

law.<sup>256</sup> The defendant's argument that the shares (and dividend rights) were never really transferred in *corporate* law was deemed irrelevant in the face of a separate and entirely enforceable *contractual* promise by one party to pay over dividends to another. Here the Shanghai People's Court side-stepped a possibly messy corporate law/equitable rights transfer question by focusing solely on the formalistic action (or inaction) of the parties and a purported contractual obligation. In a case from 1999-2000, the Shanghai No. 2 Intermediate People's Court overturned the expansive view of the Jingan District People's Court (and the latter's invocation of Article 4 of the General Principles of the Civil Law)<sup>257</sup> in a corporate shareholders' suit, and pulled the parties back to a strictly formalistic approach to the corporate law and property rights.<sup>258</sup> In that case, the court of first instance acted liberally in recognizing the plaintiff investor's direct equity interest in a project company even though the plaintiff was a so-called "hidden" (*yinming*) shareholder, *i.e.*, merely in contract with a name shareholder of the company and maintaining no legal privity whatsoever with the corporate vehicle. Aside from the broad invocation of Article 4 of the General Principles of the Civil Law, the lower court said the other declared shareholders in the company were estopped from denying the hidden shareholder's interest because they had knowledge of the plaintiff's investment participation in the company. The Shanghai No. 2 Intermediate People's Court, seeking to correct the errant lower Court, took a much more formalistic approach to the problem, dismissing the application of vague Article 4 of the General Principles of Civil Law and declaring with enviable certainty

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<sup>256</sup> Shanghai Xinlu Battery Co. v. Shanghai Dongda Imp. Exp. Co., NEW COMPANY LAW CASES 231-33 (unidentified Shanghai People's Ct., 2001), (defendant obligor's claim that stock transfer agreement with plaintiff transferee is not effective deemed irrelevant to enforceability of defendant's obligation to pay over 20% of dividends to same plaintiff transferee shareholder).

<sup>257</sup> The catch-all (commercial) "good faith" clause which so often in the Chinese People's Courts justifies equity court-style adjudication. See *supra* notes 157-180 and accompanying text, the section entitled "The People's Courts Act in "Equity" or in a Common Law Fashion".

<sup>258</sup> Shanghai Jingan Food and Beverage Serv. Co. v. Shanghai Foreign Econ. Serv. Co., SELECTED COMPANY LAW CASES 86-93 (Shanghai Jingan Dist. People's Ct., 1999), *rev'd*, Shanghai No. 2 Interm. People's Ct. (2000).

that the agreement between the hidden and name shareholders was effective only between those two parties, and had no legal meaning against third parties or the world at large, including other name shareholders or the company itself.<sup>259</sup>

In a 2001 opinion upheld by the Shanghai Higher People's Court, a District-level People's Court refused to award an ESOP-like participating former employee any *stock* interest in a newly-established corporate entity promoted partially on the basis of the ESOP's contributed shareholding interest in a predecessor company. Both Courts justified the refusal with the rationale that participants in the dissolved ESOP were not identified in the share register of the new company.<sup>260</sup> In 2004, the Shanghai Higher People's Court struggled *not* to award the hidden investor in a Chinese-foreign joint venture an equity interest in a successor limited liability company, because the interest was booked to a different name and notwithstanding years of dividend distributions to the real investor and a written promise by the company acknowledging that the equity investment was put in the name of another only "temporarily" at the time of conversion of the legal entity into a limited liability company.<sup>261</sup> The Higher Court's opinion in the case was based on its view that recognition of the real investor's US\$2.17 million investment in the company was a matter to be sorted out between the name investors and the true parties in interest, which had a "direct legal relationship," not by the company which had no legal privity with the capital provider. This position is a stretch, as the company had itself issued

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<sup>259</sup> From a corporate law policy perspective, this is almost certainly the correct result in the case, as it is the only way to encourage parties in Shanghai to delineate and confirm, as a public matter, their purported property rights, and remove from the Shanghai docket a huge number of intent-determined property rights cases. However, it also serves to over-turn the more accommodating, legal realist, adjudication of the lower People's Court in the case.

<sup>260</sup> See *X. Jiyin Chip Co. v. Y. Group Co., Ltd.*, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 71-77 (Shanghai Luwan Dist. People's Ct., 2001). This result no doubt is one of the reasons for new Article 33 of the 2006 Company Law, which stipulates that only those natural or legal persons identified in the share register of a limited liability company can "exercise the [full] rights of a shareholder." 2006 Company Law, *supra* note 5, art. 33.

<sup>261</sup> See *Honghui Int'l Co. v. Shanghai Minfeng Inv. Co., Ltd.*, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 270-77 (Shanghai Higher People's Ct., 2004), (equity interest by real investor in limited liability company not recognized over interest of name investor, because real investor must seek remedy not from issuing company but name investor).

a document acknowledging the real investor's contribution of US\$2.17 million to the company's capital account, and promising to transfer the resulting interest into the name of the rightful investor.<sup>262</sup> This example once again shows a Court in the Shanghai system striving not to use China's corporate law in a flexible way, but instead in an entirely undiscerning and mechanical manner to avoid the exercise, or appearance of the exercise, of significant judicial power. A similar 2006 case shows the Courts rejecting a dissident shareholders group request to order amended firm registration to *status quo ante*, even though the defendant's re-registration was proven in separate proceedings to have been fraudulent.<sup>263</sup> In that same case, the Courts awkwardly invalidated the dissident (but majority) shareholders' meeting based upon a very minor defect in the notice given to the *same* dissident shareholders.<sup>264</sup> It seems nonsensical for the Courts to invalidate a meeting organized by a group of shareholders because of a defect in notice *to those shareholders*, who never even pleaded the defect. Clearly the Courts in this case were reaching for whatever safe harbor they could find to avoid involvement in a shareholder squabble and adjudication of somewhat abstract misfeasance (oppressive and opportunistic behavior by the defendant shareholder).

Even in areas where it is clear that litigation will arise, and even in the face of lower-level People's Courts consciously trying to act more autonomously, the Shanghai People's Courts often take the same conservative approach to issues where there is no clear legal or policy basis. A good example of this approach is the reaction of the Shanghai judiciary in 2006-2007 to the problem of contributed services (as capital). Although Article 27 of the 2006 Company Law is

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<sup>262</sup> As a back-up to this argument, the Court holds that the original investment by the (Hong Kong-domiciled) plaintiff in the company, when it was a Sino-foreign joint venture, was not in compliance with law (and thus would not be recognized in law *ex post*), because it was/would have been a capital contribution by a foreign investor into a foreign invested enterprise without the required approvals from the foreign investment review authorities.

<sup>263</sup> Yu Xiaoqi v. Shanghai Changxin Accountancy Co., Ltd., ANALYSIS OF NEW CASES 178-184 (Shanghai Changning Dist. People's Ct., 2006), Shanghai No. 1 Interm. People's Ct., (2006).

<sup>264</sup> *Id.* at 186-87.

silent on the permissibility of human capital contributions, the 2005 “Regulations of the PRC on Administration of Company Registration”<sup>265</sup> specifically forbid the contribution of labor services (*laowu*).<sup>266</sup> The Shanghai Higher People’s Court reported in 2007 that the Pudong New District People’s Court system had on its own already accepted a large number of cases concerning human capital or services contribution. The Higher People’s Court duly noted that with no legal or regulatory basis for the definition of “human capital,” and no local People’s Government or “department-in-charge” policy guidance, the People’s Courts had found it very difficult to define the concept in practice. This state of affairs was problematic for the Shanghai judiciary, said the Higher Court, because many company establishments in Shanghai are capitalized, whether in shareholders’ agreement or the Articles of Association of the company, by the contribution of personal knowledge, technical skills and ability, and the like. Accordingly, in 2005 the Shanghai *Municipal* People’s Government had been forced to issue the *District*-specific “Pudong New District Provisional Measures on Human Capital Contributions” setting forth two legally cognizable mechanisms for the valuation of such contributions.<sup>267</sup> As noted further in the report, upon promotion and establishment of companies accepting personal services contributions as equity, lawsuits invariably arose, most often in the context of individuals trying to leave a company or transfer the equity interest gained in exchange for their personal intangible investment. At the same time, said the Court, very difficult questions concerning (potential) harm to third party creditors and undercapitalization of the firm partially capitalized with

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<sup>265</sup> See *supra* note 183.

<sup>266</sup> “A shareholder shall not make his capital contributions with labor service (*laowu*), credit (*xinyong*), the name of the natural person, goodwill, franchise rights (*texu jingyingquan*), secured property, or the like, at its appraised value.” *Id.* at art. 14(2).

<sup>267</sup> Those being evaluated by a third party certified appraiser or agreed by the entire shareholders meeting. The Measures also set forth an accepted mechanism for paper confirmation of such valuation by an accredited capital verification institution. The Higher People’s Court reported that historically all cases had relied on shareholders’ meeting agreement for the valuation of human capital contributions, done casually, even “blindly”, in a relatively uninformed way, and in a fashion where the opportunities for inaccuracy and undercapitalization were rife.

services were at issue. Recognizing all that, and understanding the requirement that human capital contributions to corporate business organizations be permitted, and notwithstanding its praise for the solution implicit in the rogue District-level norms, the Higher Court in 2007 nonetheless counseled the Shanghai People's Courts to take a very cautious approach to the question<sup>268</sup> and warned against "blind support and pursuit of a policy with very obvious defects."<sup>269</sup>

The Shanghai judiciary appears to defer when faced with the lack of an explicit legal basis in at least two other areas. The Shanghai Higher People's Court report on the 2006 application of the new Company Law states categorically that the Shanghai Courts are "temporarily" *not* to accept the invitation in Article 184 of the 2006 Company Law allowing them to direct the establishment of liquidation committees because "[the Shanghai People's Courts] lack liquidation rules, and the Courts affirmation of effective liquidation lacks a legal basis (*falü yijü*)."<sup>270</sup> In the same vein, one senior judge at the Shanghai No. 2 Intermediate People's Court in 2008 called for an explicit legal basis to help in the handling of related party creditors in bankruptcy proceedings, or something similar to the doctrine of equitable subordination or the "Deep Rock Doctrine." That judge asserted that the PRC is a "civil law country" (*chengwenfa guojia*) and therefore any doctrine of equitable subordination, like any definition of related party creditors, can be introduced into judicial practice only via additional statute, or judicial Regulations. In doing so he rejected out of hand any idea that the Shanghai

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<sup>268</sup> In the words of the Court, so as to serve the highest values of standardization (*guifan*) and promotion of healthy market development.

<sup>269</sup> *Shanghai Company Law Report*, *supra* note 8, at 46.

<sup>270</sup> *Id.* at 45. Echoed in the remarks of the Chief Judge of the No. 2 Civil Division of the Shanghai Higher People's Court noted *infra*.

People's Courts might themselves develop such a doctrine for application in bankruptcy cases.<sup>271</sup> Yet another Shanghai judicial official, this time a Shanghai Higher People's Court judge, asked for the same kind of direction in 2008 with respect to an implantation of a *de facto* merger doctrine, again discounting any possible elaboration of this concept by the judiciary or outside of Supreme People's Court Regulations or legislative pronouncement.<sup>272</sup> One interesting aspect of this push-back justified on the lack of any "legal basis" is that explicit examples appear more often *post-2006* and thus after a legal basis had been provided in statute for an enforceable aspect of corporate law.<sup>273</sup>

The autonomy breakdown I note here is in many situations indicated by the explicit request for superior bureaucratic guidance in respect of difficult (and not so difficult) cases. For instance, in its report on Company Law implementation in 2006, the Shanghai Higher People's Court indicates with some apparent relief that in 2006 it never<sup>274</sup> actually "pierced the corporate

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<sup>271</sup> Fu Yang, *Pochanfa Miandui Guanlian Zhaiquan de Kunjing Yü Shenshi Yuanze de Yinrun* [Problems Facing Related Party Creditors Under the Bankruptcy Law and Use of the Deep Rock Doctrine], in COMPANY CONTROVERSIES, *supra* note 218, 184-91.

<sup>272</sup> Remarks of Yang Yisheng, Judge of the Shanghai Higher People's Court, at "Company Controversies and Judicial Remedies" Conference held at East China University of Politics and Law, Shanghai, PRC (Dec. 5, 2008) (notes on file with the author).

<sup>273</sup> Prior to 2006, one of the only explicit examples of such rejection is the 2001 opinion which fails to award a former employee of a collective any *stock* interest in a newly-established corporate entity promoted partially on the basis of the ESOP's contributed shareholding interest in a predecessor company because the ESOP has no basis in PRC law. See *X. Jiyin Chip Co. v. Y. Group Co., Ltd.*, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 71-77 (Shanghai Luwan Dist. People's Ct., 2001).

<sup>274</sup> *But see*, after 2006, *Shanghai Huaxin Elec. Wire and Cable Co. v. China Tietong Group Co.*, 2007 HU GAO MIN ER (SHANG) ZHONG ZI NO. 145 (Shanghai No. 2 Interm. People's Ct. (No. 4 Civ. Div.), 2007) (RMB 32 million creditor pierces to the Beijing-based SOE parent of a Shanghai limited liability company debtor where the parent has undercapitalized the debtor by RMB 38 million yuan, as confirmed by separate judicial decisions of Suzhou and Beijing People's Courts, specifically upholding the assertion of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law), *aff'd*, Shanghai Higher People's Ct. (2007), available at <http://www.hshfy.sh.cn/fyitw/gweb/>. The idea that the Shanghai People's Courts are not handling piercing cases post-2006 and into the end of 2008 was *vigorously* disputed in December 2008 by Zou Bihua, the Chief Judge of the Shanghai Changning District People's Court and a judge from the Shanghai No. 2 Intermediate People's Court, who stated that the workload of piercing cases has only increased with formal authorization in the 2006 Company Law (notes on file with author).

veil,” because all such cases were settled,<sup>275</sup> withdrawn, or dismissed. The Shanghai Higher People’s Court evidences some happiness at this result and openly wonders how, if piercing had happened, its subordinate Courts might have performed in specific aspects such as assessing liability for all shareholders (*i.e.*, not just the controlling shareholder) of the discarded corporate form, the extent to which the Courts can keep on piercing (up through successive layers of limited liability), and how to define “misuse” of the corporate form.<sup>276</sup> These aspects, and above all the factors determinative in disregarding the corporate form, remain mysterious to the Shanghai Courts, to the extent that the Shanghai Higher People’s Court requested that the Supreme People’s Court or the legislature provide guidance.<sup>277</sup> The Shanghai Higher People’s Court explicitly sought the same kind of guidance on how to handle *creditors’* suits for liquidation<sup>278</sup> and situations in which the shareholders of a company in liquidation do not want to implement liquidation for the benefit of creditors, who want liquidation.<sup>279</sup> As noted above, in 2008 the Supreme People’s Court issued the 2<sup>nd</sup> Regulations on application of the 2006 Company Law in just this area. Still, the Chief Judge of the Shanghai Higher People’s Court No. 2 Civil Division declared in December 2008 that the Shanghai Courts still feel at a complete loss in shareholder-instigated dissolution-liquidation proceedings and are still hesitant about accepting them.<sup>280</sup> In much the same way, the Shanghai Higher People’s Court noted difficulties

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<sup>275</sup> Seen for example before 2006 in *Xishan City Chem. Prod. Mfg. Co. v. Shanghai Aoshi Enter. Co.*, NEW COMPANY LAW CASES 293-99 (unidentified Shanghai Dist. People’s Ct., 2000), *aff’d*, unidentified Shanghai Interm. People’s Ct. (2000).

<sup>276</sup> The Higher People’s Court itself tries to identify some of the factors which might constitute “misuse”, including undercapitalization, high debt to equity (registered capital) ratios, and same premises, management overlap, etc. In an indication of the direction they might be headed, the Higher People’s Court asserts that the same premises-shared management phenomenon is especially prevalent *at SOEs* that have formed subsidiary listed companies limited by shares.

<sup>277</sup> *Shanghai Higher People’s Court No. 2 Civil Division 2007*, *supra* note 8, at 48.

<sup>278</sup> Which it says it will not accept until there are judicial Regulations promulgated addressing the same.

<sup>279</sup> *Shanghai Higher People’s Court No. 2 Civil Division 2007*, *supra* note 8, at 49.

