Protection of Minority Shareholders in China:
A Task for Both Legislation and Enforcement

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I. Introduction

Features of China's financial system (especially the strict capital control) helped insulate the country from a fierce stroke of Asian financial crisis,\(^1\) which was largely blamed on poor corporate governance. For China, actually the concept of corporate governance had just appeared a couple of years before the crisis (Zhang, 1994; Wu, 1994), and the first Company Law was passed in the same period.\(^2\) However, from theories to practice, corporate governance has been developed quite a lot during the passed decade. In the end of 2006, especially for the listed companies which are the key figures of corporate governance and this essay itself, the State Share Reform (\textit{Guquan Fenzhi Gaige})-- a program to convert non-tradable shares held by the state into free-floating shares tradable on the national securities exchanges—is going to be finished, which means corporate governance of those listed companies will undergo even larger transitions.

Protect minority shareholders from opportunistic expropriation of management or/and controlling shareholders is always a critical principle of corporate governance, but to be frankly, protection of those minorities is not the chief concern of the Company Law of 1994. The reason for this was not only the Berle and Means image of the firm with separation of ownership and control which dominated in Britain and the United States did not fit the reality of China where the principal owner type (the state ownership) prevailed, but also that, the enactment of the Company Law was then first aiming at settling down the political objective of transforming State Owned Enterprises (SOEs) into stock companies (\textit{Gufenzhi Gaizao}), founding a legislative authority for this transformation, and preventing possible losses of State-owned


\(^2\) Company Law of the People's Republic of China (adopted by the 5th Session of the Standing Committee of the 8th National People's Congress on Dec. 29, 1993, and effective July 1, 1994) [hereinafter “Company Law of 1994” or the “old Company Law”]
Company law which is considered to be a basic statute for the common business enterprises was then (at least partially) drafted as a law of converting SOEs into stock companies. In this background, rights of shareholders other than the State itself were either not available or made clear, or not given clear accesses to remedies.

In the years after the birth of the Company Law, the demand for investor protection has increased significantly in Mainland China for the following reasons: The number of individual shareholders exploded due to the rapid expansion of the securities market; Promotion of scholars, the China Securities Regulatory Commission (“CSRC”) leaders and public media after the corporate scandals and market declines caused the awareness of rights of investors; The importance of developing the stock market to lessen the oppressive pressure on banking finance was recognized by the government; The majority of SOEs have been successfully converted into stock companies, then providing guide and privilege to such conversion was no longer the chief concern of the company legislations. All these elements have led to increased awareness of investor protection and corporate law enforcement as significant policy issues.

In October of 2005, both the most important laws concerning corporate governance of listed companies in China have been widely revised to introduce a lot of measures to further the protection of minority shareholders’ interests. Devices

See §§ 81, 80.1, 24.1, the Company Law of 1994.

For example, as stated in the Company Law of 1994: The Law was promulgated “with the aim to establish a modern enterprise system...” (§ 1); The state assets held by a company belong to the State (instead of by the company itself)(§ 4.3); When a SOE is to be converted into a company, the conversion of management style shall be conducted in accordance with the laws and administrative regulations (§ 7); Where a SOE is converted into a stock company, the State assets is strictly prohibited to be under-valued in exchange for shares, be sold at prices below the prevailing market price, or be allocated to any person without consideration (§ 81); The establishment of a stock company (the only type of company which has access to equity financing market) shall have the approval of the ministries authorized by the State Council or the relevant provincial government (§ 77).


with the function of compensation and deterrence have been established under the laws, administrative regulations and stock exchanges’ rules to address those chronic illnesses of the corporate governance, especially “looting” of listed companies by their controlling shareholders. Although researches showed that improvement of law provisions would contribute to the performance of companies and welfares of the shareholders, as we will see, the new measures in the laws would still fall short to fulfill the demand of shareholders’ protection.

Part II of this essay will introduce the protection of minority shareholders provided by the new laws and the formal enforcement measures in China. Part III will discuss the possible alternative solutions to domestic enforcement regimes, including a "self-enforcing" corporate law model, cross-listings on foreign stock exchanges and the possibility of nonprofit organizations to act as corporate law enforcement agents. Part IV provides some thought to securities-related class action, which is now absent from the law. Part V is a brief conclusion.

II. Revision of Laws and The Formal Enforcement Institutions

Since (as believed) the poor condition of minority shareholders in China has hindered the improvement of local companies’ corporate governance as well as development of the capital market, drastic modifications have been made to China’s 12 years old Company Law. Law makers pronounced clearly that one of the major objectives of the reform is to strengthen the protection of minority shareholders and to improve corporate governance in China. Further, they hoped the revised company law will especially “standardize corporate governance of the listed companies, stipulate strictly responsibilities and legal liabilities of those companies and their related personnel, and promote the stable and healthy development of the capital market” (Cao, 2005). When the revisions of the Securities Law were passed the same day to “improve the regulation of listed companies and raise those companies’ performance”
(Zhou, 2005). In the end of 2005, a Revision Bill (Xiuzhengan) of the Criminal Law was also passed to combat with “the crimes that bring severe damages to the interests of listed companies and their public investors” (An, 2005).

Birth of the new laws have been widely applauded in China (e.g. Liu, 2005A; Zhao, 2005; Fan, 2006; Zhou, 2006; Liu, 2005B; Guo, 2006; Tong, 2006). The revisions (although only on paper) will raise China’s scores in LLSV’s “shareholder protection” index developed by LaPorta and his colleagues in their Law and Finance article (LaPorta et al., 1998). They will probably also increase welfares of minority shareholders of listed companies (Shen 2004; Shen 2005).

In this part, I will give a brief introduction to the protective provisions in especially the Company Law for the minority shareholders, analysis the missing concepts in the statute, then discuss the formal enforcement institutions which are counted on to bring the provisions on paper into reality.

