Abstract

From the start of the PRC’s “corporatization” project in the late 1980s, a Chinese corporate governance regime subject to increasingly “enabling” legal norms has been determined by “mandatory” regulations imposed by the PRC securities regulator, the CSRC. Indeed, the Chinese corporate law system has been cannibalized by all-encompassing securities regulation directed at corporate governance, at least for companies with listed stock. This article traces the path of that sustained intervention, and makes a case – wholly contrary to the “quack corporate governance” critique much aired in the U.S. – that for the PRC this phenomenon is necessary and appropriate, and benign. That analysis in turn reveals a great deal about: the development of Chinese law and legal institutions after 1979; China’s contemporary political economy; the true identity of the firm under the PRC “corporatization without privatization” program; the normative character and function of corporate law across the globe; and the ways in which state intervention may protect against state abuse of power and enable greater private autonomy.
After a decade of experimentation and experience, effectively-implemented supervision systems and methods [for Chinese listed companies] are in place. However, these supervisory systems and methods stop in large part at the level of administrative regulation and policy, resulting in too large a gap for effective enforcement [between such administrative regulation and] national laws like the Company Law, the Securities Law, etc., and a lack of required coherence [in the legal-regulatory system].

State Council of the PRC, Legal Affairs Office, September 7, 2007

Introduction

From the start of its “corporatization” project in the late 1980s and early 1990s, corporate law and corporate governance in the People’s Republic of China (‘PRC’ or “China”) have been determined by China’s securities regulator acting far beyond the bounds of parallel structures with which the terms “corporate” and “law” are associated. Indeed, the broad extent of China’s securities regulation incursion into the notionally separate domain of PRC corporate law should cause purveyors of a “quack corporate governance” complaint in the United States of America (“U.S.”) the deepest alarm.

The received “quack corporate governance” wisdom directed at recent U.S. legal and regulatory reforms has been well publicized. In this article, after briefly taking note of that critique, I analyze the completely opposite trajectory witnessed in China over the last two decades: the veritable cannibalization of corporate law norms by securities agency regulation which determines absolutely the governance of China-domiciled companies with listed stock. This analysis serves several functions: At one level, it allows for a better understanding, generally, regarding the development of Chinese law and legal institutions in the post-1979 reform era, and, specifically, key legal institutions operating at the heart of China’s corporate system during the establishment and rapid expansion of domestic capital markets. At a second level, this study helps elaborate the true identity of the modern Chinese firm under the PRC’s “corporatization” program and in that nation’s special political economy, and how it differs from business

2 “Shanghshi Gongsi Jiandu Guanli Tiaoli (Zhengqiu Yijian Gao)” Qicao Shuoming [Explanation of the Drafting of “Articles for the Administration and Supervision of Listed Companies (Comment Draft)”] attached to Guowuyuan Fazhi Bangongshi Guanyu Gongbu “Shanghshi Gongsi Jiandu Guanli Tiaoli (Zhengqiu Yijian Gao)” Ji Qi Shuoming Gongkai Zhengqiu Yijian De Tongzhi [Notice of the State Council Legal Affairs Office Regarding Promulgation of “Articles of the Administration and Supervision of Listed Companies (Comment Draft)”, It’s Explanation and Seeking Public Comments], at one time available at http://www.chinalaw.gov.cn (Sept. 9, 2007), hard copy on file with the author.
organizations in other developed and developing world jurisdictions. Third, this article aids us in pondering the very nature of corporate law itself, and how corporate law norms function on firms and shareholders situated in vastly different political economic circumstances even across globalized capital markets. Fourth and finally, I hope that the analysis here will prod serious thinking about how private autonomy can be protected in the corporate commercial spheres of different political economies, and the perhaps counterintuitive role state-enforced mandatory provisions can play in remedying structurally-determined exploitation of minority shareholders in what is presented as a neutral and autonomy-conferring legal architecture.

I. The “Quack Corporate Governance” Critique

The last ten years in the U.S. have seen a volley of critiques directed at high-profile corporate law and governance reforms implemented through federal securities law and agency regulatory action. This criticism has originated with U.S. law academics, profoundly offended by the incursion of U.S. federal regulation into the domain of U.S. state regulation principally through the July 2002 and July 2010 legislative enactments known as the Sarbanes-Oxley Act of 2002 (“SOX”) and the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank”) respectively, but also other Securities Exchange Commission (“SEC”) regulatory initiatives pre-dating SOX. Indeed, the push-back is not


6 For example, the SEC’s attempt to require one share, one vote (i.e., forbid dual-class common), for publicly-listed companies, invalidated by the U.S. federal courts in 1990.
simply academic, as even sitting state-level judges openly lament these developments, and U.S. federal courts almost casually invalidate regulatory action perfectly consistent with the spirit of the SEC’s mission or explicitly sourced in such statutory enactments, and pursuant to an incorrect standard of review (for rule-makings by independent agencies).