<sup>280</sup> Remarks of Ms. Yu Qiuwei, Chief Judge of Shanghai Higher People’s Court No. 2 Civil Division, Dec. 5, 2008 (on file with author). As noted above, this discomfort is ostensibly based on a self-perceived competence deficit, as much as constrained autonomy.



in actual application of the 2006 Company Law's new resolution-invalidating mechanism. Although the statute provides precise shareholder level and period requirements for derivative lawsuits, no similar statutory requirements apply to lawsuits seeking to invalidate shareholders' and directors' resolutions. While the Court acknowledged that it now must accept the latter kind of cases, even for publicly-listed companies, it also calls on its bureaucratic superior to set qualifications on the action, lest listed companies become subject to vexatious litigation or opportunistic strike suits by minority shareholders.<sup>281</sup>

On occasion, the Courts ask not for instructions from their bureaucratic superior, but from the legislature. For instance, both the 1994 and 2006 Company Laws place an upper limit of 50 shareholders for the limited liability company form. This limitation fans the widespread problem of hidden shareholders in China, individuals with an economic interest in a company who must conceal their formal shareholders' interest so as not to exceed the maximum legal number of shareholders.<sup>282</sup> In its report on Company Law application in 2006, the Shanghai Higher People's Court urged PRC legislative institutions to create a legal basis for "trust" relationships, in which a single "trust" can be the name shareholder on behalf of a larger body of individuals with economic interests in the investee company. Although the solution is a creative one, and it is a positive development to see a PRC judicial institution openly asking for more, and better, substantive law from the legislature, the appeal symbolizes how the People's Courts have so far deferred from *on their own* creating such "trusts" for share ownership.<sup>283</sup>

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<sup>281</sup> *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 48.

<sup>282</sup> A problem especially prevalent at converted collectively-owned enterprises and state-owned enterprises which want to issue share interests to many former collective members or SOE employees.

<sup>283</sup> *Shanghai Company Law Report*, *supra* note 8, at 46. Part of the concern here is not just institutional but political, as the Court is transparently worried about abuse of such "trust" shareholding arrangements as a way to hide prohibited personal official (political cadre) investment participation in companies.

iv. Avoiding Application of Fiduciary Duties Doctrine

A fourth and more specific expression of conservatism is the Shanghai judiciary's struggle not to implement corporate fiduciary duties, and not to recognize corporate fiduciary duties breaches in cases in which there is relative safety (and no claim for the plaintiffs) in strict reliance on statute or regulation.

The aversion to implementation of corporate fiduciary duties, admittedly a complex and difficult task, is a bit of a puzzle. The PRC People's Courts clearly applied corporate fiduciary duties doctrines even before authorization in the 2006 Company Law,<sup>284</sup> there is some evidence showing use of the doctrines in Shanghai,<sup>285</sup> and the Shanghai Courts seem content to advertise their ability to handle such cases.<sup>286</sup> Notwithstanding these proclaimed powers, the 2003 Shanghai Company Law Opinion does not mention any such case in its review of a decade's worth of corporate law adjudication in the period between 1993-2003. The later 2007 report by the Higher People's Court on 2006 adjudication admits that the People's Courts under its jurisdiction took relatively few cases involving "corporate management rights and obligations"—

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<sup>284</sup> See *Doctrine That Dared Not*, *supra* note 20.

<sup>285</sup> See *supra* notes 119 to 127 and accompanying text. Note however that there are also pre-2006 examples of the Shanghai Courts strenuously avoiding corporate fiduciary duties: see *China Textile Mach. Co. Ltd. v. Shanghai Mach. Imp. Exp. (Group) Co.*, NEW COMPANY LAW CASES 239-43 (unidentified Shanghai Dist. and Interm. People's Cts., 2001), (at entity established before 1994 Company Law on the basis of a "joint investment agreement", eventually with separate Articles of Association and "enterprise legal person" registration, one investor in not funding its full capital contribution and in transferring assets out of the arrangement without board or shareholder approval has breached its *contractual obligations* to the other investors, and *infringed upon the rights* of the other participants), *appeal dismissed*, unidentified Shanghai Interm. People's Ct. (2001), likely decided in this corporate fiduciary duties-avoiding way because the subject entity is not, at inception, a formal corporation, but a legal enterprise person initially formed by contract and only registered later.

<sup>286</sup> In its 2007 report on application of the Company Law in the Shanghai Courts, the Shanghai Higher People's Court celebrated the fact that after January 1, 2006 it could accept cases which were formerly dismissed because the underlying claims were without a "legal basis". Farther along in the same document, the Shanghai Higher People's Court indicates that it accepts such suits, or expects to accept them, as it has set up a special case designation for the same, or "disputes in which the directors or senior management have infringed upon the rights of shareholders" and "disputes in which the directors or senior management have infringed upon the rights of the company." See *Shanghai Company Law Report*, *supra* note 8, at 50.

breach of corporate fiduciary duties—in calendar year 2006.<sup>287</sup> And although as noted above there is evidence that the Shanghai People's Courts have acted after 2006 to define fiduciary standards,<sup>288</sup> my survey of Shanghai company law opinions found very little direct evidence of breach of corporate fiduciary duties cases for the Shanghai area.<sup>289</sup> In fact, any application and enforcement of corporate fiduciary duties standards against directors, officers and controlling shareholders at all can only be understood by a close reading of the pleadings in cases ostensibly about something else,<sup>290</sup> and in the context of CSRC enforcement actions against public company directors and officers.<sup>291</sup> Most often, the defects alluded to even there relate not

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<sup>287</sup> Because of the relative degree of difficulty of hearing such cases. *See Shanghai Company Law Report*, *supra* note 8, at 38.

<sup>288</sup> A. Precious Metal Co. v. China Indus. and Commercial Bank W. City X. Branch, 2006 NIAN SHANGHAI FAYUAN ANLI PINGXI 94-99 (Shanghai Luwan Dist. People's Ct.), (District-level People's Court investigates allegation of failure by entrustee/agent to conform to its "duty of cautious [investigation]" (*jinshen zhuyi yiwu*) (plaintiff's claim) or "duty of care of a good manager" (*shan liang guanlire de zhuyi yiwu*) under Article 406(1) of the PRC Contract Law (Shanghai Higher People's Court commentary), and finds no breach), *appeal dismissed*, unidentified Interm. People's Ct. (2006). How much happier the PRC People's Courts would be in trying to apply a fiduciary duty of care if the National People's Congress had passed the version first submitted to it which, at Article 20, contained an expanded version of duty of care and a standard of application (taken from Taiwan's Company Law and Taiwan's Commercial Code, and already a part of CSRC-promulgated mandatory articles of association). *See LAO Company Law Explanation*, *supra* note 19, at 530.

<sup>289</sup> The reports are equally spare for other jurisdictions; *see, e.g.*, Li Xiaozhong v. Jin Rongzhong, ANALYSIS OF NEW CASES 312-17 (Nanchuan People's Ct., 2006), (Nanchuan Municipality: directors, supervisory board members and senior management duty of loyalty); Wuxi Weiyuan Co. v. Xu Naihong, ANALYSIS OF NEW CASES 322-28 (Jiangsu Wuxi Binhu Dist. People's Ct., 2006) (Wuxi Municipality: senior management breach of duty of loyalty).

<sup>290</sup> *See, e.g.*, Tang Chunxiao v. Zhou Huizhong, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 138-44 (Shanghai No.1 Interm. People's Ct., 2005); Yang Lizhi v. Cao Chengjie, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 205-10, ANALYSIS OF NEW CASES 356-59 (Xuhui Dist. People's Ct., 2006).

<sup>291</sup> Usually as listed on the CSRC website, or occasionally reported in the Chinese press when a director or officer allegedly in breach (and subject to a CSRC fine) contests the administrative penalty. *See* Wang Dianxue, *Shanghai Gongsi Dongshi Beifa Zhuanggao Zhengjianhui [Penalized Director of a Listed Company Sues the CSRC]*, XINJINGBAO [NEW CAPITAL NEWS], June 4, 2008, at A24 [hereinafter *Listed Company Director Sues*], detailing a common situation: Shenzhen Shenxin Taifeng Co., Ltd. was de-listed on March 25, 2008, when the board of directors issued a notice stating that the board chairman had been arrested for overstating the capital of an important subsidiary. In August of 2007 the CSRC had announced that in its 2003 periodic reporting the company had: falsely inflated its inventory by RMB 20 million yuan and its receivables by RMB 65 million yuan, failed to report the misappropriation of RMB 26 million yuan of company funds, and failed to disclose in a timely manner five external guarantees (no doubt for related party beneficiaries) or 72 pending litigations relating to the company. The CSRC fined the chairman of the board, all of the directors, and the president of the company. Included among the punished directors was a Mr. Ding, who was fined RMB 30,000 yuan by the CSRC. Mr. Ding brought suit against the CSRC in the Beijing No. 1 Intermediate People's Court asking that the fine be overturned. Mr. Ding's lawyer pleaded for Ding's exculpation because Ding was "only a director appointed by a shareholder, and did not really participate in operation and management of the company" and so did not directly administer or operate the

directly to breaches of corporate fiduciary duties *per se*, but to the failure to disclose breaches such as breach of a fiduciary duty of loyalty in undisclosed related party transactions, or false or misleading disclosure resulting from director or officer failure to exercise due care in signing off on disclosure documents.<sup>292</sup>

More compelling perhaps than lack of fiduciary duties cases is the affirmative evidence that Shanghai People's Courts' strive to avoid corporate fiduciary duties doctrine, or refuse to take judicial notice of clear corporate law aspects which are not specifically pleaded. The following six cases are exemplary. First, a 2003 case involved the transfer of RMB 6.1 million yuan out of a Chinese-foreign equity joint venture-owned RMB yuan account *by and to* the Chinese partner, without the joint venture legal person's or the other investors' approval. The District People's Court and then the Shanghai No. 2 Intermediate People's Court deemed the transaction "not inappropriate" and thus permissible because accounting regulations applicable to foreign invested enterprises seem to confer power of disposition of such domestic funds on the Chinese partner.<sup>293</sup> A less deferential judicial agency might have been more sympathetic to the

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company, or directly manage or operate the company, "the only two kinds of people who can be fined under the *PRC Securities Law*" (emphasis added). The CSRC answered sternly in its counter-argument, stating that Ding had failed to demonstrate he had met his *corporate/securities law* "duty of care" (*qinmian yiwu*) in reviewing and approving the disclosure documents, or by failing to raise his disagreement with the false information once disclosed and put into the market. As noted *infra* notes 330 to 331 and accompanying text, this report also provides insight into how Chinese citizens (not just lazy directors and their lawyers) understand the (non-) application of the Company Law to publicly-listed companies, and may account for the relative paucity of public company cases in the Shanghai People's Courts. For an entirely similar argument on the responsibilities of a public company non-executive director, see the "Flower Vase" (Lu Jiahao) director case described at *Doctrine That Dared Not*, *supra* note 20, at 226-28.

<sup>292</sup> See Lu Jianming v. Shanghai Light Indus. Mach. Co., Ltd., ANALYSIS OF NEW CASES 189-94 (Shanghai Jingan Dist. People's Ct., 2006), Shanghai No. 2 Interm. People's Ct. (2006) (board resolution nominating director of listed company director not invalidated by board's failure to disclose—in the resolution—that nominee formerly worked for listed company's controlling shareholder and is defendant company's Legal Representative's wife), a case which normally would have been subject to CSRC enforcement. The fact that the case made it into the People's Courts is rare.

<sup>293</sup> See A. Co., Ltd. v. Shanghai B. (Group) Co., 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 83-86 (Shanghai No. 2 Interm. People's Ct., 2003), (transfer of RMB yuan funds out of corporate account by and to Chinese investor permitted because of special nature of account use and accounting regulation giving Chinese partner disposition rights over the same; the accounts were established to fund social welfare obligations payable in RMB yuan to Chinese employees of the joint venture and were not included in the joint venture financial accounts).

plaintiff's request for return of the funds, with interest, and then a reallocation of the same in accordance with the original partners' respective equity interests in the corporate joint venture. In certain contexts this kind of deference by judicial actors might be admirable. But here it eliminates the ability of those same judicial actors to intervene when participants in corporate legal persons opportunistically or oppressively use the corporate form to breach basic underlying corporate law obligations.<sup>294</sup>

Second, the late 2005 *Yingdafang* case briefed in the Case Reports Appendix shows a circumstance where multiple breaches of fiduciary duties are not recognized or punished because of a tightly constrained view of the sources of obligation (the Articles of Association of the legal person entity *only*) and a most exacting reading of the corporate law itself (limiting the application of non-compete prohibitions to directors and officers, not controlling shareholders in close corporations).<sup>295</sup>

Third, a subsequent 2006 case in which shareholders had their application for judicial dissolution denied by the first level People's Court also refused to consider, in the same action,

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Yet see the *contra* result in *Shanghai X. Elec. Co. v. Mr. A*, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 114-17 (Shanghai No. 2 Interm. People's Ct., 2003), (Japanese director of Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC invested limited liability company because of Japanese partner's sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director's personal account without joint venture board approval or joint venture investor (shareholder) approval). The difference in the two cases lies perhaps in the nationality of the fiduciary absconding with funds from the corporate entity, but also because the funds in the latter case are indisputably those of the corporate entity, with no investor in the entity having any color of a disposition right, and because the funds are accounted for as cash assets on the books of the same legal person entity. These cases are also interesting because they show that the Shanghai People's Courts will accept cases regarding Chinese-foreign joint ventures and apply the PRC Company Law to them, except where there are specific laws or regulations governing such joint ventures differently. Some national People's Courts, and many business people and lawyers disagree with strict application of China's corporate law to such foreign invested enterprises.

<sup>294</sup> See for example the much earlier case, *Chen Zhijin v. Shanghai Kaikai Enter. Co., Ltd.*, 1998 HU ER ZHONG JING ZHONG ZI No. 729 (Shanghai Jingan Dist. People's Ct., 1998), *partially aff'd*, Shanghai No. 2 Interm. People's Ct. (1998), where the People's Court supports a mandatory buy-back of so-called "internal" (employee) shares, and at a very low price of RMB 1.00 per share against net per share asset value at the time of buy-back of RMB 2.80 yuan, because the plaintiff has only challenged the buy-back and not "raised" the price issue.

<sup>295</sup> See *Shanghai Yingdafang Serv. Co. v. Shanghai Yingdafang Zhangjiang Prop. Mgmt. Co.*, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 190-95 (Shanghai Pudong New Dist. People's Ct., 2005), Shanghai No.1 Interm. People's Ct. (2005), reported in detail in the Case Reports Appendix.

evidence of breach of corporate fiduciary duties by defendant directors (including transfer of corporate funds into personal accounts, diversion of assets sale proceeds into personal accounts, and some evidence of accounts manipulation). Instead, the Court held very closely to the Article 183 inquiry as pleaded.<sup>296</sup>

Fourth, in the complex dissident shareholder case invoked above<sup>297</sup> the Shanghai People's Courts avoided discussing clear fraud (already identified and punished by other public institutions) and breach of corporate fiduciary duties by a controlling shareholder/Legal Representative, and ruled out of order and ineffective shareholder self-help (resolutions produced at a special shareholders' meeting) aimed at defeating the rogue partner. The decision was based on the most technical grounds pertaining to compliance with detailed procedures in the company's Articles of Association.

In a fifth case decided in 2006, Shanghai People's Courts refused to identify how the failure to disclose a public company nominee director's employment and personal relationships was a breach of the fiduciary duty<sup>298</sup> to inform shareholders prior to the exercise of their voting rights.<sup>299</sup>

Finally in a sixth case, also from 2006, an appeals-level People's Court subjected a shareholder to a mandatory buy-back of his stock in a "cooperative stock" entity, even though the first-level People's Court and the appeals-level Court (in the first hearing and opinion)

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<sup>296</sup> Yang Lizhii v. Cao Zhengjie, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 205-10, ANALYSIS OF NEW CASES 356-59 (Xuhui Dist. People's Ct., 2006).

<sup>297</sup> Yu Xiaoqi v. Shanghai Changxin Accountancy Ltd., ANALYSIS OF NEW CASES 178-87 (Shanghai Changning Dist. People's Ct., 2006), Shanghai No. 1 Interm. People's Ct. (2006).

<sup>298</sup> Think breach of "duty of candor" described in *Smith v. Van Gorkom*, 488 A.2d 858 (Del. Sup. Ct., 1985).

<sup>299</sup> Lu Jianming v. Shanghai Light Indust. Machinery Co., Ltd., ANALYSIS OF NEW CASES 189-94 (Shanghai Jingan Dist. People's Ct., 2006), (board resolution nominating director of listed company director not invalidated by board's failure to disclose—in the resolution or the accompanying notice—that nominee formerly worked for listed company's controlling shareholder and is the wife of the defendant company's Legal Representative), Shanghai No. 2 Interm. People's Ct. (2006). Here the Courts rule very narrowly on the specific question of whether the board resolution is "in violation of law or regulation," or whether the content of the resolution violates the company's Articles of Association as in effect at the time of the meeting.

identified the forced put as an opportunistic use of the shareholders' general meeting highly indicative of breach of fiduciary duties and fair dealing in the close corporation context.<sup>300</sup>

In each of these cases, the People's Courts involved stubbornly refused to take cognizance of facts and circumstances rather pregnant with breach of corporate fiduciary duties, and instead ruled very narrowly based upon whatever affirmative law, regulation or stipulation of the Articles of Association was available and/or specifically pleaded. This evidence again suggests not only an institutional distaste for cases which require a high degree of technical competence, but more importantly a constraint on the autonomy of the Courts in reaching beyond contract, the Articles of Association or any other positive legal norm to apply powerful corporate law doctrines.