A. New protective provisions under the Company Law

Under the new Company Law, especially the controlling shareholders are required not to abuse their shareholders’ rights (§§ 20.1, 20.2), unfair related-party transactions is strictly prohibited (§ 21). Tasks and powers of the board of statutory auditors (Jianshihui) have been expanded, it is also made more convenient to convene a Board meeting (§§ 118.2, 119). The independent directors are required to be introduced to the board of directors of listed companies (§ 123). Not only duty of loyalty, but also duty of care are now established for the board members and senior officers, when the “bright line rules” are just set for the former (§§ 148, 149). Company's shareholders

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7 Just like Allen, Qian and Qian (AQQ, 2002), we give China score on shareholder rights law following the LLSV law and Finance methodology. For old company law provisions applying to listed companies China was assigned an antidirector rights score of 3 (out of 6)(the “old score”). After the revision, the score is now up to 4 (the “new score”). When the old score put China’s shareholder rights score below the English-origin average (4) but above both the German-origin average (2.33) and French-origin average (2.33), which would make China to rank right at the average of all LLSV countries (developed and developing) for shareholder rights if China had been in the LLSV list of countries, with the new score, China is now doing as good as the average of English-origin jurisdictions, and will be in the fore part of all LLSV country list.
are given the right to bring an action in court against the members of a company's
directors and officers, in which they can seek damages on behalf of the corporation
for violation of these persons' obligations to the corporation (§ 152). Cumulative
voting is advised (although not compulsively required) for the election of members of
board of directors (§§ 106). Some majority outside shareholders may even petition the
people's court to dissolve a company if it has met such difficulty in its business
operations that the continued existence of it will cause serious losses to the interests of
the shareholders and such situation can not be rectified by any other means (§ 183).
Coupled with other protective measures already provided in the old Law, e.g., “one
share, one vote” principle (§ 106.1 of the old Law, § 104.1 of the new Law); A
supermajority vote required for fundamental changes to a company: charter
amendments, increasing or decreasing the charter capital, merger (or accession),
division (or separation), and liquidation (§ 106.2 of the old Law, § 104.2 of the new
Law), the Company Law (even only on paper) will provide some protection for the
minority shareholders.

Apart from the statutes, some mandatory rules of the CSRC and Listing Rules of
the securities exchanges also contribute to the progress of corporate governance of
listed companies in China. E.g., the new Guide to Articles of Association of Listed
Companies (Shangshi Gongsi Zhangcheng Zhiyin, “GAALC”) 8 limits the number of
insider directors to be no more than 50% of all the directors, 9 requires the accountants
firm who will serve as the auditor of the company to be only employed by the
shareholders’ meeting instead of by the board of directors, 10 demands the companies
to provide a means for shareholders to vote by mail or network rather than only in
person, 11 entitles the independent directors to convene an interim shareholders'

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8 Revised and entered into effect since March 16, 2006.
9 GAALC § 96.3, “insider directors” means those directors who also serve as executive officers or the
representatives of employees of the company.
10 GAALC § 159, while the Company Law (§ 170.1) entitles the company’s articles of association to determine if
the board should have the power to hire or/and dismiss the auditor of the company.
11 GAALC § 44.2.
The new Rule of the Shareholders’ Meetings of Listed Companies (Shangshi Gongsi Gudongdahui Guize, “RSMLC”) requires that the company should provide shareholders with all of the information they need to make an informed decision on the issues that they are asked to vote on, orders a mechanism for providing reasonable assurance that the votes will be counted honestly and an independent tabulation team should consists of attorneys, representatives of shareholders and statutory auditors. To convene a shareholders’ meeting, when the board of directors fails to provide the shareholders’ list, the board of auditors or qualified shareholder(s) may apply to the Securities Registration and Settlement Organizations (Zhengquan Dengji Jiesuan Jigou) for the list. The new Listing Rules of the two national securities exchanges also stipulate detailed rules of voting procedure and disclosure requirements covering all related-party transactions.

B. Missing concepts

As some authors put it, since transition economies have a high proportion of companies that are controlled by a single shareholder or a small group of shareholders, those economies are also often characterized by relatively weak non-legal constraints (e.g., efficient capital and product markets) on the powers of managers and controlling shareholders to act to benefit themselves at the expense of minority shareholders, there should be even stronger rules that are designed to protect minority shareholders than in developed market economies (Alexander Ivanovich Kiseliov, et al., 1999). Although great progresses have been achieved in the revisions of especially the

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12 GAALC § 46.1, but if the board decline the Independent directors’ proposal to convene such a shareholders’ meeting, those independent directors may not convene the meeting on the name of themselves, see GAALC § 46.2.
13 Be revised and enter into effect on March 16, 2006.
14 RSMLC § 16.
15 RSMLC § 37.
16 RSMLC § 11.
17 Shanghai Securities Exchange Listing Rule and Shenzhen Securities Exchange Listing Rule (revised and entered into effect on May 19, 2006), Chapter 10 “Related-party Transactions”.
Company Law, the provisions in the new law may still not be good enough to provide thorough protection to the minority shareholders in China.

1. In the statutes

Comparing with the corresponding company law provisions in the neighboring countries (e.g., Japan and Korea, both German-origin countries), the revisions to China’s law seem really moderate to protect the minorities.

E.g., mandatory cumulative voting for members of the board of directors is not the law, even if the listed companies “opt in” cumulative voting, the rules of minimum board size and no staggering of board terms are not provided either. The minimum percentage of shareholding that entitles a shareholder to make proposals to a shareholders’ meeting or to call for an extraordinary shareholders’ meeting is set too high (3% and 10%, separately), and the law fails to provide a procedure for shareholders to obtain a list of other shareholders, so as to solicit support for their proposals, it either provide a means for shareholders to receive all of the information they need to make an informed decision on the issues that they are asked to vote on.19

As to voting on the shareholders’ meeting, there may be advantages to specifying the minimum vote required to approve fundamental changes to the company as a majority or supermajority of all voting shares, rather than a majority or supermajority of the votes of shareholders who participate in the voting, but until now, even quorum is not needed to validate a shareholders’ meeting in China.

The minimum percentage or term of shareholding that entitles a shareholder to bring a derivative law suit against the directors or controlling person is also set too high (the plaintiff must have individually or collectively held more than 1% of the shares of the company for more than 180 consecutive days, § 152.1 of the new Company Law). Redemption and appraisal rights of dissent shareholders (§§ 75, 143.1(4)) are limited to very few situations (only in the occasion of a merger or a

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19 Similar requirements are provided for in the CSRC rules, as mentioned. But the requirements in the rules are set too narrowly, and sometimes the provisions are so important (e.g., the rights to the information) that should be included in the law itself.
In addition to the rights to authorize the number of shares that may be issued, shareholders may need additional protection during the issuance of new shares to prevent such shares from being issued at an unfairly low price to selected buyers, and to prevent the use of such issuance to reduce the influence of particular shareholders or groups thereof, but it is not required by the law that a company issues and acquires its own shares only at a price no lower than their market value. The law doesn’t either convey mandatory preemptive rights (call options) to acquire shares in proportion to the shareholders’ ownership stake, as protection against underpriced stock issues, "targeted" sales of new shares to others and general attempts to dilute the vote of existing shareholders.