9 Including a collection of what Dean Clark calls “conflict-reducing” and “action-inducing” rules: the entirely independent director requirement for audit committees (SOX, Section 301); the prohibition on accounting firms provision of non-audit services (including financial information system design and implementation, appraisal or valuation services, internal auditing services, investment banking services, legal and expert services unrelated to audit, brokerage services and actuarial services) to audit clients (SOX, Section 201); the prohibition of corporate loans to officers or directors (SOX, Section 402(a)); executive certification of periodic reports and financial statements (SOX, Section 302); entirely independent director requirement for compensation committees (Dodd-Frank Section 952, 1934 Act Section 10C and Rule 10C-1 (June 2012)); direct regulation of the use of compensation consultants (Dodd-Frank, 1934 Act Section 10C and Rule 10C-1 (June 2012)); “claw back” of incentive-based compensation received by executive officers at public companies where there has been an accounting restatement (Dodd-Frank Section 954, 1934 Act Section 10D); mandated (advisory) shareholder vote on executive compensation at least once every three years; power to company shareholders to determine how often review of executive compensation should occur during that three year period (Dodd-Frank Section 951, 1934 Act, Section 14A); “comply or explain” requirement regarding whether chairperson of the board and CEO posts are split (Dodd Frank Section 972, 1934 Act, Section 14B); and a statutory requirement that public companies include shareholder nominees on proxies (Dodd-Frank Section 971, 1934 Act, Section 14 (amended) and judicially-invalidated Rule 14a-11).
legislation in the same area, much less pass legislative directives mandating federal agency regulation in the same areas; any attempt to change this allocation represents a usurping transfer of power from the states to the federal government (the “state jurisdiction” critique)

- In the words of Roberta Romano, “… the more efficacious corporate and securities law regimes are the product of competitive legal systems, which permit legal innovations to percolate from the bottom up by trial and error, rather than being imposed top down by regulators or corporate governance entrepreneurs, who are far removed from the day-to-day operations of firms”¹⁰ (the “legal systems market/laboratories of federalism” critique)

- The reform mandates operate so as to eat away at the allegedly beneficial norms (for organizational decision-making) of director primacy/board centrism, and thus frustrate the governance efficiencies promised by thoroughgoing separation of ownership and management (the “director primacy” critique)

- The packaging of what could have been conventional securities regulatory disclosure mandates as substantive corporate governance mandates is more costly (the “choice of regulatory approach cost” critique)

- Compliance with reform mandates is a new cost incurred by regulated firms, and is in absolute terms pretty expensive, with no or little benefit (the “costs of new compliance/cost-benefit” critique)

- The prospect of burdensome compliance with reform mandates applied through national securities law and regulation causes externally-domiciled issuers to avoid the reform-regulated capital markets, or flee from the reform-regulated market to less burdensome capital markets (the “unattractive to securities issuers” critique)

¹⁰ Romano, supra note __, at 1529, and see id. at 1598-99 (all echoing ROBERTA ROMANO, THE ADVANTAGE OF COMPETITIVE FEDERALISM FOR SECURITIES REGULATION (2002)). And see Bainbridge, supra note __, at 1795 (”… the uniformity imposed by [U.S.] federal law precludes experimentation with differing modes of regulation. Accordingly, as the sphere of federal domination grows, the room for new and better regulatory ideas to be developed shrinks. Instead of the laboratories of federalism, we risk being stuck with rules that may well be wrong from the outset and, because Washington moves only in response to crises, may quickly become obsolete.”)
• Many of the federal corporate governance legislative initiatives carried by the likes of SOX and Dodd-Frank are long-standing ideas advocated unsuccessfully by “corporate governance entrepreneurs” acting for allegedly undeserving constituencies and thus are not appropriate responses to, or remedies for, the alleged triggering events (Enron, WorldCom, the Global Financial Crisis, etc.) (the “opportunistic packaging of spurious preventatives” critique)

• Empirical studies demonstrate that the proposed substantive reforms do not “work” (e.g., reduce wrongdoing, make fiduciaries more independent, improve fiduciaries’ or firm performance, increase firm value, benefit investors generally, allow investors to distinguish between good and bad firms, etc. – there being some real variance on precisely what desired effect is not brought about, often in the same paper) (the “empirical studies demonstrate ineffectiveness” critique)