In its 2007 report on the first year of application of the 2006 Company Law, the Shanghai Higher People's Court describes a basic adjudication principle which casts some light on why there is a paucity of corporate fiduciary duties cases (outside of those implicated in the almost blanket refusal to accept public company limited by shares cases discussed *infra*) and evidence of studied avoidance of such claims. That basic principle is the priority given to commercial law (*shangfa*) over civil law (*minfa*) in corporate law cases. The principle is a profound one in the workings of the Chinese legal system and civil law-family jurisdictions.<sup>301</sup> In the Chinese case it holds that the People's Courts should apply the directly related commercial law (*e.g.*, the Company Law, the Securities Law, or the Contract Law) first, and only then having recourse to

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<sup>300</sup> Shanghai Shenmao Dianci Factory v. Wang Longbao, 2006 HU YI ZHONG MIN SAN (SHANG) ZAI ZHONG ZI NO.1, 2004 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 324-27 (Shanghai Nanhui Dist. People's Ct., 2004), (forced buy-out of stock in "non-profit" stock cooperative upon Vice Chairman's leaving employ pursuant to board regulations, shareholders' resolution and Articles of Association not a violation of shareholders' rights, where the Court cites *not* the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry level Commission on the Restructuring of the Economic System and Shanghai "Provisional Measures" on stock cooperatives and collectives), *aff'd*, Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2004), *rev'd on reh'g* Shanghai No. 1 Interm. People's Ct. (No. 3 Civ. Div.) (2006), *also available at* <http://www.hshfy.sh.cn/fyitw/gweb/>.

<sup>301</sup> This is not to say that the PRC's legal system should be construed as a part of the civil law family of legal systems.

more generalized “civil” law if the specifically-tailored “commercial” law does not address the problem. This principle is part of a conservative vision which seeks to dampen the People’s Courts’ enthusiasm for application of broad doctrines and remedies (such as the catch-all breach of (civil law-system) “good faith” (*chengshi xinyong*) or “infringement of rights” (*qinquan*) under the General Principles of the Civil Law) in favor of close adherence to what the Chinese legislature has offered in statute as legal causes of action and remedies.<sup>302</sup> As an illustrative example, in a pre-2006 breach of fiduciary duty of loyalty context this guiding principle would counsel that judges identify a specific breach of bright-line loyalty provisions over invocation of a breach of abstract corporate fiduciary duties (cast as lack of “good faith” or “rights infringement” under the General Principles of the Civil Law). This orientation perhaps illuminates the relative lack of fiduciary duties cases pre-2006. For the post-2006 period, the similar lack of application indicates persistent adherence to the same underlying principle, regardless of new statutory authorization in the supposedly prioritized “commercial” law, and explains why some Shanghai judges are openly calling for a collapse of the unwieldy separation.<sup>303</sup>

Whatever the complex of reasons for this non-utilization of a key corporate law doctrine, it was obvious before 2006 that the implementation of such doctrines would be aided greatly by a broadly drawn and flexibly applied notion of corporate fiduciary duties in the Company Law

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<sup>302</sup> And yet it is interesting to note that even before wholesale amendment of the Company Law, the Chinese State Council and legislature recognized how the two apparently separate legal systems could not help but bleed into each other. Thus the 2005 amendments were the product of input from both “civil” and “commercial” law specialists. See *LAO Company Law Explanation*, *supra* note 19, at 526. There is yet another *genus* of non-criminal “civil” law in China, “economic law” (*jingji fa*), which is law concerning the relationship between the state and private economic actors. Thus, traditionally, Chinese analysts and legal theorists would think of anti-trust or anti-monopoly law as “economic law” and company law as “commercial law”. This distinction is rapidly fading in modern China, especially as the “commercial law” school is spawning sub-species of commercial law: “banking law,” “securities law,” “commercial instruments law,” “finance law,” etc.

<sup>303</sup> In December 2008, one Shanghai No. 2 Intermediate People’s Court judge advocated a collapsing of this distinction, and permission for mixed civil-commercial law claims, as well as corporate law pleadings in the alternative. Remarks of Yu Wei, Dec. 5, 2008 (notes on file with author).



itself. Without doubt, this is one of the reasons the drafters of the new Company Law and the academics who advised them pushed so hard for new Article 148 and a newly-actionable Article 149 in the 2006 statute.<sup>304</sup> The hunger on the part of the judiciary for the ability to apply such broader corporate law principles is embodied in a 2003 opinion. In that case, the Shanghai No. 2 Intermediate People's Court had to struggle with the overly bright-line articles of the 1994 Company Law prohibiting fiduciaries' looting to support the plaintiff's claim that it was wrong for a director to take RMB 324,000 yuan (and interest) out of the company and pay it into his personal account without shareholder or board approval.<sup>305</sup> Without a broad fiduciary duty principle to apply, and the very narrow focus of the bright line prohibitions of Article 50 of the 1994 Company Law, the first-level People's Court had no choice but to rely on the company's Articles of Association and their requirement that certain "major matters" be approved by all shareholders. This approach elevated the diversion of a relatively small *quantum* of funds to the director (who pleaded the transaction as the disbursement of his salary) into a qualitatively significant breach of the Articles of Association. The Court, seemingly with a sigh of relief, was able to equate this transgression of the Articles of Association to a full-fledged "breach of the director's duty of loyalty and obligation to protect the company's interest."<sup>306</sup> It is easy to perceive the same ambition—and relief at the inclusion of new Articles 148 and 149 in the 2006 Company Law—in the Shanghai Higher People's Court post-January 1, 2006 commentary on the same case, celebrating how the new Company Law (and broader principles of corporate fiduciary duties) ensures that such diversions of funds by fiduciaries, whether as "salary" or something

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<sup>304</sup> See *Doctrine That Dared Not*, *supra* note 20.

<sup>305</sup> Shanghai X. Elec. Co. v. Mr. A, 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 114-17 (Shanghai No. 2 Interm. People's Ct., 2003), (Japanese director of Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC invested limited liability company because of Japanese partner's sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director's personal account without joint venture board approval or joint venture investor (shareholder) approval).

<sup>306</sup> *Id.* at 116 (which judgment is upheld on appeal by the Shanghai No. 2 Intermediate People's Court).

else, are a new kind of “internal” or “private” corporate governance matter which can be attacked *ex post* through “public authority” judicial proceedings.<sup>307</sup>

### C. *Absence of Public Company Cases*

In all of my reviews of Shanghai Higher People’s Court reports, discussions of corporate law adjudication with Shanghai or Supreme People’s Court judicial officials, PRC academics and lawyers, or readings of published case collections and case opinions posted online by the Shanghai Higher People’s Court, I found very little evidence of (i) companies limited by shares, or (ii) such companies which have any part of their capital listed on stock exchanges, PRC or foreign.<sup>308</sup> Indeed, in the many civil case judgments I reviewed for this study, only a few touched on disputes or shareholder actions arising in relation to companies limited by shares.<sup>309</sup>

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<sup>307</sup> *Id.* at 117. In the alternative, the Chinese judiciary (and People’s Procurate) might have taken up a harder instrument in attacking such transactions, by criminalizing breaches of fiduciary duty. *See, e.g.*, PRC v. Yang Demao, NEW COMPANY LAW CASES 460-65 (Shanghai Luwan Dist. People’s Ct.), (preferential transfers by controlling shareholders out of a company entering liquidation either to loot company in breach of duties, or remove assets from creditors’ claims, is judged the basis for guilt in the crime of “harmfully impeding liquidation”), *aff’d*, Shanghai No. 1 Interm. People’s Ct. (2003). *See also* the prosecution of Guan Guoliang for continuing use of the criminal law to punish breaches of corporate fiduciary duties. Luo Changping, Yu Ning & Luo Jieqi, *Yi Shen Guan Guoliang [First Hearing for Guan Guoliang]*, CAIJING, Dec. 8, 2008, at 140-42 [hereinafter *Guan Guoliang Criminal Prosecution*].

<sup>308</sup> In addition, there is no evidence whatsoever in the Shanghai People’s Courts of (i) the wholly state owned sub-*genus* of limited liability company (2006 Company Law, *supra note 5*, arts. 65-71) or (ii) the new sole shareholder limited liability company (*id.* at arts. 58-64), including what many thought would be abundant veil-piercing actions going to the personal assets of the sole shareholder (*id.* at art. 63). The reason for the absence of wholly state-owned companies is perhaps more structural than political: such companies do not actually have a shareholders’ general meeting or a board of directors responsible to the shareholders’ meeting, thus eliminating a whole host of possible plaintiffs and plaintiffs’ claims. In addition, such wholly state owned companies are still run very much as SOEs under line ministries (even if the line ministries have been dissolved and a Ministry-level Commission has taken over formal authority with respect to the firms), and thus disputes and difficulties will be worked out in purely political *fora* or between government departments or administrative bodies. The limited scope of the new sole shareholder firms probably explains why contract or tort creditors do not go to formal judicial institutions with small claims against such defendants.

<sup>309</sup> Two cases in the very thin pre-2006 and post-2006 sample are: Zhang X. v. Shanghai A Co. Ltd., SELECTED COMPANY LAW CASES 229 (unidentified Shanghai Dist. People’s Ct., 1995), (ruling that delegation of statutory power to elect directors to board contained in Articles of Association through a shareholders’ meeting is invalid, as are related director “appointments” made by the board of directors), *appeal filed*, unidentified Shanghai Interm. People’s Ct. (1995); Lu Jianming v. Shanghai Light Indus. Mach. Co., Ltd., ANALYSIS OF NEW CASES 189-94 (Shanghai Jingan Dist. People’s Ct., 2006), Shanghai No. 2 Interm. People’s Ct. (2006), (ruling that a board resolution nominating director of listed company director was not invalidated by the board’s failure to disclose in

The absence of such entities does not mean that companies limited by shares and their shareholders are not getting into trouble, or are being operated without discord and in perfect conformity with the highest standards of value generation, transparency, and good corporate governance. In fact, malfeasance and worse can be divined by the literally daily reports of corporate governance failure, oppression, misappropriation, and sins too manifold to mention in China's sophisticated and independent financial press. Instead, these cases are absent from the Shanghai People's Courts, which is after all the *situs* of the Shanghai Stock Exchange or China's "Big Board", for two primary clusters of reasons. First, the People's Courts simply do not accept such cases, either voluntarily, or because of bureaucratic instruction. A good deal of this refusal posture is based in Party, state and Court fears about large group actions and their potential impact on the third rail of Chinese governance culture, "social stability". Second, shareholders and other affected parties do not bring such cases to the formal judicial system, but instead to the CSRC securities regulatory authority, or even the Exchanges. This is partly rooted in the way Chinese public shareholders think about the property and legal rights represented by their stock interests in public companies, as well as the existence of a substitute regulatory regime perceived to reside in the CSRC as the PRC's anointed securities regulatory authority.

i. People's Court Refusals – Voluntary and Instructed

The awkward interactions between the Shanghai People's Courts and public companies have a long history, and date from the early corporatization effort, the creation of tradable quasi-stock instruments, the later establishment of Exchanges and over-the-counter ("OTC") markets,<sup>310</sup> and what appears to be the proximate trigger, the promulgation of the form of

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resolution and meeting notifications that nominee formerly worked for listed company's controlling shareholder and was the wife of defendant company's Legal Representative).

<sup>310</sup> For a pithy narrative of these developments, see CHINA'S STOCKMARKET, *supra* note 67, at 9-31.

China's first Securities *Law*. The Shanghai Courts' rejectionist stance was embodied in the first public shareholders' suit brought against a capital markets issuer (and its board, officers and accountants) for false and misleading disclosure and the posture famously taken by the Pudong New District People's Court in response.<sup>311</sup> *Jiang Shuzhen v. Hongguang Industry Co., Ltd. Directors et al.* In May 1997, a Sichuan Provincial Government-promoted SOE previously transformed into a company limited by shares and named "Hongguang Industry Co., Ltd." (here, "Hongguang") went public on the Shanghai Stock Exchange and raised RMB 400 million yuan with an "A" share IPO.<sup>312</sup> Six months after the IPO, a CSRC investigation confirmed that the Hongguang IPO was based on wholesale fraud and misrepresentation.<sup>313</sup> In June of 1997, long before completion of the CSRC investigation and public announcement of CSRC sanctions against Hongguang, investor Jiang Shuzhen purchased 1,800 shares of Hongguang on the Shanghai Stock Exchange for almost RMB 16,000 yuan. When the CSRC announced the investigation and penalties for Hongguang in late 1997 and details of the fraud and misrepresentation in the Hongguang offering were revealed in the financial press, the firm's share price dropped sharply. Shareholder Jiang sold just after the CSRC announcement, suffering a loss of RMB 3,136.30 yuan on the Hongguang shares held between June and December 1997. On December 14, 1998, or within the one-year statute of limitations period for general infringement of rights under Articles 106(2) and (3) of the General Principles of the Civil

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<sup>311</sup> The case and details are described consistently in a large number of PRC texts and articles. See COLLECTED SECURITIES CASES, *supra* note 77, at 58-64.

<sup>312</sup> "A" shares are RMB yuan-denominated shares issued by PRC-domiciled companies and listed on the Shanghai or Shenzhen Stock Exchanges, initially allowed to be purchased and traded only by PRC individuals and institutions (but now accessed by a narrowly drawn group of foreign "qualified foreign institutional investors" granted quota participation in the wholly domestic capital markets and, very recently, certain other permitted foreign participants).

<sup>313</sup> On every front, from the issuer's application for listing filed with the Sichuan Provincial People's Government (and then the Shanghai Stock Exchange), to Hongguang's legally-mandated disclosure and its complete failure post-IPO to comply with the "use of proceeds" described in its offering prospectus (only 16% of the IPO proceeds were assigned to uses described in the IPO prospectus, with 35% of the same proceeds going into speculative purchases of other Shanghai Stock Exchange-listed shares).

Law, Jiang brought suit in the Pudong New District People's Court against Hongguang's directors, officers, and outside accountants.<sup>314</sup> In addition to the General Principles of the Civil Law, the lawsuit was loosely grounded in the 1994 Company Law.<sup>315</sup> Although China's first Securities Law had not yet come into effect, it had already been adopted by the legislature and its form published and heavily propagandized.

More than two months later, in March 1999,<sup>316</sup> the Pudong New District People's Court finally refused outright to accept the case, saying: "The plaintiff's case regarding behavior in violation of laws and regulations in the stock market should be handled by the CSRC. The plaintiff's suit regarding a securities dispute does not come within the jurisdiction of this People's Court."<sup>317</sup> Regardless of the formal justification offered by the Pudong Court in 1999,<sup>318</sup> the Court's rejection of the Jiang Shuzhen lawsuit is emblematic of how the entire

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<sup>314</sup> Although the issuer, Hongguang, was domiciled in Sichuan, the Shanghai Stock Exchange had already moved from Shanghai's old Astor Hotel over the Suzhou Creek and across the Huangpu River—and the Bund—to the Pudong New District of Shanghai.

<sup>315</sup> No report the author has seen indicates which aspect of the 1994 Company Law was relied upon. It is likely that the claim was generally based in the Company Law in the sense that natural persons and the artificial legal person that was Hongguang had done damage to the plaintiff through a legal form authorized and established under the Company Law.

<sup>316</sup> Notification was given only on April 2, 1999 after the lapse of the stipulated period for appeal, neatly blocking Jiang Shuzhen's ability to appeal the Pudong New District People's Court's refusal to accept the case.

<sup>317</sup> The Pudong New District People's Court's refusal to accept the case did not impede the same Court from offering its view on the merits of the case, declaring in People's Court-style *dicta* that there was *no causal connection* between the wrongs allegedly committed by Hongguang officers, directors and outside accountants and the damages suffered by Jiang and other shareholders who saw the value of Hongguang stock plummet.