Once control of a listed company has been acquired by a shareholder, the old Securities Law provided for a system of "takeout" rights: When an investor acquires 30 percent of the outstanding shares of a listed company, the shareholder must offer to buy all remaining shares at a fair price. This gave the remaining shareholders an opportunity to decide whether they want to remain as shareholders in the controlled company. The system of takeout rights has been adopted by several countries in Europe and is consistent with the rules envisaged in the EU directive. However, the new Securities Law abandons the requirement that the shareholder who achieve control should extend a takeover bid to all the remaining shares (§ 88 of the new Securities Law, compared with § 81 of the old Law), the new Listed Company Takeover Rule even cancels the requirement for the fair offer price, then cripple the protection to the minority shareholders. Rules to restrict freeze-out transactions are

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20 There should have been a number of other instances where appraisal and redemption rights can be made available: (1) for a charter amendment that limits shareholder rights; (2) for a reorganization; and (3) for a major transaction. A judge or an independent appraiser is also needed to determine the value of the redeemed shares.


22 Principle 10 and Rule 9, The City Code on Takeover and Mergers (UK); Article 35, The Securities Acquisitions and Takeovers Act (Germany); Article 5, Directive 2004/25/EC of the European parliament and of the council of 21 April 2004 on takeovers.

23 § 35, Measures for Administration of Takeover of Listed Companies (Shangshigongsi Shougou Guanli Banfa, revised and published on July 31, 2006).
also absent from the statutes.

2. In the Judiciary Explanations

The detailed and complemental rules of the Company Law, absence of which would finally impede people’s courts to hear related cases, still wait to be promulgated by the Supreme People’s Court of PRC (SPC). If or if not the derivative suit mechanism can provide some redresses to the damaged listed companies and their minority shareholders may depend on rules in the forthcoming Judiciary Explanation (“Si Fa Jie Shi”). The critical points comprise, among others: (1) The litigation fee. If the fee was set according to a percentage of requested damages, just like in other private litigations, the amount of fees will have a chilling effect on filing a suit. (2) Expenses recovery. As plaintiffs would not be able or willing to shoulder the burden of the litigation fee, they should have a right of recovery of such expenses from the corporation. (3) Security Deposit. Whether the court would require the plaintiff shareholders in every suits to provide an “appropriate security deposit” in consideration of possible losses the defendant may incur is critical. (4) Liability of individuals. If the defendant directors and officers will be ordered to bear responsibilities with their own money (instead of through insurance or company reimbursement), deterrent purpose of the institution can be better fulfilled. Some other Company Law articles which provide shareholders with private right of action may face similar problems.

24 The first Judiciary Explanation of the new Company Law has been published on April 48, 2006, which only address the coordination of the new and old Company Laws.

25 E.g., § 22.2 (Shareholders’ right to challenge the resolution of a shareholders’ meeting or a board meeting); § 183 (In very limited situations, shareholders may petition the court to dissolve the company)

26 High shareholding thresholds for the exercise of important shareholder rights and the significant economic risks of filing suit have historically been major obstacles to shareholder activism in other East Asia jurisdictions. See, Curtis J. Milhaupt, Nonprofit Organizations as Investor Protection: Economic Theory and Evidence From East Asia, Yale Journal of International Law (2004), 29 Yale J. Int’l L. 169
C. Control of tunneling to protect minority shareholders

Use “tunneling” as an example to contemplate, if the revisions of company law, securities law and even the criminal law will be helpful to reduce looting of listed firms by their controlling shareholders.\(^{27}\) In China, The principal forms of expropriation are: failure by the controlling shareholders to pay for their capital contributions; loans to controlling shareholders, direct or contingent; ruinous (to the listed company) transactions with the controlling shareholder, and even naked takings (Ho, 2003).

1. Private right of action

Quite a lot private liability provisions have been added to the Company Law. E.g., § 20.1(prohibition of abuse of shareholder’s rights), § 20.2(a shareholder’s liability for compensation to the company and other shareholders for abusing rights), § 21.2(a shareholder’s liability for compensation to the company for abusing “affiliation relationship”),\(^{28}\) § 152.3 (shareholders’ right to bring a derivative suit against “a third party” who infringes upon the interests of the company),\(^{29}\) § 22.2 (shareholders’ right to challenge the resolutions of a shareholders’ meeting or a board meeting). The new Securities Law provides further remedies to the public shareholders in a listed company. E.g., § 69(a controlling person who knowingly directs a false statement to be made should bear joint and several liability with the issuer itself). Protections to the minority shareholders on book seem to be not bad, but legal enforcement remains a problem. Firstly, the court system is not necessarily active to hear the related cases. Listed companies and their officers still have some kind of political backing, while

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\(^{27}\) We use the term “tunneling” in the meaning of Simon Johnson et al. (2000) to refer to the transfer of assets or profits out of a company to its controlling shareholders.

\(^{28}\) “affiliation relationship” under China’s Company Law refers to the relationship between the controlling shareholder, de facto controlling person, director, supervisor, or senior officer of a company and the enterprise under their direct or indirect control and any other relationship that may lead to the transfer of any interest of the enterprise. However, the enterprises in which the state holds a controlling interest do not have an affiliation relationship between them simply because the state holds a controlling interest in them. See § 217(4) of the Company Law.

\(^{29}\) Although not stated clearly, “a third party” can be understood to refer especially to the controlling shareholder and/or de facto controlling person of the disputed company.
Chinese courts are not experienced nor politically powerful and are hence reluctant to take cases involving complicated reasoning and powerful defendants. It turns out that the local courts have been reluctant and very inefficient to hear securities-related claims although the Supreme People's Court did allow them to take a limited class of those claims.\(^{30}\) Secondly, class actions are not permitted in China. Although transplant of the institution has been supported by a lot of voices,\(^{31}\) class action still seems to be not feasible in the foreseeable future. Thirdly, since the absence of key institutions such as the contingent fee and award of attorneys' fees, the function of the "private attorney general" to recognize the role of private litigation in the enforcement of laws is difficult to appear (Coffee, 1983).\(^{32}\)

2. The administrative liabilities under the Company Law and the Securities Law

The CSRC swore to solve the tunneling problem (especially misappropriation of listed company’s assets) in China’s market within 2006, that means to make the majority shareholder (or controlling shareholder) to be accountable for the assets or profits transferred illegally from the listed companies. Nevertheless, the agency is hampered in several ways to approach this achievement. First, the Company Law does

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\(^{30}\) According to a famous securities lawyer, Mr. Song Yixin, Since the first action filed in 1996, there have been about 10,000 investors to have initiated securities related suits, among them only about 1000 achieved some kind of compensation from settlements or judgments of cases. Actually the number of plaintiffs is probably less than 10% of all those who have been damaged and have the standing to sue, and all the damages claimed may be less than 5% of the whole losses arouse from the illegalities. “Justice Claiming Team for the compensation from Kelong and Deloitte’s False Statement: Establishment of Investor Protection Association Becomes Imperative” (Kelong An Lushi Weiquantuan: Jinkuai Sheli Touzizhe Baohu Xiehui), on China Securities (Zhongguo Zhengquanbao) (July 24, 2006). In our statistics, since SPC permitted the shareholders to sue the listed companies and their executives for the misrepresentations in the prospectus and other statements (SPC, 2003), when about 120 companies (and related executives, controllers, and accountants) may have met the strictly formulated criteria to fall into the small group of possible defendants, among them only 17 companies have really been sued to the courts, and even fewer have been held to be responsible for or have agreed through settlements to pay the losses of the plaintiff investors. Source: News reports on the professional newspapers, such as China Securities, Shanghai Securities (Shanghai Zhengquan Bao), Securities Times(Zhengquan Shibao).

\(^{31}\) Supporters of securities related class action include Chairman of CSRC, CEO of Shenzhen Securities Exchange and many commentators. See Part IV.

\(^{32}\) E.g., under the Lawyer Service Fee Regulatory Rule promulgate by the State Development and Reform Commission and the Justice Ministry (Lushi Fuwu Shoufei Guanli Banfa, April, 2006), contingent fee is not permitted in multi-party litigations.
not provide CSRC with any specific power to curb the tunneling illegalities, while the new Securities Law only order all listed companies to disclose their de facto controlling persons.\textsuperscript{33} Further, as the supervisor of the controlling shareholders of listed companies,\textsuperscript{34} CSRC’s principle weapon to combat the lootings is to declare concealment of the looting facts as a “material omission” in statutory reports and then give moderate sanctions to those issuers and their executives.\textsuperscript{35} CSRC may deprive the right of the responsible persons to engage in any security-related business or be elected to the board of listed companies (\textit{Shi Chang Jin Ru}) which CSRC has not used quite a lot in the past.\textsuperscript{36} Second, as a quasi-government agency with tasks of both the enforcement of rules regarding disclosure and merits regulation of the investment quality of the public issuers, CSRC is limited by its personnel scale to enforce the law (Clarke 2003). Moreover, the agency still lacks sufficient administrative authority to discipline those high-level state-owned shareholders behind some listed companies. Now it seems that the ambitious anti-misappropriation plan is not likely to be achieved only by the authority itself.

3. Disciplinary actions of the self-regulatory bodies.

China’s two national stock exchanges are joining the war against tunneling, but it is even more doubtful if they have been given effective and appropriate authorities to achieve any breakthrough. The exchanges may administer private reprimand or public

\textsuperscript{33} §§ 54, 66, 67.2(8), the Securities Law of 2006. Under the Company Law, the term “de facto controlling person” means any person who is not a shareholder of a company but has de facto control of the acts of the company by means of investment relationship, agreements or any other arrangements.

\textsuperscript{34} § 71.1, the Securities Law. Under the new Company Law, the term “controlling shareholder” means a shareholder whose capital contribution accounts for more than 50% of the total capital of a limited liability company, or a shareholder whose shareholdings accounts for more than 50% of the total equity of a company limited by shares, or a shareholder whose capital contribution or shareholdings account for less than 50% but who holds the voting rights on the strength of its capital contribution or shareholdings that are enough to have an important influence on resolutions of the shareholders’ meeting or the shareholders’ general meeting. See, § 217(2), the Company Law of 2006.

\textsuperscript{35} § 193, the Securities Law.

\textsuperscript{36} Since 1997 when the CSRC provided itself with the power of \textit{Shi Chang Jin Ru}, it has employed the power in about 30 securities law cases. Resource: CSRC bulletins, on http://www.csrc.gov.cn/cn.jsp/index.jsp?path=ROOT>CN>%D6%A4%BC%E0%BB%E1%B9%AB%B8%E6, last review: Sept. 1, 2006.
censure, which are not likely to be effective against those scrupulous offenders of the law. For more pressing measures they may depend on the action of discontinuance or suspension of listing of a company. However, even if the exchanges are willing to act, it is more painful to the innocent shareholders than to the guilty controllers who have caused the tunneling of the companies. The exchanges may declare the offender of the laws, regulations or Listing Rules to be unsuitable for the membership of the board of directors or board of supervisors, they may also advice the company to dismiss its secretary of the board of directors, 37 but they seldom deploy those sanctions in the past two years.

4. The criminal liabilities.

A revision to the China’s Criminal Law has been passed in 2006, which makes the directors or managers and even controlling shareholder(s) or de facto controlling person(s) of a listed company to be subject to criminal liabilities if they knowingly make the company to engage in harmful actions and then suffer substantial losses. 38 While the revision still needs to be explained by the SPC, one of the critical questions remains that, if the profits siphoned off or assets transferred out of the listed company were used to propped up the troubled firms in the same state-controlled group of the listed company (e.g. to pay salaries for workers in those firms), the “criminal culpability” which is required by the criminal law for an action to constitute a crime may be very difficult to prove. Nevertheless, the listed companies controlled by private capital are increasing year by year in China, 39 lootings by controlling

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38 The harmful actions include: (1) provide funds, commodities, service or other assets to other units or persons while receiving no considerations; (2) provide or accept funds, commodities, services or other assets under manifestly unfair conditions; (3) provide funds, commodities, services or other assets to manifestly insolvent units or persons; (4) provide collateral for the debts of manifestly insolvent units or persons, or provide collateral for the debts of units or persons without justified reasons; (5) disclaim a property right or bear a debt for others without justified reasons; (6) damage the listed company in other ways. See, § 169-1, the Criminal Law of PRC (revised on June 29, 2006).
39 As the end of 2004, the listed companies with its first large shareholder to be collectively-owned enterprise, privately-owned enterprise, foreign enterprise or Limited Liability Company amount to 390, about 28.32% of all listed companies. The other 987 companies (71.68% of all listed companies) were still controlled by the State-owned Assets Regulation Commission or by SOEs. As the end of 2003, the corresponding figures are 347
shareholders also happened in these companies, criminal liabilities well defined should have some power to deter those illegalities.40 Furthermore, China’s listed companies’ corporate governance is not just characterized as control of a dominant state-owned shareholder (yigu duda), but also as under "insider control" (neibu ren kongzhi) and "absent owner" (suoyouzhe quewei). While effective control rights are assigned to management, which generally has a very small, or even nonexistent ownership stake (Wei, 2000), assets of state-controlled listed companies may be converted through various subterfuges into the personal property of management (Clarke, 2005). Thus the games played by the government, management, and outside investors become more complex than those addressed in the traditional corporate finance models (Su, 2000; Li and Zhang, 2005; Zhao, Lowe and Pi, 2005). Criminal penalty would have its roles in curbing those illegal self-interest actions of management as well.