<sup>318</sup> The formal justification of the Pudong New District People's Court in 1999 seems to be the following (in my words): "Laws may not be applied and interpreted by judicial courts because such laws (and the underlying claims) pertain to the stock market regulated (even if not *exclusively*) by the CSRC." While outside observers might think such a rationale unsustainable or plain silly, it is very close to the defense of the non-dutiful director noted *supra*, who tells a Beijing People's Court that he cannot be in breach of his *Company Law* fiduciary duty of care at a public company because his alleged failure is governed by the *Securities Law* which imposes such a duty only on people who directly operate or manage the firm. See *Listed Company Director Sues*, *supra* note 291. Later, and in the context of the January 2002 Supreme People's Court ban on private shareholders' suits which preceded the January 2003 Supreme People's Court Regulations allowing such suits, more credible justifications were offered: no legal basis for a private right of action; questionable technical competence of judges hearing corporate and securities law cases; or simply the overwhelming complexities of the new Socialist Market economy. Even after lifting of the ban in January 2003 and allowance of shareholders' suits for damages (only) in false or misleading disclosure cases, the securities regulatory authority (and the state, through the People's Procurate) continues to monopolize every other aspect of public company and securities regulation and enforcement aside from false or misleading disclosure—such as stock manipulation or insider trading. And even in cases brought the fines have

Chinese court system initially handled, or refused to handle, what all aspects of the PRC government feared would quickly become a flood of shareholders' lawsuits brought throughout the nation, at all levels of the court system.<sup>319</sup>

In considering the critical question of the Shanghai Court system's blanket refusal to accept a whole *genus* of cases, it is important to note that the Shanghai Courts both constrain themselves voluntarily and are limited by bureaucratic instruction. It is well known that the Chinese People's Courts act *voluntarily* to reject or cease hearing cases from the recent example of a nation-wide voluntary halt on hearing cases seeking enforcement of transferred non-performing loans.<sup>320</sup> That judicial strike commenced with a report by the President of a Provincial Higher People's Court delivered to the central government in late 2005, and to date no central authority, even the Supreme People's Court working in tandem with the State Council, has been able to prod the People's Courts back into action. With respect to formally instructed refusal, as noted herein I was able to find several explicit instructions *before* January 1, 2006

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been low, with the CSRC deprived of the ability to bring civil suits against market actors. Only in the Fall of 2008 did the CSRC first levy a fine exceeding US\$1.5 million for stock manipulation (coupled with confiscation of US\$2 million in illegal profits, and reference for criminal prosecution) in the Shoufang Financial Advisory-Wang Jianzhong "pump and dump" case. See *Manipulator Penalized*, *supra* note 77. This fine and reference for criminal prosecution was the high point in a six month period which saw very vigorous enforcement by the CSRC against market manipulators, corrupt funds trading, false disclosure, insider trading, etc., including the public investigation of the trading activities of one of China's commercial superstars, the Chairman of the Guo Mei ("Gomei") electronics concern. See *Penalties Imposed by CSRC*, *supra* note 77, at B9 (detailing enforcement actions and fines levied between April 8 and November 21, 2008).

<sup>319</sup> That flood duly materialized, forcing the Supreme People's Court to issue the ban on shareholders' rights cases in January 2002, which was only lifted in January 2003 with the Supreme People's Court Regulations permitting a narrow range of false and misleading disclosure cases into the Courts, but only after something like a determination of fact by the CSRC (or the Procurate for criminal faults), only with respect to evaluation of damages, and forbidding absolutely anything like class action suits (with lawyers' contingency fee arrangements forbidden in regulations applicable to PRC lawyers). See the ban of January 2002: Zuigao Renmin Fayuan Guanyu Shouli Zhengquan Shichang Yin Xujia Chenshu Yinfa de Minshi Qinquan Anjian Youguan Wenti de Tongzhi [Supreme People's Court Notice Regarding the Issues Related to Acceptance of Civil Rights Infringement Cases Arising from False Disclosure in the Securities Markets] (issued on Jan. 15, 2002), at CLC, *supra* note 5, at 5-29 – 5-30; and the January 2003 limited permission: the MISREPRESENTATION IN SECURITIES MARKETS REGULATIONS, *supra* note 97.

<sup>320</sup> See *supra* notes 102 to 104 and accompanying text.

calling on the Shanghai People's Courts not to accept certain types of public company cases.<sup>321</sup> But I found no evidence of written instructions, Regulations, Opinions or Approving Responses commanding the same *after* the 2006 Company Law became effective. However, the President of one of Shanghai's busiest and most expert District People's Court systems did refer to some kind of internal instruction from the Supreme People's Court (note, not the CSRC) forbidding acceptance of public company cases.<sup>322</sup>

There are at least two sets of rationales supporting such rejection. One set of factors is relatively unique to the PRC political-legal circumstance, and largely unknowable for the external analyst. The Shanghai People's Courts may be loathe to accept public company cases because the controlling shareholders, directors or insiders of listed companies most likely to appear as defendants are in some degree powerful *political* actors, whether state or Party officials, or their family members. Again, the validity of this supposition is extremely difficult to gauge, as it requires understanding the background of firms which are never actually dragged into open view before the People's Courts. Still, real world knowledge of who the promoters and powers behind listed firms often are, and the People's Courts posture in cases with far less political sensitivity (*e.g.*, the transferred non-performing loan collection cases), indicate that there must be substantial truth to these insights. Interestingly, there seems to be no shyness whatsoever about accepting FIE-related disputes,<sup>323</sup> which (on the Chinese side) often feature the

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<sup>321</sup> For example, the prohibition in the Shanghai Company Law Opinion on Shanghai People's Courts hearing public company shareholder challenges to shareholders or directors' resolutions. *See infra* note 324 and accompanying text.

<sup>322</sup> Remarks of Judge B, Dec. 5, 2008 (notes on file with author).

<sup>323</sup> The Shanghai Courts have no particular problem dealing with the one limited liability company form which actually pre-dated the Company Law and China's entire corporate law system, the *foreign-invested enterprise* forms comprising Chinese-foreign equity and cooperative joint ventures, wholly foreign-owned enterprises, and foreign-invested companies limited by shares, each of which have their own specific statute and/or regulations governing aspects of their legal identity, operations, and shareholder relations. One of the reasons more FIE-related cases are not seen in the Shanghai People's Courts is that foreign investors and their PRC co-investors almost

same cast of political-economically privileged characters. Perhaps in the case of FIEs the People's Courts and local governments are keen to show foreign investors the formal legal system at work and in the manner promised, and such benefits outweigh the costs of involvement in Court proceedings.

A second set of explanations is probably stronger, and much more easily divined from my study of the People's Courts bureaucratic documents and adjudication practice. These explanations hold that the People's Courts are told to decline, or voluntarily refuse, listed company cases for fear of large plaintiff groups, and the perceived impact on social stability or maintenance of the "super-value" in Chinese administrative-political culture: social harmony. The Shanghai Higher People's Court notes the legal-political "redline" explicitly in saying that the Shanghai Courts after January 1, 2006 will accept petitions for invalidation of public company resolutions they previously refused to hear:

In view of the fact that these kinds of cases may give rise to issues related to mass litigation (*quntixing susong*) and volatility in the securities markets, [the Shanghai People's Courts] have taken an especially cautious attitude towards accepting these cases; in accepting these cases, we ask that the shareholders provide related evidence showing why the shareholders' or board resolution is invalid or should be invalidated, and we will examine this evidence strictly so as to protect against vexatious shareholder litigation.<sup>324</sup>

The same facial rationale was offered by the District People's Court President cited immediately above who referred to an internal Supreme People's Court instruction warning subordinate Courts off of public company cases. He said the instruction was based largely on the desire to discourage vexatious shareholder litigation nationally.<sup>325</sup> Certainly the Supreme People's Court and the Shanghai Higher People's Court express legitimate concerns in pointing to the battle

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uniformly choose arbitration as the exclusive means of dispute resolution, thus depriving the Courts of any opportunity to hear such claims.

<sup>324</sup> *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 44.

<sup>325</sup> Remarks of Judge B, Dec. 5, 2008, (notes on file with author).



against “vexatious shareholder litigation,” but the concern seems over-estimated in the Chinese context, where there are no class actions suits, no lawyers’ contingency fees, and various judicial bureaus and just semi-autonomous lawyers’ associations have issued notices requiring caution in accepting large plaintiff group cases.<sup>326</sup> The more authentic concern here is the problem of mass litigation or large plaintiff group lawsuits and their purported impact upon social and political stability, freely discussed in popular PRC journalism.<sup>327</sup>

ii. Availability and Understanding of Substitute Enforcement

Another set of explanations for the absence of public company cases focuses not on the People’s Court bureaucracy, but the potential plaintiffs in such missing actions. First, such cases may not make it into the formal Court system because of the existence of a substitute enforcement architecture for listed companies cases—that is, the public prosecutor (the People’s Procurate)<sup>328</sup> and the CSRC (as prodded by the very effective and muckraking financial media in China). That simple proposition, however, is not the same as saying that the substitute is adequate, that the substitute is not resource-constrained, or its coverage is unlimited. Neither the public prosecutor nor the CSRC has the resources or the competence to be a fully adequate substitute for the judiciary in bringing the Company Law to act on China’s companies limited by

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<sup>326</sup> See Xin Tang, *Protecting Minority Shareholders in China*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 153-58 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008).

<sup>327</sup> See *Mass Compensation*, *supra* note 52. Ben Liebman has noted a related point, that refusal by the People’s Courts to entertain certain kinds of cases, even those merely politically “warm”, is an entirely rational response by institutions which feel that any kind of decision will only bring trouble or in most cases remain unenforceable (thus diluting their own power and legitimacy). See *Restricted Reform*, *supra* note 21.

<sup>328</sup> For recent examples of the public prosecutor using the Criminal Law to punish corporate law violations (such as breaches of duty of loyalty) see the December 2008 hearing on the prosecution of New China (Xinhua) Life Insurance’s former chairman Guan Guoliang for embezzlement of over US\$30 million in the Beijing No. 2 Intermediate People’s Court, which included “financial advisory fees” paid to a financial consultancy established in Shanghai and controlled by Guan. *Guan Guoliang Criminal Prosecution*, *supra* note 307, at 140.

shares, public or not. This happens, for instance, in regards to *ex post* veil-piercing, derivative actions, or fiduciary duties litigation.<sup>329</sup>

The focus on potential plaintiffs leads to a second set of demand-side explanations. As is true throughout the world, shareholders in PRC companies limited by shares do not bring actions because of familiar collective action problems. These problems are heightened in China, due to the absence of class action lawsuits, contingency fee arrangements and other cost-spreading mechanisms. More specific to China, many PRC shareholders do not bring such cases because they do not understand the People's Courts, as contrasted with the securities regulator, as the appropriate forum for hearing their claims.<sup>330</sup> This attitude is well expressed in the apparently sincere pleadings reported above in the discussion of fiduciary duties claims.<sup>331</sup> In those pleadings, the defendant director, obviously negligent in fulfilling his corporate fiduciary duties, asserts that he is not one of the named persons who has a fiduciary duty under the PRC *Securities Law*—thereby completely ignoring the application of the *Company Law* to his role as a director of a company limited by shares with publicly-listed shares. Translated, his claim is that listed companies are not subject to the *Company Law*, but instead the *Securities Law* and its

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<sup>329</sup> But see the rare CSRC-diminishing and judicial system-activist posture taken by the Shanghai No. 2 Intermediate People's Court in the case fully briefed in the Case Reports Appendix: Lu Jianming v. Shanghai Light Indus. Mach. Co., Ltd., ANALYSIS OF NEW CASES 189-94 (Shanghai Jingan Dist. People's Ct., 2006), Shanghai No. 2 Interm. People's Ct. (2006), (ruling that a board resolution nominating the director of listed company was not invalidated by the board's failure to disclose in resolution and meeting notifications that nominee formerly worked for listed company's controlling shareholder and was the wife of defendant company's Legal Representative).

<sup>330</sup> One Shanghai Higher People's Court judge told the author that both the great proportion of closed company (limited liability company) cases and the absence of company limited by share/listed company cases are a result of the relative completeness and clarity of the *Company Law* in addressing companies limited by shares and because limited liability companies evidence recurring problems of small company shareholder oppression and shareholder-labor relations. Judge A, Shanghai Higher People's Court Judge (Dec. 5, 2008) (on file with author). This explanation seems dubious, especially if there is indeed some kind of policy guidance from the Supreme People's Court constraining lower level People's Courts from accepting such cases, as strongly hinted at by other Shanghai People's Court system judges. The first part of the statement about "relative completeness and clarity" of law embodies one view of law and regulation in Chinese legal-political culture which has a very long pedigree, holding that the more "scientific" a norm, the fewer disputes will arise in the governed sector.

<sup>331</sup> See *Listed Company Director Sues*, *supra* note 291, at A24.

enforcement apparatus under the CSRC. Although the argument is flawed in the legal sense, it highlights a prevalent understanding and approach to the separate world of Chinese limited liability companies, on one side, and companies limited by shares with listed stock, on the other.

iii. Negative Implications of the Public Companies' Refusal

This unhappy bifurcation, or non-implementation of the Company Law with respect to companies limited by shares or listed companies, can be evaluated initially in two contradictory ways. On the one hand, it begs for restructuring of China's business organization law and creation of a conforming corporate partnership, LLC or "close corporation" type statute. The Company Law would then be used solely for more suitable application to companies limited by shares and listed companies. Very sadly, the situation today is the opposite of what it should be. That is, the state and the People's Courts only rarely apply the Company Law to companies limited by shares or such entities with listed stock, and awkwardly apply the statute in the close corporation, or partnership, context. Yet, as also noted above, the likelihood of such an adjustment in the near term is almost *nil*. So, the phenomenon perhaps conversely suggests that there is a significant amount of room for the People's Courts to begin engaging with corporate claims involving companies limited by shares and listed companies, using the doctrines that they have started to announce and apply in the less provocative close corporation/corporate partnership context. This approach may in fact add to the space for future autonomous action by the People's Courts in corporate and commercial cases.

Whatever the causes of the relative paucity of public company cases in the Shanghai Courts, it does not excuse the same phenomenon. That lack of application constitutes a real tragedy for Chinese corporate governance reform, as it was the dire state of corporate governance at public companies in China which occasioned the 2006 Company Law

amendments and the statute's new "justiciability" outlined here,<sup>332</sup> and it has long been recognized that there is no more efficient or effective way to implement corporate governance in China. Since companies limited by shares or publicly-listed companies and their shareholders are simply not present in the Shanghai Courts, the following claims go unimplemented in the Shanghai judiciary: promoters' agreements, either among promoters,<sup>333</sup> or against promoters;<sup>334</sup> shareholders' meeting resolutions offered by shareholders (3% shareholding);<sup>335</sup> rights and privileges of different share "classes";<sup>336</sup> convening of board meetings by shareholders (10%), directors other than the board Chairman (one third), or the supervisory board;<sup>337</sup> prohibition on company loans to directors, supervisory board members or senior managers;<sup>338</sup> shareholders' approval of proposed transfer of "major" (*zhongda*) assets;<sup>339</sup> supermajority approval by shareholders (two thirds) of sale of "major" (*zhongda*) assets or guarantee of value exceeding 30% of corporate assets;<sup>340</sup> recusal by conflicted directors on board resolutions considering related party transactions;<sup>341</sup> shareholders' power to convene a shareholders' meeting (10% shareholder);<sup>342</sup> promoters' and directors, officers and supervisory board members' one year transfer restrictions;<sup>343</sup> merger-objecting shareholders' appraisal rights;<sup>344</sup> listed company mandatory disclosure obligations (another badly-drafted incursion of the Company Law into the province of PRC securities regulation);<sup>345</sup> or shareholder (10%) petitions for company

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<sup>332</sup> See CHINA CORPORATE GOVERNANCE REPORT, *supra* note 18, at 135.

<sup>333</sup> See 2006 Company Law, *supra* note 5, arts. 80, 84 & 94.

<sup>334</sup> *Id.* at art. 95.

<sup>335</sup> *Id.* at art. 103.

<sup>336</sup> *Id.* at art. 132.

<sup>337</sup> *Id.* at art. 111.

<sup>338</sup> *Id.* at art. 116.

<sup>339</sup> *Id.* at art. 105.

<sup>340</sup> *Id.* at art. 122.

<sup>341</sup> *Id.* at art.125.

<sup>342</sup> *Id.* at art. 101(3).

<sup>343</sup> *Id.* at art. 142.

<sup>344</sup> *Id.* at art. 143(4).

<sup>345</sup> *Id.* at art. 146.

dissolution.<sup>346</sup> In only one rare case in the 1992-2008 sample do the Shanghai People's Courts intrude into the explicit province of the CSRC.<sup>347</sup> This however is a criminal case, where the Courts act at the direction of the People's Procurate and as an adjunct to the CSRC in its central regulatory mission, and the judgment is firmly based in a Company Law provision which overbroadly addresses securities trading (a provision which should be covered exclusively by the PRC Securities Law).<sup>348</sup>

From an institutional standpoint, a central question for the future of the Chinese judiciary is the sustainability of this defensive posture against mass plaintiff cases of all kinds, not just of public company cases in the Company Law sphere. Aside from urgings of reformist intellectuals and lawyers, and despite older studies (2001 and 2002) which show some litigation-adversity among China's urban and rural citizens,<sup>349</sup> individuals and groups continue to push into the courts *en masse*. In late 2008, the Shanghai No. 1 Intermediate People's Court announced that it alone had seen skyrocketing numbers of "group" (*qunti*) lawsuits *accepted* in the past few years:

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<sup>346</sup> *Id.* at art. 183.