III. Alternative Solutions To Domestic Enforcement Regimes

A. A self-enforcing model of corporate law

Professors Black and Kraakman (1998) argues that in emerging economies, the

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40 There are reports that only in March 2006, at least three controlling persons of several listed companies are facing criminal charges for looting those companies. They are Qiu Baozhong, chairman of the board of directors of ST Long Chang (600772, SH), de facto controlling person of both Fujian Sannong (000732, SZ) and Zhejiang Haina (000925, SZ); Zhang Liangbin, chairman of the board of directors of Zhaohua Jituan (000688, SZ); Zhong Xiaojian, chairman of the board of directors of Shuma Wangluo (000578, SZ). In August, the chairman of board of ST Sanlong (000732.SZ) was also arrested. As reported, since the “tunneling” problems were revealed in the listed companies controlled by the private-owned enterprises, about 15 companies’ chairman or CEOs have been under investigation, detained or arrested. Presently There Are Still 29.4 Billion Yuan Been Misappropriated From 123 Listed Companies (Muqian Liangshi Haiyou 123 Jia Shangshigongsi Bei Zhyong Zijin 294.05 Yiyuan), on Shanghai Securities, Sept. 1, 2006.
best legal strategy for protecting outside investors in large companies while simultaneously preserving managers' discretion to invest was a self-enforcing model of corporate law. The self-enforcing model structures corporate decisionmaking processes to allow large outside shareholders to protect themselves from insider opportunism with minimal resort to legal authority, including the courts. The model may really be a feasible choice for emerging markets to protect the minority shareholders, actually we find China’s legislators have been designing the Company Law based (at least partly) on that model. E.g.: Although a mandatory cumulative voting rule for election of directors is not yet provided, a rule requiring both shareholder- and board-level approval for self-interested transactions is now in the law. As provided by the Law, if a company invests in another enterprise or provides security for another party, a resolution shall be passed by the board of directors or by the shareholders’ meeting or shareholders’ general meeting according to the articles of association of the company. If the articles of association stipulate a limit on the total amount of investment (security) or the amount of a single investment (security), the stipulated limits should not be exceeded. If a company provides security for a shareholder or the de facto controlling person of the company, a resolution of the shareholders’ general meeting must be passed. The interested shareholders are not permitted to participate in the voting, such resolution shall be adopted by more than half of the voting rights held by the other shareholders present at the meeting.\(^4\) While in the old Company Law, providing security for a shareholder was strictly forbidden.\(^5\)

As the regulator of China’s securities market, CSRC has also been exploring its way to construct a self-enforcing corporate governance model for listed companies. In 1997, 2000 and 2001, the agency promulgated a series of important rules to strengthen the rule of shareholders’ meeting and introduce the independent director system.\(^6\)

\(^4\) § 16, Company Law (2006) of PRC.

\(^5\) §§ 60.3 and 123.2, Company Law (1994) of PRC.

\(^6\) See especially the Guidelines for the Articles of Association of Listed Companies (Shangshi Gongsi Zhangcheng Zhiyin), issued on Dec. 16, 1997, revised on Mar. 16, 2006; Regulatory Opinions for General
Some of them have been revised after the revision of both the Company Law and Securities Law. Pursuant to another rule of CSRC, implementation of or application for the following matters can only be made upon approval by all shareholders in the general meeting of a listed company, by more than half of the voting rights represented by the circulating shares’ public holders voting on the resolution: (1) the company issuing new shares to social public, issuing convertible bonds and placing of shares to existing shareholders (other than shareholders with de facto control undertaking to subscribe for such shares in full in cash before the meeting); (2) material asset restructuring of the company, the total consideration payable for acquiring the assets has a premium which is equal to or exceeds 20% of the audited net book value of such assets; (3) the repayment of debt owed to the company by a shareholder using the shares of the company that he holds; (4) the overseas listing of a subsidiary of material importance to the company; (5) relevant matters in the development of the company which have material impact on the interests of social public shareholders. When voting on the above matters, the company are required to provide its shareholders with a network voting platform, the shareholders may vote through the network. The latter Rules actually considers the “public shares” held by minority shareholders as a different class of shares other than the shares held by the controlling shareholders or de facto controllers (often SOEs or even the government itself) of the company, and all the aforementioned issues to be possibly harmful to the minority shareholders.

The CSRC does not limit its corporate governance rules in the internal decisionmaking processes of the listed companies, it also tries to seek help from the financial intermediaries who are deemed to be the “watchdogs” of the market. To cure false representations in the annual report and financial statements of listed companies,
the CSRC requires issuers applying to make a public share offering or to issue convertible corporate bonds by way of underwriting shall appoint a qualified organization to be a “sponsor” (Baojianren). The sponsor shall comply with the principles of honesty and trustworthiness and due diligence to conduct due diligence review on the application documents and information disclosure of the issuer, supervise the conduct of the issuer even after its shares have been listed for one or two years (in accordance different conditions).\(^{46}\) The sponsor shall bear joint and several liabilities, with the issuer or the listed company, to the losses suffered by the investors if false representations and/or material omissions have been found in those documents, unless they can prove that they are not at fault.\(^ {47}\) If there have been found such representations and/or omissions in the sponsoring documents themselves, the sponsor and its responsible staffs will be subject to fines and other administrative penalties.\(^ {48}\)

In the newest Takeover Rule, the CSRC establishes the key rule of the financial consultants (Caiwu Guwen) in maintaining orders in takeover activities. Except for a few particular circumstances (such as the administrative allocation of state-owned stocks, the lack of change in de facto controller after the transfer of stocks, and the obtaining of stocks by inheritance), the Measures obligates the acquirer of a target company to retain a financial consultant who will issue an expert opinion about if the acquirer have fulfilled its obligations under the rule. The board of director of a target company facing a tender offer or the independent directors of a company facing a management buy-out offer shall also invite financial consultants to help them to confirm whether the offer is fair.\(^ {49}\) Moreover, the rule contains a special chapter defining the financial consultant's duties and responsibilities in the takeover of listed companies.\(^ {50}\) Some of these duties include due diligence and follow-up tracking in

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\(^ {47}\) § 69, Securities Law of PRC.


\(^ {49}\) §§ 9, 17, 28, 32, 51, Measures for Administration of Takeover of Listed Companies.

\(^ {50}\) §§ 65-71, Measures for Administration of Takeover of Listed Companies.
takeover transaction, as well as continuous supervision after the takeover transaction. It should be noted that just like the aforementioned sponsors, the financial consultants will be qualified, supervised and disciplined mostly by the CSRC, as “watchdogs” in takeover transactions, they are devised to be responsible for the market regulator, not for the courts.

It still needs to be seen if the self-enforcing model of corporate law or corporate governance would play a major rule in overcoming China’s enforcement problem. But as Black and Kraakman pointed out, even such a model cannot slide over all the needs for law provisions of liabilities and their formal enforcement. The key point is, since company laws and securities regulations are inherent “incomplete”, the ambiguous provisions or even gaps in even the self-enforcing laws will have to be explained or filled in by a regulator or court, otherwise corporate governance failures may occur. Further, plagued by collective action problem, the general meeting of shareholders may be too weak to provide real protection to its members. Finally, the supporters of a self-enforcing model may overrate the effectiveness of such laws in a emerging market with very weak judicial enforcement, market constraint, and faint reputation institution.

B. The role of cross-listings

Professor Coffee predicts when the large firms around the world opt into higher regulatory or disclosure standards and thus to implement a form of 'bonding' under which firms commit to governance standards more exacting than that of their home countries, the U.S. securities laws should, and will accommodate functional convergence--both through migration and harmonization--so as to raise, rather than

51 Bernard Black, Reinier Kraakman, A Self-enforcing Model of Corporate Law, Harvard Law Review (June, 1996), 109 Harv. L. Rev. 1911, 1918 (“We can only reduce, not wholly avoid, the need for official enforcement.”) See also Bernard S. Black, The Legal and Institutional Preconditions for Strong Securities Markets, UCLA Law Review (April, 2001), 48 UCLA L. Rev. 781 (Effective regulators, prosecutors, and courts are the most important institutions that control information asymmetry, which is critical for developing strong public stock markets).
lower, governance and disclosure standards. As Coffee, good enforcement can be attained through firms in weak enforcement regimes bonding themselves to "good" corporate law- a regime imposes high disclosure requirements and subjects listed firms to a stringent foreign regulatory and private enforcement regime.

From the establishment of the Securities Law in 1999, China has imitated US on both the disclosure principle and quite a lot of substantive provisions (an evidence of convergence). Nowadays, China’s securities law seems to be able to regulate controlling shareholders to some extend on the following junctures: (1) Articles 86 and 87 of the Securities Law of 2006 require any investor who has attained a 5% shareholding in a listed company through securities trading on a stock exchange solely or as a joint shareholder through an agreement or other arrangements, to file a written report within three days, the report should include (among others) the name and address of the investor. The takeover rule of CSRC requires much fuller disclosure, including the identity of the investor and the persons who agree to act in concert with respect to attaining more than five percent of shares, the purpose of acquisition, transactions of the listed companies’ shares within 6 months before the acquisition.\(^{52}\) Then the provisions, just like section 13(d) of the Exchange Act of US, deny the controlling shareholders the veil of anonymity by requiring a transparent ownership structure. (2) The insider trading rules restrict (with criminal penalties) the controlling shareholders ability to purchase or sell based on material, nonpublic information.\(^{53}\) (3) The takeover rule assures, through both disclosure and substantive rules (particularly regarding timing, withdrawal, and proration rights) all shareholders of a listed company an equal opportunity to participate in any tender offer for their shares.\(^{54}\) (4) The continuous disclosure system generally requires timely disclosure of material developments by the issuer or controlling shareholders. (5) Providing the remaining shareholders a right of selling their shares to the acquirer of a listed companies when the company is delisted in a going private transaction, the takeover

\(^{52}\) § 16, Measures for Administration of Takeover of Listed Companies.

\(^{53}\) §§ 73-76, 202 of the Securities Law, § 180 of the Criminal Law.

\(^{54}\) Especially §§ 37, 42, 43.1, Measures for Administration of Takeover of Listed Companies.
rule also plans to deny controlling shareholders the practical ability to squeeze out the minority at an unfairly low price. Nevertheless, plagued by the enforcement problem, those provisions may be kept just on paper, instead of being turned into fact. Therefore, some of the best local firms seeking any of a variety of goals--to show a credible and binding commitment by the issuer and its controller not to exploit the minority investor, to raise more equity capital, to increase share value, to achieve worldwide recognition or to make acquisitions for stock--may decide to list on a developed stock exchange and thereby opt into foreign governance standards. This kind of immigration to foreign market may help to ease the enforcement problem in China.

Up till now, some locally well-known companies have been listed in US, UK Hong Kong, or Singapore markets, some have faced with class action lawsuits filed in the United States against the companies (e.g., Chinalife, Chinadotcom, NetEase) and certain of their officers and directors, the chairman of a company listed in Hong Kong (Skyworth Digital Holdings Ltd. (0751.HK)) was even sentenced to jail for misappropriating funds and conspiring to defraud in connection with the granting of share options. But it remains a question if the corporate governance in Mainland China can achieve a global convergence mainly through encouraging the local companies to go to list in US or other developed markets. The reasons are as follows: (1) Until now not so many companies have been permitted to list their shares on overseas markets. To the end of April, 2006, there have been only 129 cross-listed companies in China, among them 109 issued and listed H shares in Hong Kong, only around 20 have listed shares in US, UK and other markets. The influence of those companies’ governance to their local counterparts may be limited. (2) As there have

55 § 44, Measures for Administration of Takeover of Listed Companies.
been very limited channels for domestic citizens to invest their money into foreign markets, and the national exchanges in China have not been fully opened to foreign capitals, a real competition among local and abroad stock exchanges have not yet begun, thus the exchange harmonization would be deferred. (3) Cross-boarder supervision of cross-listed companies need an efficient cooperation of regulators and even courts from different jurisdiction, being out of which will bring about a failure of enforcement.  

Cross listing may help to improve corporate governance in some local companies, but even those firms have "escaped" their weak home country institutions through foreign listings, as Bernard Black points out, without the help of local enforcement and other institutions, such escape is only partial.

C. The Role of the nonprofit organizations

Professor Milhaupt maintained that nonprofit organizations have emerged as perhaps the most important corporate law enforcement agents in Korea, Taiwan, and Japan, their action may be another partial solution to the problem of weak investor protection and corporate law enforcement (Milhaupt, 2004).

As widely known, China doesn’t have a tradition of active NPOs, but a similar “organization” of securities lawyers has emerged in the nearest months.

After the CSRC published its administrative penalties on Kelon (a locally listed

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57 E.g., presently there are more and more finance scandals revealed in the Mainland China’s companies listed in Hong Kong, but the local regulators and courts of HK have been impotent in the inquiries and legal enforcement against their illegalities since the companies’ assets, business and even the illegal facts are all in Mainland instead of HK, the key personnel may choose to stay in Mainland or have been detained there and then will not be reached by HK’s law enforcers. See The Haiyu Event Tortures the Cross-boarder Supervision (Haiyu Shijian Kaowen Kuajing Jianguan Nanti), on Shanghai Securities, August 2, 2006.