<sup>347</sup> The case relates to securities, and the trading of securities outside of a CSRC-approved Exchange and implementation of 2006 Company Law Article 139. See *PRC v. Fang Kun, 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN* (Shanghai Pudong New Dist. People's Ct., 2006), (ruling that trading in unlisted securities, including acting as agent-underwriter in public offerings, without CSRC approval and registration to engage in the securities business, constitutes the crime of "illegal business operations"), *aff'd*, Shanghai No. 1 Interm. People's Ct. (2007).

<sup>348</sup> For both companies limited by shares (listed or not) and limited liability companies (even the close corporation/corporate partnership form prevalent in China), a wide range of the tools offered in the 2006 Company Law are not used by the People's Courts either. These tools include: shareholders' civil suits against other shareholders for oppression; claims against control or "actual control" parties for harm to the company; specifically-pleaded (arts. 148 and 149) breaches of "duty of care" or "duty of loyalty" (including funds misappropriation, illegal lending or guarantees, self-dealing, corporate opportunity, corporate secrets confidentiality); specifically-pleaded claims against directors, officers or supervisory board members for compensation arising from law-breaching behavior; specifically-pleaded derivative actions under art. 152; adjudication of "actual control person" status; failure to make financial reports to shareholders; company dividend distributions; or breach of duties for a People's Court-confirmed liquidation group. Even in the apparently more accessible context of limited liability companies, there are few lawsuits involving new or previously existing claims permitted under the 2006 Company Law, such as contract claims by shareholders against other shareholders for failure to pay in subscribed-for capital, preemptive rights on new issuance of capital, or mandatory buy-back/appraisal rights. As demonstrated in this article, limited liability companies do see claims related to a narrow band of new rights offered in the new Company Law or pre-existing rights, including shareholders' information rights; 50% shareholder consent, and right of first refusal, on equity transfers; and shareholder (10%) petitions for company dissolution. See 2006 Company Law, *supra* note 5, arts. 20, 21, 28, 34, 35, 72, 75(3), 150, 166, 167, 172, 183, 190, and 217(3).

<sup>349</sup> See *Measuring Harmony*, *supra* note 49, at D24.

from 27 group cases suing on the same cause of action and 1047 claimants in 2006, to 50 cases (1671 claimants) in 2007, and 62 cases (1449 claimants) to October 1, 2008.<sup>350</sup> That is a doubling in case acceptances over 24 months, and the referenced report does not indicate how many of such cases were refused. The majority of these cases pertain to labor disputes, residential housing management, administrative condemnation of land and buildings, and rural contracting disputes;<sup>351</sup> other data indicate that continued assays directed at the People's Courts nationally come in respect of labor rights,<sup>352</sup> environmental torts, official misfeasance,<sup>353</sup> food contamination,<sup>354</sup> securities lawsuits, and so on. One Intermediate People's Court in the Shanghai system, recognizing the unstoppable force of such group actions, has issued special procedures to handle such cases, procedures which may act to provide early warning to the entire Court system of the approach of such lawsuits.<sup>355</sup> Of course, the more direct way of handling the phenomenon is simple refusal to accept cases potentially giving rise to large—and angry—plaintiff groups. That is apparently the response of the Shanghai judiciary (and by extension the

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<sup>350</sup> Pan Gaofeng, *Shanghai's First Intermediate People's Court Explores New Adjudication Measures*, XINMIN WANBAO [NEW PEOPLE'S EVENING NEWS], Nov. 5, 2008, at A3 [hereinafter *New Shanghai Adjudication Measures*].

<sup>351</sup> *Id.*

<sup>352</sup> One public report in late 2008 shows how overburdened a very local level court in the Dongguan area of Guangdong Province is. Until November 15, 2008, a Basic level People's Court serving a sub-district of Dongguan with only 13 judges had to process 7,540 cases (mostly labor contract cases and disputes regarding the handling of laid off workers), corresponding to roughly 580 cases per judge—as against a national average of 42 cases per judge; this case acceptance and adjudication rate was already a 100% increase over cases in the same district for the entirety of 2007. *See China's Busiest Court*, *supra* note 57, at A7.

<sup>353</sup> *See, e.g.*, Edward Wong, *Parents of Schoolchildren Killed in China Quake Confirm Lawsuit*, N.Y. TIMES, Dec. 23, 2008, at A10 (reporting on a group of parents who filed a lawsuit against government officials for the collapse of elementary school buildings during the Sichuan earthquake in May 2008).

<sup>354</sup> *See, e.g.*, Andrew Jacobs, *Chinese Parents Reject Milk Settlement, Seeking Care for Victims*, N.Y. TIMES, Jan. 14, 2009, at A7 (reporting that Chinese parents of children poisoned by tainted domestic dairy products were collecting signatures for a petition demanding remedies and preparing to refuse a government-sanctioned compensation package as part of their demand for long-term health care and preventive research); Edward Wong, *Milk Scandal in China Yields Cash for Parents*, N.Y. TIMES, Jan. 17, 2009, at A6 (reporting that parents of one child poisoned by the tainted milk products had already accepted a compensation package from the dairy manufacturer, but mentioning that other parents were persisting with their petitions for relief).

<sup>355</sup> *See New Shanghai Adjudication Measures*, *supra* note 351, at A3 (discussing the effectiveness of the new coordinating mechanism between the District and Intermediate People's Courts for *qunti*—or group—lawsuits).

national People's Courts) in respect of companies limited by shares that have listed shares in the hands of hundreds or thousands of Chinese citizen shareholders.<sup>356</sup>

## V. CONCLUSIONS

In this study I have shown two aspects of company law adjudication in the Shanghai People's Courts between 1992 and 2008: bold autonomy,<sup>357</sup> and continuing constraints on that autonomy. Two aspects of the constraints identified are worrying. First is the perverse authorization-constraint dynamic seen in the increasingly conservative application or non-application of corporate law doctrines like veil piercing, the derivative lawsuit or corporate fiduciary duties after the basis for those doctrines has at last been provided by statutory law. Second, and perhaps of greater concern, is the evident "red line" drawn around companies limited by shares (with many shareholders) and in particular companies limited by shares with public listings (even more shareholders), where the Shanghai People's Courts simply do not accept or adjudicate cases involving corporations with a large number of shareholders. As noted in the body of this article, this is exemplified by the Courts' rejection of shareholders' suits generally, and shareholders' claims to overturn board or shareholders' resolutions, force dividend distributions, cause judicially-mandated sale of equity, or spur dissolution, in each case specifically at companies limited by shares or such companies with listings. Recall how the No. 2 Civil Division of the Shanghai Higher People's Court explicitly addressed the situation in its

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<sup>356</sup> Most Chinese analysts understand that a rejectionist response is not sustainable in the long term, even if that refusal is animated by the sheer inability to process the huge number of cases flooding into the courts. *See Assuaging Popular Anger, supra* note 11, at E31 (suggesting that the Chinese government use the judicial systems as a "buffer" to abate acute political and social issues); *Mass Compensation, supra* note 52, at 152 (reasoning that for major claims involving mass compensation, the People's Courts should be the first institution providing remedies for injured parties, rather than administrative action).

<sup>357</sup> As noted *supra* note 88 increased autonomy may not be an undiluted "good" as it may permit judicial institutions to act autonomously but illegally or corruptly.

grudging reversal of the pre-2006 policy ordering rejection of public company shareholders' petitions for invalidation of corporate resolutions:

In view of the fact that these kinds of cases may give rise to issues related to mass litigation (*quntixing susong*) and volatility in the securities markets, [the Shanghai People's Courts] have taken an especially cautious attitude towards accepting these cases; ...<sup>358</sup>

The same concern can also be perceived, albeit more subtly, in the Shanghai judicial system's unremitting bias in favor of "stability" (including business entity preservation at all costs) over other corporate law values such as transactional efficiency, adaptability and the easy redeployment of capital, or the rights explicitly granted in statute to firm participants. The evidence presented above shows that the shyness about accepting claims associated with multiple shareholders was largely ordered inside the Court bureaucracy. Under the 1994 Company Law, the Supreme People's Court, the Shanghai People's Courts and other People's Courts systems assuredly issued "Opinions" and "Notices" explicitly forbidding the acceptance and adjudication of public company cases and directing those cases to the CSRC. In the post-2006 scenario, many of those explicit prohibitions have been removed<sup>359</sup> or made moot by clear authorizing provisions in the 2006 Company Law, and yet the evidence presented here indicates that cases concerning such corporate entities and their many shareholders are not making it into the People's Courts. The problem then is the very strong concern in the People's Courts for political or social order even in the mundane world of corporate law adjudication, in which Law, regulation, coherence, and "fairness" (often invoked by the Shanghai People's Courts in corporate law cases) should be dispositive, and outside of the more sensitive social control context. This concern causes the judiciary to disregard the power it is clearly authorized to wield

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<sup>358</sup> *Shanghai Higher People's Court No. 2 Civil Division 2007*, *supra* note 8, at 44.

<sup>359</sup> Although, as noted *supra*, at least one senior Shanghai People's Court system judge alluded to some kind of broad non-public direction from the Supreme People's Court asking the lower level courts *not* to take public company cases. *See supra* note 322 and accompanying text.



under the 2006 Company Law, or causes the political and administrative masters of the Court system to limit jurisdiction in bald contradiction with the scope of their power now outlined in statute.

With respect to the authorization-constraint dynamic, the development path presented here may appear counter-intuitive. It seems rare indeed to witness a state or governmental organ acting with less autonomy upon the grant of more power. As with the rejection of public company cases, the Courts' refusal to hear cases they are now authorized doctrinally to adjudicate is the result of both specific instructions inside the bureaucracy and voluntary deference by the People's Courts. These refusals are both political and bureaucratic in origin. Doubtless, because of the keen political sensitivities sometimes in play, superior departments of the state or Party warn the Courts off certain kinds of cases. There is also ample evidence that the People's Courts voluntarily reject cases when they perceive a political problem. The latter phenomenon is exemplified by the People's Courts' nationwide refusal starting in 2005 to adjudicate creditor claims on non-performing loans transferred to China's asset management companies and then resold to third party purchasers. This coordinated refusal was sourced in lower-level Court fears that such cases might implicate one of transitional China's hot-button issues: the theft of state assets.<sup>360</sup> Most importantly, this national refusal came bottom-up, and has persisted even in the face of repeated public urgings from numerous central government authorities to re-start case acceptance and adjudication. The bureaucratically-based refusals are by and large voluntary and not ordered by superior departments. Revived voluntary constraints on autonomy—now in the more complex and less apparently political areas of fiduciary duties, veil-piercing, and firm dissolution—exemplify the underlying bureaucratic nature and status of

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<sup>360</sup> This worry was first articulated in a report issued in late 2004 by the Hebei Provincial Higher People's Court President Liu Ruichuan. See *Two Regulation Difficulties*, *supra* note 102, at 60 (describing President Liu's report) and *Unfreezing Litigation*, *supra* note 104 (the same).

the People's Courts in China. Without any mention of certain doctrines in statute before 2006, the People's Courts apparently felt free to range about and implement common sense or "justice"/"fairness"-oriented solutions, such as invocation of corporate fiduciary duties against obviously opportunistic or inattentive directors, or *ad hoc* derivative lawsuits, even if not pleaded.<sup>361</sup> However, with some of these doctrines now included in formal "Law", even if very much in principle, the People's Courts as embedded bureaucratic actors subject to Party direction now wait to see how the apex of their bureaucracy—the Supreme People's Court in Beijing—will instruct implementation of these newly-authorized doctrines. This view, however, cannot be wholly explanatory as even the Shanghai People's Courts did continue to act freely in some specific areas after January 1, 2006 without Supreme People's Court Regulations or any kind of superior direction.

The effects of the autonomy dialectic revealed here may be profoundly injurious for the Chinese legal reform project. As noted above, two of the functions asserted for judicial institutions in non-democratic, non-rule of law, states like the PRC are to bolster a regime's claim to "legality" and to facilitate investment, and then growth.<sup>362</sup> With respect to legality and legitimacy, in the counter-intuitive developments identified in this article we may be seeing unfortunate effects akin to what Xu Xiaoqun, historian of an earlier period of Chinese judicial reform, has called the "paradox of [judicial] modernity."<sup>363</sup> Professor Xu describes the efforts toward judicial reform in China's late Qing and Republican eras (1900-37), and the relatively consistent motivations and goals of the central state/Party in promoting that reform. He

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<sup>361</sup> This incidentally is exactly the opposite of what might be expected from bureaucratic judges working under a quota system, or subject to punishment for "incorrectly-decided" cases. *See Judicial Responsibility Systems*, *supra* note 26.

<sup>362</sup> AUTHORITARIAN RULE OF LAW, *supra* note 21, at 4.

<sup>363</sup> XU XIAOQUN, TRAIL OF MODERNITY: JUDICIAL REFORM IN EARLY TWENTIETH-CENTURY CHINA, 1901-1937 (2008) [hereinafter 20<sup>TH</sup> CENTURY JUDICIAL REFORM].

questions whether expansion of the formal state and judicial system resulted in real “development,” by which he means the increased effectiveness, efficiency and legitimacy of those same state institutions (including the courts). Xu focuses on the defeated expectations of the consumers/subjects of the judicial power, who were made abundant promises by the “modernizing” state, but upon which the judiciary cannot deliver, thereby injuring the efficacy and legitimacy of the judiciary itself.<sup>364</sup>

Xu’s insights about early 20<sup>th</sup> century China shed important light on the expansions of, and constraints on, judicial autonomy described in this article. Likewise, the expansion of and constraints on judicial autonomy in the years 1992-2008 with respect to corporate law adjudication exemplify not only the failure to deliver resolution, justice and some kind of predictability, but also serve to diminish the legitimacy of the “state” and its institutions, the People’s Courts in particular. Contemporary China is witnessing the same paradox in the hesitancy of the Shanghai People’s Courts—and by implication the national People’s Courts—to hear cases which they used to accept and adjudicate without any legal basis in statute, and after a firm legal basis has been provided in the Company Law and the Law has—nominally—increased its “justiciability.” The same phenomenon can be perceived in the Courts’ rejection of mass plaintiff, public company, cases. Of course, this paradox is most searing, disheartening, and delegitimizing—and most readily noted by PRC and foreign legal analysts—in other areas of PRC judicial activity such as the application of criminal law or in the more direct social/political control context.<sup>365</sup> Yet this negative phenomenon is equally important in the corporate and

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<sup>364</sup> *Id.* at 20-22.

<sup>365</sup> The hardy appetite for rights protection and recourse to law in the Company Law sphere is echoed in all other sectors of Chinese civil society. Among others, they include peasants living under the fist of oppressive, corrupt and ill-educated local tyrants, laid off workers in Northeast China, and sweatshop workers in Southern China. See CHEN GUIDI & WU CHUNTAO, ZHONGGUO NONGMIN DIAOCHA BAOGAO, (2004) (detailing constant reference to local judicial institutions in the face cadre oppression). See also AGAINST THE LAW, *supra* note 23 (demands on and sustained access to the People’s Courts regarding labor disputes, particularly in the “Sunbelt”

commercial sphere. It is important not just because of the harmful effects visited on economic development in an increasingly marketized and corporatized China. Its significance arises from the fact that formal institutional development and increased notional access to the People's Courts in the Company Law sphere, specifically, have spurred societal demand for competent institutions able to apply the Company Law fairly—which in turn only doubles the disappointment upon subsequent institutional failure or rejection of claims.

There is no question that China's 1994 Company Law and its 2006 re-formulation, and the existence of corporate business organization in Reform-era China, have changed the nature of law and legal institutions in China, the expectations of the consumer/subjects of the law in China, the idea of "rights" (including property rights but also brushing up against civil and political rights), and the relationship between the state (and Party) and the governed as mediated through the legal and political system. In Weberian-North terms<sup>366</sup> China is still very far from the complete rule of law state with seamless protection of property rights and property expectations. Notwithstanding, my analysis of corporate law cases and opinions shows that the corporatization/partial privatization program and the implementation of a justiciable corporate law calling for *ex post* application of judicial standards by a stand-alone judiciary have spurred the nation's formal legal institutions to develop competence, autonomy and the beginnings of

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region of the PRC); *China's Busiest Court*, *supra* note 57, at A7 (noting the huge volume of cases directed towards a Basic level People's Court in Guangdong Province, the majority of such actions concerning labor disputes). This article does not focus on the "demand" side of corporate and commercial litigation, but the expertise and autonomy of China's judicial institutions when they are confronted with corporate law cases. There continues to be a very healthy debate on just how litigation-adverse modern PRC urban and rural citizens are. See *Measuring Harmony*, *supra* note 49, at D24 (citing a 2001 urban study performed by Ethan Michelson with support from the Ford Foundation on behalf of the Beijing Municipality and seven Beijing Districts, and a February 2002 study by the Sociology Department of Renmin University in six rural Counties and 30 Villages).