58 “A company's reputation is strongly affected by the reputations of other firms in the same country. And reputation unsupported by local enforcement and other institutions isn't nearly as valuable as the same reputation buttressed by those institutions.” See Bernard S. Black, The Legal and Institutional Preconditions for Strong Securities Markets, 48 UCLA L. Rev. 781, 822 (2001).

company which submitted false accounting reports) and Deloitte (an international accounting firm which gave an unreserved opinion on the financial report of Kelong), 60 lawyers from 45 law firms around the country have comprised a “Justice Claiming Team for the compensation from Kelon and Deloitte’s false statement” (*Kelong, Deqing Xujiaochenshu Minshi Peichangan Quanguo Lushi Weiquantuan*). The “Justice Claiming Team” consists of lawyers who have been participating in China's securities-related civil compensation lawsuits and then boasting rich practical experience, it released its Movement Statement through high-profile media, claimed that the lawyers’ group was a loose and open-end organization, accepting any qualified Kelon shareholders’ trust of lawsuit, and the most important, if there were any similar misrepresentation cases occurring in the future, all the members of the team would change into the members of the new “justice claiming team” automatically. 60 As Mr. Song Yixin, one of the convenors of the “Justice Claiming Team”, the Team is the biggest lawyers group aiming at one single case in the history of the country, it has three tasks from now on: (1) (Organize the member lawyers to) discuss the difficult law problems in the Kelon and Deloitte case, coordinates the lawyers and law firms involving in the case, explores the way of improvement of the securities-related civil suits and the private compensation law system; (2) Makes connection with the CSRC, the SPC and related lower courts, accepts their guidance, provides professional comments and advices; (3) provides practical legal education to the investors, persuades them “to believe the strength of the law, believe the strength of themselves.” 61

The “Justice Claiming Team” is not likely to be registered with the local government as a NPO, it is now rather a forum for the securities lawyers to exchange experience and information they own from the cases have been representing. But that

60 “Justice Claiming Team for the Compensation From Kelon and Deloitte’s False Statement: The establishment of Investor Protection Association is urgent” (*Keling An Lushi Weiquantuan: Jinkuai Sheli Touzizhe Baohu Xiehui*), on China Securities (July 24, 2006).
61 The Members of the Justice Claiming Team Has Amounted to 60, The Lawyers Come From 45 Law Firms Around the Country (*Weiquantuan Chengyuan Yida 60 Ming, Fenshu 45 Jia Lushishiwusuo*), on Shanghai Securities (July 24, 2006).
difference seems to be not so important. Unlike in Japan or Korea, there appears to be less public antipathy in China toward allowing lawyers to play a larger role (even basically for profit) in the resolution of economic problems, at least before the emergence of real corporate and securities law-related NPOs in the country. In such an environment, the high-profile group of activist lawyers would still be partial (even transitory) response to the public goods problem of corporate law enforcement. In the future, the role of the NPOs may also be played by a government sponsored “Securities Investor Protection Fund” and a “Securities Investor Protection Fund Limited Liability Company” (SIPFLLC) being in charge of the financing, management and using of the funds.  

IV. Class Actions in the Future

China’s Civil Procedural Law and Securities Law don’t provide for a class action institution, the Judiciary Explanations aiming at civil liabilities of misrepresentation on the securities market made it clear that, the securities-related litigations can adopt “representative suits with the number of litigants been fixed” (Renshu Queding De Daibiaoaren Susong, § 54, the Civil Procedural Law), but not “class actions”. For

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62 As to § 134 of the Securities Law, a securities investors protection fund (“SIPF”) has been established by the State government. The Fund comprises funds contributed by the securities companies and other funds raised. According to § 7 of the Measures for the Management of Securities Investor Protection Funds (Zhengquan Touzizhe Baohu Jijin Guanli Banfa)(issued by the CSRC, Ministry of Finance and Peoples’ Bank of China on June 30, 2006), the funds of the SIPF are only used to compensate the creditors of a securities company when it goes into bankruptcy, be closed or took over by the government. The SIPFLLC was registered on Aug. 30, 2006.


64 “Class action is not applicable to securities related actions”, see § 4, Circular of the Supreme People's Court Concerning Issues Relating to Acceptance of Civil Tort Suits Filed Due to False Representation on the Securities Market (Zuigao Renmin Fayuan Guanyu Shouli Zhengquan Shichang Yin Xujia Chenshu Yinfa De Minshi Qinquan Jiefen Anjian Youguan Wenti De Tongzhi), (issued on Jan. 15, 2002, hereinafter “2002 SPC False Representation Circular”).
multi-party litigations (*Quntixing Susong*), government agencies and Lawyers’ Association have just announced strict control on the plaintiff lawyers.\(^6^5\)

On the other hand, since frauds have been common on the securities market, and the supply of investor protection is not sufficient, from the regulator, stock exchanges, business lawyers to the public media, more and more voice have been heard to support the transplant of securities-related class action system.\(^6^6\)

Whether a securities-related class action system should be transplanted to China may be examined by balancing the pros and cons of having such a system. The answer to the question also depends on the drafted provisions of the system, the securities regulation framework and legal infrastructure.

**A. Overview of Conflicting Arguments**

Since the adoption of the Civil Procedural Law in early 1990s, many scholars have noticed the differences between “representative suits with the number of litigants not been fixed” (*Renshu Buqueding De Daibianren Susong*) under China’s Civil Procedure Law and US style class actions (Jiang and Xiao, 1994; Zhang and Dong, 1996; Zhang, 2000; Liang, 2000). Many of them argued the “representative suits with the number of litigants not been fixed” had a better support in the civil procedural law theories and might be able to meet the demands of local reality even better. In the following years, however, more literatures are on the side of endorsing a class action

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\(^{6^5}\) Under the Lawyer Service Fee Regulatory Measures (*Lushi Fuwu Shoufei Guanli Banfa*, issued in April, 2006) promulgate by the State Development and Reform Commission and the Justice Ministry, contingent fee is not permitted in multi-party litigations. Under the Guideline to *Multi-party Litigations* (*Zhonghua Quanguo Lushi Xiehui Guanyu Lushi Banli Quntixing Anjian Zhidao Yijian*, issued in Mar., 2006) promulgate by the National Lawyer Association, those litigations are subject to “supervision” of the Association.

system (e.g., “the Civil Procedural Law Revision” research program, 2005).

**B. Benefits of a Class Action system**

The primary benefit of allowing securities-related class action lawsuits is that the result of the lawsuit will bind those who have not actually participated in the lawsuit, thereby providing an efficient means of giving relief to a larger class. Secondly, a class action helps to overcome the collective action problem in the plaintiff class. Without the system, the amount of damage to a single plaintiff may be minimal and the cost of litigation prohibitive, thus precluding any incentive for plaintiff to litigate individually. Finally, a class action system will deter wrongdoing when the administrative penalties can not achieve the same result.