<sup>366</sup> See generally DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE (Cambridge Univ. Press, 1990); MAX WEBER, *Self-government, Law and Capitalism*, in THE RELIGION OF CHINA: CONFUCIANISM AND TAOISM 84-104 (Hans H. Gerth trans., 1964) (1922); Donald C. Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 14 AM. J. COMP. L. 459, 494 (2003) (addressing the PRC's remarkable record of economic growth notwithstanding the absence of rule of law and clear and predictably-enforceable property and contract rights).

political independence in the application of one kind of law—all factors very important for economic growth. Those developments, and expectation of future developments on the same trajectory, have provided some of the assurances necessary for growth-enhancing economic bargains and investment, including the establishment of China's public equity capital markets. The critical question for China going forward is how long obvious non-application of law or failures to exercise judicial autonomy can continue before the purported market environment and investor expectations are so poisoned as to negatively affect growth and the efficient allocation of capital to its most productive uses, or cause generalized collapse.

## CASE REPORTS APPENDIX

1994 Company Law – Corporate Establishment Construed as a General Partnership by the People’s Courts

*Zhang Qingzhao v. Zhang Wenhui*, 55:1 Renmin Fayuan Anli Xuan 234-41 (Shanghai Baoshan Dist. People’s Ct., 2002), (Shanghai No. 2 Interm. People’s Ct., 2004).

*Precis Summary of Case and Judgment:* The legal facts of a formal corporate establishment and its funding are to be disregarded, and investors participating in the business association are to be seen as general partners, with distribution of return *on* investment, *of* investment, and post-liquidation rights determined accordingly.

*Parties/Defined Terms:* Shanghai Hufeng Steel Structuring Company (“Hufeng Entity”), transformed into, and renamed as, Shanghai Baoxing Machinery Maintenance and Manufacturing Company (“Baoxing Company” or “Company”); Wang Zhaoming (“Plaintiff Wang”); Zhao Qingzhao (“Plaintiff Zhang”); Zhang Wenhui (“Defendant Zhang”); and Zhang Wenyao (“Defendant’s Brother”).

*Facts:* Baoxing Company was formed out of the Hufeng Entity. The Hufeng Entity was approved and registered at the relevant Bureau of the State Administration of Industry and Commerce (“AIC”) on October 27, 1998, with its registered address at the Shanghai Municipality Baoshan District North Wenchuan Road Economic Development Zone. It was registered as a “domestic equity joint venture limited liability company” (*guonei hezi youxian zeren gongsi*), with the two shareholders—Defendant Zhang and Defendant’s Brother—and a registered capital of RMB 500,000 yuan. Defendant Zhang was to contribute RMB 300,000 yuan, and Defendant’s Brother RMB 200,000 yuan, all in cash. On March 25, 1999, the Hufeng Entity changed its name to “Shanghai Baoxing Machinery Maintenance and Manufacturing Company Limited.” On April 29, 1999, Defendant Zhang entered into a “Shareholders’ Agreement” (*gudong xieyi shu*) with the two Plaintiffs, pursuant to which: Defendant Zhang and the two Plaintiffs would promote the establishment of the Baoxing Company with investment of RMB 1,821,693 yuan; the three parties would “have the same equity, share profits and losses equally, and have equal management rights”; policy issues to be decided by a vote, with at least the vote of two of the three parties required for effectiveness. This “Shareholders’ Agreement” was fixed with the seal of the Baoxing Company. At the request of the two Plaintiffs, on September 28, 2003, the Shanghai Baoshan District People’s Court retained an accounting firm to audit the sources and actual capitalization of Baoxing Company, its operating condition to August 2002, expenditures, use of funds, revenues and profits, etc. That accounting firm reported the following: (i) the Baoxing Company accounts showed May 30, 1999 “other revenues” of RMB 100,000 yuan, “fixed assets” of RMB 400,000 yuan, and a notation describing “received capital” of RMB 500,000 yuan, but the firm could find no actual receipts or documentation showing the receipt or payment of this cash or value, and thus had no way to confirm the purported contributions by Defendant Zhang or Defendant’s Brother of cash or fixed assets into Baoxing Company; (ii) in May, 1999, Plaintiff Zhang contributed RMB 128,500 yuan to Baoxing Company for 24.83% of Baoxing Company’s received capital; Plaintiff Wang contributed RMB 200,000 yuan (made up, in part, by conversion of RMB 44,024 of receivables

due from Baoxing Company) for 47.15% of Baoxing Company's received capital; and Defendant Zhang contributed RMB 145,020 yuan for 28.02% of Baoxing Company's received capital. In the period to August 2002, Plaintiff Zhang had received from Baoxing Company RMB 66,410 yuan, Plaintiff Wang had received from Baoxing Company RMB 190,000 yuan and an additional RMB 30,000 yuan in employee compensation, and Defendant Zhang had taken out of Baoxing Company RMB 335,000 yuan; (iii) to August 2002, Baoxing Company's cash on hand and undistributed profits amounted to RMB 706,728 yuan, which, with the deduction of depreciation and rent payables, left undistributed cash of RMB 643,248 yuan—it being noted by the accounting firm that prior to the submission of capital by the Plaintiffs, the Baoxing Company had shown no records of profit or loss; and (iv) no evidence that vehicles or any materials used by Defendant Zhang had ever been included on the Baoxing Company accounts as company assets. The firm concluded its report by giving the accounts a fairly clean opinion, unable to identify any great variance or failure to record assets and liabilities. Finally, as the court proceedings started, Defendant's Brother asserted that he was merely a low-level person at Baoxing Company without any management involvement whatsoever, and in fact only knew about the "Shareholders' Agreement" between his brother Defendant Zhang and the two Plaintiffs once the litigation was filed.

*Plaintiffs' Allegations at Time of Suit:* The two Plaintiffs argue that when they signed the "Shareholders' Agreement" with Defendant Zhang in April of 1999 it was an agreement to jointly capitalize and establish the Baoxing Company. Under the Agreement, the three signatories were to have equal shares, and share the risk of profits and liabilities equally. After the Agreement took effect, the three parties invested RMB 519,059.41, comprising Plaintiff Zhang's RMB 130,000 yuan, Plaintiff Wang's RMB 244,024 yuan, and Defendant Zhang's RMB 145,034 yuan. Baoxing Company was established on March 25, 1999. Through the efforts of the three parties they exceeded initial expectations and did rather well, accumulating profits of RMB 706,728 yuan by August of 2002. In addition, in the period between March 2000 and the end of August 2002, Baoxing Company returned (*fanhuan*)<sup>367</sup> RMB 665,000 yuan to the investors, with RMB 130,000 to Plaintiff Zhang, RMB 190,000 to Plaintiff Wang, and RMB 335,000 to Defendant Zhang. At the present time, the three parties have encountered disagreements about management of the Baoxing Company and Defendant Zhang has frozen the two Plaintiffs out of any management role in the company. In light of this, the two Plaintiffs ask the People's Court to issue an order confirming their rights as shareholders of Baoxing Company between April 1999 and August 2002; Plaintiff Wang sues for an order by the Court causing Defendant Zhang and Baoxing Company to return RMB 54,024.94 yuan of his investment; the two Plaintiffs ask for an order causing Defendant Zhang and Baoxing Company to distribute undistributed profits of RMB 471,152 yuan, and a separate order causing Defendant Zhang to return to Baoxing Company the RMB 335,000 yuan he improperly looted from the Company.

*Defendants' Allegations at Time of Suit:* Defendant Zhang and the Baoxing Company assert that the three-party "Shareholders' Agreement" never took effect and was never implemented. The two Plaintiffs never contributed capital, and never participated in management of the company, and thus cannot be considered "shareholders" of Baoxing Company or be seen to have any right to the company's profits or request dividend distributions. Because the two Plaintiffs were never

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<sup>367</sup> The use of this term in Chinese shows the Plaintiffs think this is a "return of capital", not a distribution of profits, or salary and wages, etc. Obviously, this characterization needs to be settled by the People's Courts.

shareholders of Baoxing Company, there is no issue of share transfer. The relationship between the two Plaintiffs and Defendant Zhang is one of creditor-debtor, and Defendant Zhang has already returned to the two Plaintiffs all amounts borrowed from them. Defendant's Brother's pleading is similar: because Plaintiffs are not shareholders of Baoxing Company, there can be no talk of "dividends" or "stock redemption".

*Shanghai District Court's Judgment:* The No. 2 Civil Division of the Shanghai Baoshan District People's Court ruled as follows on May 15, 2004: The true nature of the "Shareholders' Agreement" signed between the two Plaintiffs and Defendant Zhang was that of a contractual agreement allowing the parties to "borrow" the existing name of the Baoxing Company to undertake business activities. Judging from the AIC's records, and the results of the audit requested by the Plaintiffs and ordered by the People's Court, the Baoxing Company was actually established before April 29, 1999 (in October 1998). Thus, the three parties could not have had an intention to "establish" the Baoxing Company or become the "new" company's shareholders. Formally, Baoxing Company only had two shareholders, Defendant Zhang and Defendant's Brother, neither of whom actually capitalized the Company. This corporate form was managed and operated by Defendant Zhang, and only used the name of Defendant's Brother who did not contribute capital or participate in Company management. In fact, from the formal establishment of the Company to the date of signature of the "Shareholders' Agreement", or April 29, 1999, Baoxing Company had no real operations. Defendant Zhang, as one of the promoters—and publicly-identified (registered) shareholders—of Baoxing Company, signed the "Shareholders' Agreement" with the two Plaintiffs, which Agreement clearly stipulated that the three parties would jointly employ RMB 1,800,000 yuan to establish Baoxing Company, and that the enterprise would be managed by all three of the parties to the Agreement. However, even with the agreement of each of the parties to make their respective capital contributions and jointly run the enterprise, no change of the registered capital (RMB 500,000 yuan) or the list of shareholders was made at the relevant AIC and thereby not notified to the public at large. Therefore, and in accordance with the principle of public notice (*gongshi yuanze*) the Company itself enjoyed a reduced limitation on its liability (as against the world) of only RMB 500,000 yuan (*i.e.*, as against the RMB 1.8 million yuan of initial capitalization called for under the *post*-establishment "Shareholders' Agreement"). Thus, the Court pronounces, the April 29, 1999 "Shareholders' Agreement" in fact constitutes the borrowing of the name of the already-established Baoxing Company to undertake a "partnership" (*hehuo jingying*)-form business enterprise.<sup>368</sup> Thus, the two Plaintiffs may not simply by virtue of partial capitalization of and management rights over the business be deemed shareholders of the Company. By the same token, Defendant's Zhang's claim that the relationship between the two Plaintiffs and Defendant Zhang is that of creditor-debtor cannot be sustained. That is because the "Shareholders' Agreement" clearly stipulates that the three parties are cooperating partners, and the reality is that all three signatories participated in active management and operation of the business. With respect to Plaintiff Wang's claim against Defendant Zhang and Baoxing Company for return of RMB 54,024 yuan of his investment, the Court states as fact that Plaintiff Wang has already been given RMB 30,000 yuan as employment compensation, but that Plaintiff Wang has offered no evidence to prove that this was Defendants' obligation to provide. Thus, the Court only supports a reasonable amount of "investment return" to Plaintiff Wang (after deduction for what he has

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<sup>368</sup> This idiom, *hehuo* is not used casually, and is the Chinese character set used for what we may think of as general partnerships and registered as such under the PRC Partnership Enterprise Law.



already received from the business). With respect to the division and distribution of the profits earned by the Baoxing Company enterprise during the three-party cooperation period, when the partners can no longer work together then the commonly-derived profits should be subject to an accounting and distributed. Here, even though the “Shareholders’ Agreement” calls for total investment in the business of RMB 1,821,693 yuan with each party contributing the same share, in fact not all of this investment was made, and not by each party equally. Because the parties did not contract to share profits and losses in accordance with their capital investment, and because it is difficult to sort out the real joint contributions to the business during the cooperation period, the Court rules that notwithstanding the actual proportions of capital contributions made by the three parties, profits and losses should be shared by the parties pursuant to the principle stipulated in the Agreement that “the three parties will together share the risk and the profits”. Therefore, with confirmed retained profits of RMB 643,248 yuan, each is due a share of RMB 214,416 yuan. With respect to the obligor of these distributions, because the common investment was situated at Baoxing Company, then Baoxing Company has the obligation to make these distributions. Defendant Zhang has a double obligation here, as both a “partner” (*hehuoren*) and the Legal Representative of Baoxing Company—he has a duty to keep custody over and manage the “partnership’s profits” (*hehuo lirun*) prior to their distribution to the investors. Therefore, if there is any shortfall in the distributions of profit made to the two Plaintiffs in accordance with the foregoing, Defendant Zhang has a duty to make up any shortfall. Finally, with respect to the Plaintiffs’ claim that Defendant Zhang has illegally taken out RMB 335,000 yuan of cash from the enterprise, that claim is rejected. Defendant Zhang must be seen as one of the common operators (*gongtong jingying ren zhi yi*)<sup>369</sup> of the enterprise who has a right to share in the profits thrown off by the business. Thus, the amount taken out of the business by Defendant Zhang, although larger than his investment (and thus in excess of his return of investment) can also be seen to include his return on investment. Accordingly, the Court dismisses the Plaintiffs’ claim that he has illegally looted the enterprise.

*Shanghai Intermediate People’s Court’s Judgment:* Neither Defendant Zhang nor Baoxing Company accepted the first judgment, and appealed. In the appeal, the parties made additional or amended pleadings as follows. Baoxing Company: (i) the District People’s Court made procedural mistakes in accepting the audit report asked for by the Plaintiffs in establishing evidence in the case, and the accounts have been completely under the control of Plaintiffs since the start of the litigation, and manipulated by them; (ii) the District People’s Court’s judgment to the effect that the tripartite agreement constitutes a “partnership” is wrong—Baoxing Company was established before signature of the “Shareholders’ Agreement” and the Agreement was not actually implemented because the parties did not make their required capital contributions; therefore, from a funds flow and accounting payables point of view, the money actually contributed by the two Plaintiffs and Defendant Zhang is clearly part of a private lending arrangement between the cash providers and the Baoxing Company. In the alternative, even if the tripartite Agreement does create a partnership in law, the partnership has been dissolved in law by virtue of the parties’ receipt of return of investment; the District People’s Court ignored the fact that the parties have effected a return of capital, and incorrectly confers on the Plaintiffs a right to share in the partnership’s post-dissolution residual profits. Defendant Zhang: Repeats the pleadings of Baoxing Company, and in addition asserts that he and the Company are

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<sup>369</sup> Note how the opinion, having the opportunity, does not now identify the individual as a “partner” (*hehuoren*) as previously.

independent civil legal subjects, and that as the Legal Representative of Baoxing Company he has no responsibility for the corporate liabilities of the company he acts as Legal Representative for (Baoxing Company). Plaintiffs: They assert that they have not manipulated the Company accounts offered as evidence, and that Defendant Zhang was allowed to review them prior to submission into evidence; in addition, the first Court's view that the arrangement written up as equity investment in a limited liability company was actually an enforceable partnership arrangement is correct—the Agreement was only not implemented in part, not completely unimplemented; finally, because the Baoxing Company has been absolutely controlled by Defendant Zhang since inception, he should have personal responsibility to make up any shortfall in the Court-ordered distributions.

In its judgment of September 24, 2004, the Second Civil Division of the Shanghai No. 2 Intermediate People's Court ruled as follows: First, it dismissed the procedural attack on the District Court's use of the audit firm's review of the Baoxing Company accounts. Second, it "praises and approves" the lower Court's judgment that the three parties were in a "partnership relationship" (*hehuo guanxi*). Even though the Agreement itself talks about "establishing Baoxing Company", the Company was already established, and thus there was no possibility of the parties actually doing what the Agreement called for. With their further investment associated with the existing legal person entity, it is clear that the three parties were only using Baoxing as a "framework" of reference, but were actually engaged in a partnership, and certainly not a creditor-debtor relationship. With respect to the return of investment argument of Baoxing Company, the Intermediate People's Court understands that partnership property can only be distributed upon the unanimous agreement of all partners, and the claim that after distribution of profits initial investment cannot be recovered if the partnership is dissolved by partner disagreement is unsustainable. In sum, the partners continue to have equal rights to the distribution of all residual amounts "in" the partnership. Third, the Baoxing Company is the entity which holds the residual assets of the partnership arrangement determined to have existed in law. Even though the Baoxing Company and Defendant Zhang are indeed separate subjects of the civil law, he still has responsibility for seeing to the distribution of Plaintiff's return or profits from Baoxing (i) as the actual controlling person of Baoxing (and the Legal Representative of the corporate legal person who could frustrate such action), and (ii) as a partner with a duty to his other "partners" (the Plaintiffs). Thus, the Court rules, there is nothing untoward in making Defendant Zhang responsible for any shortfall in partnership distributions due to the Plaintiffs which have to be effected via the agency of the Baoxing Company. Costs are to be split by Defendant Zhang and the Baoxing Company.

2006 Company Law, Article 22 – Shareholder's Suit to Invalidate Board and Shareholders' Resolutions

*Shanghai Yingdafang Service Company v. Shanghai Yingdafang Zhangjiang Service Company*, 2007 Nian Shanghai Fayuan Anli Jingxuan 190-95 (Shanghai Pudong New Dist. People's Ct.), appeal filed Shanghai No.1 Interm. People's Ct. (2007).

*Précis Summary of Case and Judgment:* Plaintiff legal person shareholder seeks to annul board and shareholders' resolution of investee company under the control of two other shareholders who have apparently breached pre-company formation agreement to direct all business to investee company, and established a competing company (without participation of Plaintiff shareholder) to which all corporate opportunities due to investee company will be directed. Both the Pudong District People's Court and, on appeal, the Shanghai No. 1 Intermediate People's Court agree that such resolutions should not be annulled because they are not contrary to law, and because they do not infringe upon the rights of the investee company or the Plaintiff shareholder. Both People's Courts also strive not to rule on the apparent shareholder's – not directors' or officers' – breach of the duty of loyalty or the prohibitions against competition or taking a corporate opportunity.

*Parties/Defined Terms:* Shanghai Yingdafang Service Company (“Plaintiff”); Shanghai Zhangjiang (Group) Company (“Defendant Company A”); Shanghai Zhangjiang High Technology Park Development Co., Ltd. (“Defendant Company B”); Shanghai Yingdafang Zhangjiang Service Company (“Investee Company”); Shanghai Zhangjiang Investment Operations Company (“Defendant Companies' Holding Company”); and Shanghai Zhangjiang Service and Facilities Management Company (“Competing Company Establishment”).

*Facts:* Plaintiff, Defendant Company A and Defendant Company B executed an agreement looking to the establishment of Investee Company, and in the agreement promised “in principle” that each of the investors would direct any business related to management or facilities work in Shanghai's Zhangjiang High Technology Park to the Investee Company. Thereafter, Investee Company was formally established, with each of Plaintiff, Defendant Company A and Defendant Company B as the shareholders. (The opinion does not recite the respective equity ownership percentages of the three parties in the Investee Company, but as described below, Defendant Company A and Defendant Company B must hold 50% or more of the voting share interest. Similarly, the case report does not describe the size of the board of directors, but it is later made clear that Defendant Company A and Defendant Company B are able to direct the votes of at least three of the elected directors.) However, after the establishment of Investee Company, Defendant Company A and Defendant Company B established Defendant Companies' Holding Company, which then with Defendant Company B and a number of other outside investors established Competing Company Establishment. On September 9, 2005, Investee Company issued a board resolution which, among other things, stated that all work in the Zhangjiang High Technology Park entrusted to Investee Company by Defendant Company A would be discontinued. On the same day, Investee Company passed a shareholders' resolution, supporting and confirming the board resolution. At the time of these resolutions, the work entrusted to the Investee Company by Defendant Company A and Defendant Company B made up 75% of Investee Company's business. In accordance with the above-described board and shareholders'

resolutions, when Defendant Company B's then current contractual arrangements with Investee Company came to term, Defendant Company B took the entirety of such work and assigned it to Competing Company Establishment.

*Plaintiff's Allegations at Time of Suit:* Plaintiff alleges that, without the participation of Plaintiff (as a shareholder in Investee Company) the resolutions procured as a result of the convening of a board meeting and a special shareholders' meeting by Defendant Company A and Defendant Company B were (i) in contravention of Investee Company's Articles of Association, and (ii) harmed the interests of both Investee Company and the Plaintiff. The Plaintiff accordingly prays for the following relief: (a) a judgment declaring that the subject board and shareholders' resolutions are null and void; (b) an order commanding that Defendant Company A and Defendant Company B desist in their rights-infringing behavior, and a declaration that the transfer of business by Defendant Company A and Defendant Company B to Competing Company Establishment be without effect; and (c) court costs to be borne by the Defendant Companies.

*Investee Company (as Named Defendant) Allegations at Time of Suit:* The Investee Company, named as a defendant in the case, asserts (i) that the two resolutions were fully in compliance with the Company Law of the PRC and the Investee Company's Articles of Association, and should be confirmed to have full force and effect; and (ii) the second request by the Plaintiff (item (b) immediately above) has nothing to do with Defendant Company.

*Defendant Company A and Defendant Company B's Allegations at Time of Suit:* Defendant Company A and Defendant Company B assert (i) that they are both shareholders of Investee Company and thus have nothing to do with the Plaintiff's first pleading (item (a) immediately above) and should not be named as defendants; and (ii) there has been no harm to the interests of any party.

*Shanghai Pudong District People's Court Judgment:* The first court which considered the case understood two basic items in dispute: (i) whether or not the two named resolutions are valid, and (ii) whether or not Defendant Companies A and B have infringed upon the rights of Plaintiff. On the first question, whether or not the resolutions are valid, the 2006 Company Law clearly provides a provision whereby shareholders can sue to have shareholders' or board resolutions invalidated and declared without effect when either (a) the resolutions contravene law, regulation or the company's Articles of Association, or (b) the calling of, or voting procedures at, a shareholders' or board meeting is in violation of law, regulation, or the company's Articles of Association. On the first sub-inquiry, item (a) immediately above, the Pudong People's Court expands its inquiry beyond that directed by the Company Law, seeking to rule on whether the substance of either resolution "contravenes Law, administrative regulation, or *any agreement between the parties*" (the last prong being something more than the agreement between the parties as reduced to the company Articles of Association). As the Pudong District Court understands the situation, the three eventual shareholders of the Investee Company had executed an agreement which promised to direct all business "in principle" to the Investee Company. However, the People's Court then asserts that, with the establishment of the Investee Company, that new legal person's Articles of Association supersede and replace the terms of the apparently lesser pre-formation "agreement" between the shareholders, even though that agreement speaks

to the business that will be done by the future company. Accordingly, in the Court's view, there is no legal or factual basis for the Plaintiff's assertion of a continuing duty of Defendant Companies A and B to direct business to the newly-established company. The Court then strays farther from reasonable doctrinal application and analysis by invoking Article 21 of the 2006 Company Law (prohibition against use of related party transactions to injure the interests of the company): admitting that Defendant Companies A and B have engaged in such a related party transaction in establishing the Defendant Companies' Holding Company and then using it to create the Competing Company Establishment, the Court then lets Defendant Companies A and B completely off the hook by saying they are "operators" (presumably as well as shareholders) and the pre-Investee Company establishment had already expired, or "in the project preparation stage and before project commencement, electing to use another project services provider, ... does not constitute using related party transactions to harm the interest of the Investee Company."<sup>370</sup> On the second sub-inquiry, item (b) above, the alleged defects in the calling of, or voting at, the board or shareholders' meeting, the court reviews the specific provisions of the Investee Company's Articles of Association (including convening and chairmanship authority, required notice period, form of notice, addressees of notice, etc.) and rules that all such provisions were complied with in the calling of the two meetings. The court further says that the Plaintiff's failure to participate in the meetings, directly as a shareholder and via its representative on the board in the board meeting, constitutes a "waiver of its rights". On voting procedures, the Court again examines the Investee Company's Articles of Association, and recites the fact that certain major decisions require the approval of all of the shareholders, with other matters requiring the approval only of shareholders holding more than 50% of the shares of the company. Likewise, all board decisions require the support of three or more directors to pass. The court rules that the subject of the shareholders resolution does *not* pertain to the "major matters" requiring unanimous shareholder approval. As the shareholders' meeting was attended by shareholders able to vote more than 50% of the shares, and as the directors' resolution gained the approval of three directors, both resolutions are produced in compliance with the Investee Company's Articles of Association and are not in contravention of law and thus should not be invalidated.<sup>371</sup> Finally, on the second prong of the Plaintiff's attack, whether or not Defendant Companies A and B have "infringed upon the rights" of Plaintiff, the Pudong District People's Court piggybacks on its strangled view of the Defendant Companies A and B duties above, all in the context of board and shareholder resolutions which are procedurally and facially without defect, to rule that the redirection of business away from the Investee Company to another provider which does not include the Plaintiff as a shareholder is not an infringement of the Plaintiff's rights. Accordingly, the Plaintiff's claims are rejected, and the burden of costs assigned to the Plaintiff.

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<sup>370</sup> 2007 NIAN SHANGHAI FAYUAN ANLI JINGXUAN 192.

<sup>371</sup> Note that the Pudong District People's Court does not seem to understand a separate *quorum* requirement, *i.e.*, the requirement that either meeting be attended by shareholders voting a minimum number of shares or a minimum number of directors, as the case may be, before the meeting is established in law. It is not clear from the opinions (i) what kind of company the Investee Company is (limited liability company or company limited by shares), and (ii) whether (a) the Articles of Association in this case had quorum requirements for the respective meetings and the meetings were established, or (b) the Articles of Association had no quorum requirements. It should be noted here that the 2006 Company Law—consistent with its proclaimed "private ordering" emphasis—commands no quorum for limited liability company board or shareholder meetings, and no quorum for companies limited by shares shareholders' meetings, but a quorum for companies limited by shares' board meetings ("more than half of the directors") (see 2006 Company Law, arts. 37-51, 99-108, 112 ).

*Shanghai No. 1 Intermediate People's Court's Judgment, on Appeal:* On appeal from the Plaintiff, the Shanghai No. 1 Intermediate People's Court takes the following view: First, it agrees with the lower Court that the redirection of business away from the Investee Company to the Competing Company Establishment is important, but not one of the "major" matters requiring *unanimous* shareholder approval by all of the shareholders of the Investee Company, and not a matter that can *be read into* the language "and other matters" in the relevant article of the Articles of Association. The higher Court also affirms the legality of one specific aspect of the board resolution not addressed in the lower Court's opinion, that part of the directors' resolution which fires the President of the Investee Company (no doubt, an officer nominated by the Plaintiff). Stating that the board is responsible to the shareholders' meeting, and that both the 1994 Company Law and the Investee Company's Articles of Association authorize the board of directors to hire and fire senior officers, the Intermediate People's Court sees the board resolution which implements that power as perfectly legal. Third, the higher Court affirms the lower Court's view that the meeting convening and voting procedures are all in accordance with the PRC Company Law and the Articles of Association, and thus the resulting resolutions are not subject to attack. Finally, the Intermediate People's Court addresses the most provocative question decided on the Plaintiff's pleadings—the extent to which the Defendant Companies A and B have "infringed upon the rights" of any other party. And here, just as with the lower Court's opinion, there is an extraordinary emphasis on the almost exclusive power of the Investee Company's Articles of Association, as a summary of the rights and duties of the participants in the Investee Company. Saying that the pre-formation agreement is expired by virtue of the subsequent Investee Company establishment and agreement of the Articles of Association, and that the new all-governing Articles of Association contain no provisions either affirmatively directing business to the Investee Company or restricting shareholders or their agents from independently pursuing opportunities within the Investee Company's expectation, the Court dismisses the Plaintiff's broadest pleading. The Intermediate People's Court, in a parting shot, does at last invoke the pre-2006 Company Law (which it should be remembered did not have a statement of broad fiduciary duties for directors, officers or controlling shareholders) and its prohibition against directors and senior officers of a company engaging in competing business, but only to subject that clause to the strictest reading possible and happily pronounce that it is binding on "directors and officers" only, not *shareholders* like Defendant Companies A and B.

2006 Company Law, Article 183 – Shareholders' Suit for Dissolution

*Tang Chunxiao v. Zhou Huizhong*, 2007 Nian Shanghai Fayuan Anli Jingxuan 138-44 (Shanghai No.1 Interim. People's Ct., 2006).

*Précis Summary of Case and Judgment:* Plaintiff shareholder seeks judicial dissolution of a company (formed before 2006) under Article 183 of the 2006 Company Law, while defendant shareholder (and subject company) resists and alleges suit for dissolution is with malevolent intent and in addition that the difficulties at the subject company do not conform to the high legal standard for judicial dissolution. The Shanghai Intermediate People's Court dismisses the suit, with costs to Plaintiff, because Plaintiff has failed to offer sufficient evidence supporting his claim for relief under Article 183, *i.e.*, he has failed to prove that the only remedy for the parties is court-ordered dissolution. The Court does not respond to or rule upon any of the clear breaches of fiduciary duties by the Plaintiff, even though the Defendant responsively pleads multiple violations of the duty of loyalty by the Plaintiff.

*Parties/Defined Terms:* Tang Chunxiao ("Plaintiff"); Zhou Huizhong ("Defendant"); Fukang Century Real Estate Development Co. Ltd. ("Project Company"); Dongxing Real Estate Development Co. Ltd. ("Partner Company"); proposed Shanghai corporate buyer of Project Company ("Strategic Investor").

*Plaintiff's Allegations at The Time of Suit:* The Project Company was established on February 18, 2004 with a declared registered capital of RMB 10 million yuan, and 60% of the equity held by the Defendant and 40% by the Plaintiff. The Project Company was originally promoted to undertake a real estate development project in Zhejiang Province. By April of 2004, the Project Company had entered into an agreement with the Partner Company to develop a commercial residential housing project in Zhejiang Province, whereby the Partner Company would contribute the land use rights for the land to be developed, and the Project Company would contribute all funds needed for construction. However, because the Project Company was not able to contribute the full amount of the construction funds, the actual construction was stopped; the construction contractor sued the Partner Company for the unpaid construction cost in a Zhejiang Province People's Court proceeding and won, with the Zhejiang Province Court ordering the Partner Company to pay the unpaid amounts to the construction contractor. The Partner Company then brought a second suit in the Zhejiang Huzhou Municipal Intermediate People's Court asking for the termination of its arrangement with the Project Company, which suit is still *sub judice* at the time of the present Project Company dissolution case. Because the Plaintiff is at the same time a shareholder and a Supervisory Board member of the Project Company, and a shareholder and the Legal Representative of the Partner Company, the dispute between the Project Company and the Partner Company has only intensified the bad blood between the Plaintiff and the Defendant. At the time of the Plaintiff's suit for dissolution, the Project Company is experiencing the following difficulties: (i) the Project Company is not yet fully capitalized, because—in breach of the Project Company's Articles of Association requiring a capital contribution by the Defendant of RMB 6 million yuan—Defendant has contributed just RMB 3.34 million yuan; (ii) Defendant has engaged in the following "rights infringing" behavior: (a) in February of 2005, the Defendant forged the Plaintiff's signature to create a false shareholders' resolution and amendment to the Project Company Articles of Association

extending the Project Company's term of operation to 2015, and in June of 2005 used the same procedure to sell a 51% equity interest in the Project Company to a third party, Shanghai-based Strategic Investor; (b) on May 15, 2005, without calling a Project Company shareholders' meeting, the Defendant had himself appointed both a director and President of the Project Company; (iii) the Project Company has not been able to call a shareholders' meeting, even though the Plaintiff has on several occasions asked in writing that the shareholders' meeting be convened; and (iv) relations between the parties have worsened, because of the project development related litigation in Zhejiang Province related above. Accordingly, the Plaintiff brings the present action in the Shanghai No. 1 Intermediate People's Court seeking dissolution of the Project Company under Article 183 of the 2006 Company Law, with court costs to the Defendant.