**C. Problems of a Class Action system**

There are, on the other hand, many arguments that point out problems may be met in enacting a class action system. First, class action actually permits some of the plaintiffs to appoint themselves as the representative of the whole plaintiff class, which is in conflict with the prevailing law theories. Second, China does not have the political, social and judiciary infrastructure to accommodate a class action system, and the courts may decline to hear class actions even if it was introduced to the law. Third, class action litigation is not the only means of providing relief for a group of individuals, government agencies, local governments, local or industrial self-regulatory organizations will be in better position to solve social problems. Fourth, it is almost impossible for the class members to supervise the actions of their representatives. Fifth, instead of realizing social justice, class actions may be abused by corporate attorneys who only focus on their profitability. Sixth, the influx of numerous class actions could create a huge burden on the defendants and courts. Finally, it cannot be overlooked that US has experienced quite a lot troubles and dilemmas with class actions, while up until now there is no other legal system which has widely utilized the institution.
D. The need for a class action system

Considering the following elements, input class action firstly to the local securities regime is both necessary and possible: (1) Securities market is nascent in China, culture, legal and market constraints are too weak to provide practical protection to the inexperienced individual shareholders who constitute the main force of the investors, a robust enforcement like the class action institution is needed to address gaps in the supply of investor protection and corporate law enforcement, which cannot be filled by regulatory agencies, self-regulatory organizations, prosecutors or civil courts through suits initiated by separate individuals (instead of plaintiff class). (2) Some brazen scandals should be stricken to achieve deterrence, this is widely agreed among the government officials and commentators. (3) securities-related class action is highly professional, then politically possible for being insulated with any sensitive public policy issues. (4) After more than 10 years’ construction, a set of comparatively detailed securities statutes and rules has been established, finding and confirmation of illegalities is then much easier than before. (5) The adoption and revision of the Securities Law and related Judiciary Explanations have provided ready rights of actions to sue the misfeasors. (6) Through handling related cases, some intermediate and superior people’s courts have got primary experiences to hear especially the misrepresentation litigations. (7) More and more materials (both in theory and practical) of US class action system have been introduced to China, to make it easier to draw some lessons from them. (8) A team of institutional investors have been born to provide candidates of lead plaintiffs. (9) The rapidly expanding business lawyers and law firms have been able to provide qualified legal services for the litigating parties. (10) After the revision of the Securities Law, the CSRC is even better equipped to find out and punish the illegalities and then give out signals to the plaintiff's bar that attractive cases are available, the agency will also be very helpful in providing expert opinions as Amicus curiae.
According to the experiences in US and Korea’s markets,\textsuperscript{67} to devise an efficient class action regime for China lies in balancing three separate problems: (1) the problem of blocking frivolous suits while allowing meritorious suits, (2) the agency problem between plaintiffs’ attorneys and the plaintiff class, and (3) the lack of incentive of plaintiffs’ attorneys to focus on smaller companies.\textsuperscript{68} While the implementation is concerned, the reform should firstly focus on the misrepresentation cases with which some courts have been familiar, the SPC ought to permit experimental practices of “representative suits with the number of litigants not been fixed” (\textit{Renshu Buqueding De Daibianren Susong}, § 55, the Civil Procedural Law), and then establish a class action system.

\textbf{E. legal infrastructure for a class action system}

1. The plaintiff lawyers

In big cities in China, an active, professional corporate and securities attorney bar is forming, although most of the business lawyers are mainly focusing in non-litigious legal affairs, being familiar with corporate and securities laws still grants them particular advantages to be able to change into trial lawyers and then develop expertise in pursuing a securities class action. Today China has only a few large law firms with over a hundred attorneys, which would make it a problem to diversify the risks that any one class action may not result in a positive return for the firms. Notwithstanding, diversification may still occur across firms, as several plaintiffs’ firms may jointly share in the co-representation of different classes across several different lawsuits.

\textsuperscript{67} Several theoretical issues (especially frivolous litigation and the relationship between the professional plaintiffs’ attorneys and the plaintiff class of investors) exist in contemplating the value of private securities class actions in the United States. In the mid-1990s, the U.S. enacted the Private Securities Litigation Reform Act of 1995 that sought to address these issues. Model after the U.S. securities regime, Korea has adopted a securities-related class action law that took effect in January 2005. See, Dae Hwan Chung, Introduction to South Korea’s New Securities-related Class Action, Journal of Corporation Law (Fall 2004), 30 J. Corp. L. 165.

\textsuperscript{68} See Stephen J. Choi, The Evidence of Securities Class Actions, Vanderbilt Law Review (October, 2004), 57 Vand. L. Rev. 1465, 1510
2. Institutional investors

The presence of institutional investors being able to take an active role with respect to class actions is one of the key elements to the success of the system. A group of institutional investors (including securities investment funds, insurance companies, the Social Insurance Funds, securities companies, Qualified Foreign Institutional Investors (QFIs), Foreign Strategic Investors, among others) have appeared in China. But some of the institutional investors—especially the Securities Investment Funds (all contractual funds)—are widely criticized as being inclined to make speculative and risky investment instead of keeping stable shareholdings, being unconcerned with listed companies’ governance and sharing very little common interests with the individual investors, even involving in manipulations and other scandals. Another main type of institutional investor, the local Social Insurance Funds have been reported to have severe governance problems for themselves. It is then doubtful if those institutional investors can really be counted to act as responsible lead plaintiffs in the future.

3. judges and courts

Specialized judges and courts will have better ability to handle class actions, they may develop expertise in distinguishing between frivolous and meritorious claims, therefore be able to sanction frivolous suits. Such judges may also apply certain doctrines (such as reliance and causation, or damages measures) more consistently—a task which requires expertise, then contribute to predictability of judicial outcomes.

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leading to a greater probability of settlement. To some extend, China employs a number of specialized sub-courts (*Shenpanting*) in the Peoples’ courts. For example, the intellectual property sub-courts with specialized judges in major cities have successfully earned themselves a reputation of being efficient and professional. Employing a similarly specialized court with expert judges may provide significant benefits to a shareholder class action system.

V. Conclusive remarks

China’s corporate governance has undergone more than ten years’ development, when increased awareness of investor protection have changed into significant policy issues, the most important statutes related to corporate governance (the Company Law, Securities Law and Criminal Law, etc.) have been revised to meet the increasing demand for the protection. Researches have shown improvement of law provisions would contribute to the performance of companies and welfares of shareholders. However, plagued by the enforcement problem, some good law provisions on the paper would still fall short to fulfill the demand for better governance. The alternative solutions to domestic enforcement regimes, including a "self-enforcing" corporate law model, cross-listings on foreign stock exchanges and the possibility of nonprofit organizations to act as corporate law enforcement agents, will help to ease the chronic illnesses of the securities market, but institutions at the heart of a good national investor protection system and corporate governance, especially the formal enforcement mechanisms, will still need to be constructed.
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