*Defendant's Allegations at The Time of Suit (Joined by the Project Company):* (i) The suit by the Plaintiff to dissolve the Project Company is brought with malevolent intent. The Plaintiff, as both a director and Vice-President of the Project Company, and with full power to represent the Project Company in its dealings with the Partner Company in regards of the real estate development in Zhejiang Province, has used his position to, after the Project Company has already agreed to acquire the Partner Company, and without the Project Company shareholders' approval, personally acquire control of the Partner Company and thereby illegally taken a corporate opportunity that belongs to the Project Company and therefore seriously violated his duties of loyalty and prohibition against competition. At the same time, the Project Company has its own autonomous development rights and profit expectations arising from the development agreement with the Partner Company. Thus, the Plaintiff's suit to dissolve the Project Company is motivated by his desire to squeeze the Project Company out of the real estate development project, and have the Partner Company—which Plaintiff now controls—take all profits arising from the real estate project as it is further developed on the base established by the Project Company. (ii) The Plaintiff has primary responsibility for the difficulties now existing at the Project Company. The Project Company's major difficulties are a result of its lack of funds. There are many ways to solve this problem, and yet the Plaintiff, to further its squeeze-out scheme detailed above, has continually blocked the Project Company and the Defendant in their efforts, including: (a) frustrated the refund by the Huzhou People's Government of a part of the land use rights grant fee (RMB 1.1 million yuan) which has aggravated the shortage of funds; (b) blocked the effort to get a strategic investor—in June of 2005 the Defendant arranged a share transfer agreement with the Strategic Investor for a registered capital investment in the Project Company of RMB 5.1 million yuan, however the Plaintiff blocked the deal causing it to collapse. (iii) The operational situation at the Project Company has not reached the standard required under the 2006 Company Law for dissolution: (a) the main difficulties experienced at the Project Company and leading to a work shut-down are liquidity problems which occur at any enterprise and are solved in various ways; (b) the shareholders have no basic disagreement over the operations of the Project Company and are both willing to pursue the real estate development activity under the above-mentioned agreement (when the shareholders convened a meeting under the auspices of the development site's village head, they agreed to continue the development in accordance with the original agreement); and on April 26, 2006, when the Partner Company brought suit against the Project Company, with the Plaintiff serving as Legal Representative of the Partner Company, the latter again made clear that it wanted to continue to abide by and perform the development agreement; (c) there are many other ways to solve the operational



difficulties encountered by the Project Company, which at the very least include: first, the shareholders can invest additional capital in the Project Company (the registered capital of the Project Company is RMB 100 million yuan, with RMB 74,151,180 yuan already contributed, so the shareholders can contribute additional capital to the Project Company in accordance with the Company's Articles of Association); second, the Project Company can introduce a strategic investor; third, the Project Company can in accordance with the law seek to enforce its creditor's rights (at the present time, the Project Company is a creditor to the development site People's Government in the amount of RMB 1.1 million yuan (the refund of the land use rights grant fee) and creditor to another Shanghai company unrelated to the lawsuit(s) in the amount of RMB 119,165 yuan—if the Project Company could collect on those outstanding balances it might go some way to solving its liquidity difficulties); fourth, the Plaintiff can sell his equity in the Project Company, and exit from a difficult situation, replacing himself with another shareholder who is interested in pursuing the development; (d) the dissolution of the Project Company would harm the legal rights of both the Project Company and its shareholders, as follows: to November 21, 2005, the Project Company has already invested RMB 7.29 million yuan in the development project, and owns the exclusive development rights to the property; according to the financial projections for the project, it will produce a return (profit) to the Project Company of RMB 5.71 million yuan; if the Project Company is dissolved, then the exclusive development rights and the projected returns on the project will go only to the Partner Company, which the Plaintiff controls as its Legal Representative, with no return at all for the Project Company. Because the Plaintiff's suit is brought with malevolent intent, and because the difficulties experienced at the Project Company do not rise to the legal standard for judicial dissolution of the Project Company, the Defendant asks that the Plaintiff's suit be dismissed.

*Shanghai No. 1 Intermediate People's Court Findings of Fact:* The Court finds that much of the factual pleadings are accurate, with the following additional details or confirmations: On April 18, 2004, the Project Company and the Partner Company executed a "Joint Project Development Agreement" pursuant to which the Partner Company would contribute land use rights with a value of RMB 2.92 million yuan into the real estate development, and the Project Company would bear all other costs for the same project. On April 19, 2004, the two Companies executed a "Supplemental Agreement" giving full control over the project to the Project Company, but guaranteeing the return to the Partner Company of the invested value of the land use rights contribution (RMB 2.92 million yuan), and further agreeing that after the return of the capital contribution (represented by the land use rights) to the Partner Company, the Project Company would have the sole and exclusive right to operate the real estate project and receive all revenues thrown off by it (and would be responsible for all further costs and liabilities in connection with the project and its operation). On October 31 of the same year, the Project Company entered into a "Land and Corporation Transfer Agreement" with the Partner Company, pursuant to which the Project Company was to acquire the Partner Company. However, a month later, on November 26, 2004, the Plaintiff (still a shareholder and supervisory board member of the Project Company) and Zhao Guogang entered into an agreement with the shareholders of the Project Company, pursuant to which, for an aggregate purchase price of RMB 10 million yuan, the Plaintiff would gain a 52% interest in the Partner Company, and Mr. Zhao Guogang the remaining 48%. This latter transaction was completed, whereby the Plaintiff became the controlling shareholder and Legal Representative of the Partner Company. After January 17, 2005, the Project Company attempted to convene shareholders' meetings numerous times, but on

each occasion was unable to produce shareholders' resolutions. To April 20, 2005, the real estate project has been stopped and is sealed, yet foundation construction and first floor construction have been completed, with only partial completion of the exterior areas of the second floor. As agreed by the contesting parties, the Project Company has already invested approximately RMB 3 million yuan in the real estate construction. Finally, the Shanghai People's Court confirms that on April 26, 2006, the Partner Company sued the Project Company in the Zhejiang Province Huzhou Intermediate People's Court asking that the Project Company pay outstanding construction fees and stoppage penalties in the amount of RMB 6.4 million yuan, and that the Project Company continue to perform the two development agreements.

*Shanghai No. 1 Intermediate People's Court's Judgment:* In its judgment the Court understands the case to be limited to the question of whether or not the application for judicial dissolution meets the standards for the same under the Company Law. While acknowledging that the Plaintiff has the requisite 10% minimum equity interest to plead dissolution, and that the Project Company has not been able to function (or produce a shareholders' resolution) for more than a year, the Court rules that—at the time of suit—the evidence offered by the Plaintiff (who the Court says has the burden of proof) is not sufficient to prove that if the Project Company continues it will result in significant injury to the shareholders, or that the difficulties experienced at the Company have reached such a point that only dissolution will solve the problem (hinting strongly that the parties should be able to negotiate a buy-out to bring about the exit of one of the two contesting shareholders). Accordingly, the case is dismissed, with costs (of RMB 60,010 yuan) to be borne by the Plaintiff.<sup>372</sup>

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<sup>372</sup> Interesting are the Court's rationales supporting its dismissal of the case, offered as a kind of *dicta*. First, the Court is loathe to order the dissolution of a corporate legal person because it would "necessarily impact in different degrees market order and stability." This legal policy aim may be contrasted with what might be termed an economist's focus on the situation, or the encouragement of re-deployment of capital when shareholder relations become so difficult as to stop a project before completion and revenue earning. Second, the Court understands that any dissolution uses up judicial resources (tantamount to a bankruptcy), and negatively impacts both shareholders and third parties (including creditors). Third, and as a kind of window into an equity approach to the problem, the Court says it must consider the "appropriateness" (*zhengdangxing*) and "rationality" (*helixing*) of such a significant step as judicial dissolution. This orientation allows the court to take judicial notice in effect of the Plaintiff's rather "unclean hands", and thus support its technical dismissal of the case based on the failure to meet the statutory standard.

2006 Company Law – Shareholders’ Lawsuit to Invalidate Shareholders’ Resolution (Election of Director) for Failure to Disclose or Incomplete Disclosure

*Lu Jianming v. Shanghai Light Industry Machinery Co., Ltd.*, Zhongguo Zuijin Xin Gongsifa—Dianxing Anli Pingxi 189-94 (Shanghai Jingan Dist. People’s Ct.), (Shanghai No. 2 Intern. People’s Ct., 2006).

*Précis Summary of Case and Judgment:* Plaintiff’s suit for invalidation of a resolution electing directors is dismissed because the defect in the subject resolution was not one provided for in the Company Law provision as the basis for invalidation of board and shareholders’ resolutions.

*Parties/Defined Terms:* Lu Jianming (“Plaintiff”); Shanghai Light Industry Machinery Company, Limited (“Defendant Company”); and Shanghai Hong Chang Shen Group Company (“Controlling Shareholder”).

*Plaintiff’s Allegations at Time of Suit:* In the Defendant Company’s 2003 annual report, it was disclosed that Defendant Company’s board candidate Ms. Shi was employed at the Controlling Shareholder (under a prior name, “Shanghai Erdi Group Company Limited”). On August 2, 2008, the Controlling Shareholder changed its registered name to its present name. [In the materials distributed concerning the election of directors, the] Defendant Company did not disclose that Ms. Shi had worked at the Controlling Shareholder, the purpose being to hide the fact that it controls the Defendant Company via personnel appointments.

*Defendant Company’s Allegations at Time of Suit:* The complete disclosure of the background and employment history of board nominees in materials distributed is not required by any of the procedures relevant for the convening of board meetings, voting, or by corporate law. Moreover, the Defendant Company’s Articles of Association do not require the disclosure of whether or not there is any relationship between any board nominee and any actual control persons. Even if the Defendant Company did not fully disclose materials on the board nominee, that is not reason for the resulting board resolutions to be invalidated. There are at present no stipulations in law or administrative regulation concerning informational disclosure on board nominees, and thus there is no basis to the Plaintiff’s claim that the Defendant Company’s failure to make disclosure on a board nominee’s background is illegal or contrary to regulation.

*Facts Determined by The Court of First Instance:* The Shanghai Jingan District People’s Court determined the following: From February 16, 2005 to the time of suit in 2006, the Plaintiff owned 100 shares of the Defendant Company. On March 19, 2004, the *Shanghai Securities Daily* carried the Defendant Company’s 2003 Annual Report summary. Under the heading “Changes in Shareholdings of Directors, Supervisory Board Members and Senior Management”, it stated “Ms. Shi is a director of the [Defendant] Company from April 29, 2003 to April 28, 2006”; in a separate column describing the employment of board and supervisory board members, it stated “From October 2001 to the present, Ms. Shi has been employed at Shanghai Erdi Group Limited.” On March 25, 2006, the *Shanghai Securities Daily* carried the Defendant Company’s 2005 Annual Report summary, and board resolutions passed by the 13<sup>th</sup> meeting of the Defendant Company’s 4<sup>th</sup> Board, and announcement for convening of the 15<sup>th</sup> General Shareholders’ Meeting. Resolution No. 9 contained in that announcement stated simply that Ms.

Shi be nominated as a director for the Defendant Company's 5<sup>th</sup> Board. The same announcement contained background information on the board nominees, and in the materials on Ms. Shi her employment at Shanghai Erdi Group Limited was not raised. Finally, in the Defendant Company's 2005 Annual Report publicly posted on the Shanghai Stock Exchange website in March 2006, it stated that between April 2003 and March 2004 Ms. Shi worked at Shanghai Erdi Group Limited and that from April 2004 to that date Ms. Shi had been the Defendant Company's Deputy General Manager (Vice President) and a board director.

*Judgment of the Shanghai Jingan District People's Court:* First, the Court holds that under the 2006 Company Law shareholders may bring an action in the People's Courts for invalidation of board resolutions in cases where a board meeting has been improperly convened, the method of voting violates law, administrative regulation or the company's Articles of Association, or the content of the challenged resolution violates the company's Articles. Thus, in trying to determine whether or not a board resolution is to be invalidated, the only standard that will be applied is whether or not the resolution violates law or administrative regulation. "The Guiding Articles of Association for Listed Companies"<sup>373</sup> promulgated by the CSRC are departmental regulation (*bumen guizhang*) [*i.e.*, forms or regulations issued by Ministry-level state administrative organs] and thus do not come within the scope of "law" or "administrative regulation". Second, the Defendant Company's Articles of Association stipulate only that the board of directors should send information on a board nominee's career and basic situation to shareholders, with no clear stipulation requiring information on any relationship between an actual control party and the board nominee. Accordingly, the claim that, even though the Defendant Company made public notification of Ms. Shi's career history, because it did not allude to her service at the Controlling Shareholder the resolution passed by the 13<sup>th</sup> Meeting of the 4<sup>th</sup> Board of Directors is "in violation of the Articles of Association" goes too far. Third, listed companies are not limited to newspapers in making information disclosure. In "today's information society", shareholders can also go online to research information on a listed company. Even though the Defendant Company did not make complete disclosure of Ms. Shi's career background in its Annual Report carried in "Shanghai Securities Daily", and left out mention of her past service at the Controlling Shareholder, the same (full) Annual Report with complete disclosure about Ms. Shi's past was already filed with the Shanghai Stock Exchange, and could be easily accessed by any member of the public via the Internet. Finally, the claim by the Plaintiff that the Defendant Company purposefully and with bad intent concealed Ms. Shi's past service with the Controlling Shareholder is not supported by the facts and will not be entertained. Thus, the March 2006 board meeting was convened in accordance with valid procedure, the voting was in conformity with law and regulation, and the content of the resolutions did not conflict with the company's Articles of Association—and thus the claims of the Plaintiff cannot be supported.

The Plaintiff did not accept the judgment of the District People's Court, and appeals:

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<sup>373</sup> Note: this is the form of "mandatory" Articles of Association required of all domestically-listing companies domiciled in China (there are separate Mandatory Articles of Association for Overseas-Listing Issuers). The Court's point here is that—as a form—the stipulations in these Articles are not themselves law or regulation, they are merely a template of provisions which should be adopted by listing companies, which the CSRC enforces by forbidding listings if a company undertaking an IPO does not have conforming Articles. It would seem in this case that, at the time of the challenged board resolution, the Articles of Association had not been changed to conform with the updated (post-2006 Company Law) version of such Guiding Articles of Association.

*Plaintiff's Claims on Appeal:* The District People's Court was wrong to look to the Internet for evidence in the case, and use evidence so procured as dispositive, and this was a violation of China's civil procedure law. The "Guiding Articles of Association" are administrative regulations (*xingzheng fagui*) and should be employed in the case. The Articles of Association put into evidence by the Defendant Company were the Company's 2004 version; in accordance with a Notice accompanying the amended form of Guiding Articles of Association promulgated by the CSRC in 2006 to conform with the new 2006 Company Law, all listed companies were obligated to amend their Articles of Association at the next shareholders' general meeting to bring them into line with new Guiding Articles of Association; therefore, the Articles of Association offered up by the Defendant Company were invalid and without effect. Finally, the original judgment neglected to discover that Ms. Shi and the Legal Representative of the Defendant Company are husband and wife, which is important because any resolution nominating her for the board might impact upon the Legal Representative's personal interest.

*Defendant Company's Response on Appeal:* The Articles of Association offered into evidence were the 2005 version, with "2004" written on them by mistake. The CSRC Notice referred to by the Plaintiff was promulgated on March 16, 2006, and so when the Defendant Company sought to convene the 13<sup>th</sup> Session of the 4<sup>th</sup> Board only a week later, it had not had time to revise the Articles of Association in accordance with the new CSRC template. Accordingly, that board meeting used the 2005 version Articles of Association. The Defendant Company's [2005 version] Articles of Association and its 2006 Annual Report were all filed for the record [and posted] on the Shanghai Exchange's "official" (*guanfang*) website. They are in conformity with law, and in full force and effect. With respect to Ms. Shi's former service at the Controlling Shareholder, this was already disclosed in the Defendant Company's 2003 and 2005 public Annual Reports. Thus, there has been no purposeful concealment of information. The personal relationship between Ms. Shi and the Legal Representative of the Defendant Company is not something that is subject to mandatory disclosure, nor is it a fact which has any impact on Ms. Shi becoming a board nominee. Therefore, the subject board resolution is in conformity with the law, and effective.

*Shanghai No. 2 Intermediate People's Court Judgment:* In accordance with China's laws and regulations, the decision on whether or not a company's board resolution may be invalidated turns on law, administrative regulation and the Articles of Association. The Guiding Articles of Association do not come within the scope of law or administrative regulation. The failure to disclose Ms. Shi's past work history with the Controlling Shareholder or her relationship with the Defendant Company's Legal Representative at the 13<sup>th</sup> Session of the 4<sup>th</sup> Board in the proposed resolution is not a violation of law, administrative regulation, or the Defendant Company's Articles of Association, and the resolution is therefore effective as passed. Nor was there any purposeful concealment of Ms. Shi's history because it was fully disclosed in the 2003 and 2005 Annual Reports filed with the Shanghai Exchange and published in the "Shanghai Securities Daily" and on the Exchange website. The invocation of evidence sourced from the Internet, after confirmation from the Exchange, is appropriate and not contrary to law. The Plaintiff's invocation of the CSRC Notice calling for the amendment of the Defendant Company's Articles of Association to conform with the new Guiding Articles of Association is irrelevant, because the subject board meeting was held before the next succeeding shareholders'

general meeting, and thus a board resolution based on the 2005 Articles of Association is correct and legal. The relationship between Ms. Shi and the Defendant Company is of no relevance to the case, and the failure of the District People's Court to discover it and confirm it does not constitute a defect in the case (or justify overturning the lower Court's judgment).

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<sup>374</sup> The cases listed here are arranged first by date of final hearing/opinion rendered, and then alphabetically by the first party listed.

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