• The subject federal laws are classic “bubble laws”,11 enacted in a hurry, on an accelerating “bandwagon” (in Dean Clark’s phrase), and determined by legislators’ reelection concerns in the context of “media frenzy” and heightened public attention to (or “populist” backlash regarding) corporate malfeasance and scandals, rather than sober give-and-take over policy by experts and “legitimate” constituencies; legislators did not notice, or ignored, academic work proving ex ante that proposed corporate governance mandates would be ineffective after enactment (the “bad, panicked, uninformed, badly-informed, and inexpert legislative process” critique)

• The incursions of federal securities regulation into the domain of state corporate law operate in only one direction, or with a “ratchet” – i.e., there is no going back once the poison has been introduced (the “ratchet” critique)

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11 See Bainbridge, supra note __, at 1784-6.
Of interest in this list of complaints is lack of attention to two other critiques which might appropriately be leveled against this development, a disregard which may arise from the relative U.S.-centrism of the major academics carrying the attack:

First, there is very little invocation or exploration of the fact that corporate law and securities regulation are different areas of law – they are sourced in different traditions, with different aims and design, mostly different subjects, and entirely different modes of operation. Perhaps U.S. academics do not allude to this problem a great deal because it is subsumed in the U.S. federalism-specific “state jurisdiction” critique précised above. I will refer to this below as the “distinct legal systems” critique. Embedded in this critique is a more philosophical and essentially libertarian concern, or a worry about “state” incursion into the realm of “free” and “private” ordering – a sub-strand which takes on extra weight when the jurisdiction at issue is not a liberal democracy like the U.S. but an avowedly authoritarian state such as China.

Second, no U.S. academic I know of\(^{12}\) points to the strong likelihood of a *transnational* cannibalization of corporate law arising from the subject phenomenon – where an issuer domiciled in country A becomes subject to the corporate governance-related norms imposed by country B’s securities regulation, and the national corporate law of country A is overridden, denied, or substantially altered. This is a violation of what the U.S. calls in its domestic federal context the “internal affairs doctrine” (judicial institutions look to the laws of the state of incorporation to determine the rights and duties of firm participants), only now working across international, not U.S. state, borders. Again, this is addressed rarely because U.S. corporate law and even securities law academics do not spend enough time worrying about the extraterritorial reach and effect of U.S. law and regulation on governance at foreign-domiciled firms (as opposed to securities issuance and disclosure by such firms). But they should, as the effect in our increasingly globalized capital markets can be significant. One only needs to consider, for example,

\(^{12}\) Larry Ribstein alluded to the issue very briefly in his many writings on the subject, but in the context of increased costs for foreign private issuers accessing the U.S. capital markets or simple “lack of fit”, not the effect of U.S. securities regulation corporate governance-related mandates on the corporate law and corporate governance regime applicable to the foreign issuer under its national law. *See, for example, Ribstein 2005,* *supra* note __, at 377 and 382.
the effect on the corporate law and governance applicable to a major Delaware-incorporated U.S.
multinational were that firm to list shares on the Shanghai Stock Exchange or commence a China
Depositary Receipts (or “CDRs”) program directed at a Chinese stock exchange – initiatives we are sure
to see accomplished in the next couple of years (and have already seen in the sub-continent with the
listing of Standard Chartered Bank’s shares on an Indian exchange)\(^\text{13}\) – whereby the mandates of
Delaware corporate law, U.S. securities law, and U.S. exchange regulation will be substantially
overridden and that U.S. firm will immediately become subject to the PRC securities agency-imposed
corporate governance norms described here. I refer to this as the “transnational effect” critique below.

II. Quack Corporate Governance as Traditional Chinese Medicine

By comparison, the thirty year development of a legal corporate governance regime in the PRC
makes the U.S.-origin “quack corporate governance” concern seem decidedly quaint. In China, the exact
opposite of the development path deemed in need of protection in the U.S. has unfolded. Rather than
zealously patrolling the fragile border between corporate governance norms and securities issuer
regulation, the PRC’s public company regulators (strongly supported by some Chinese legislators, other
executive departments, and academics) have boldly and consistently acted to create, re-craft or anticipate
the most fundamental aspects of that nation’s formal legal corporate governance system, in both design
and application, and institute extremely robust board-related and/or shareholder-empowering norms.\(^\text{14}\)

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\(^{13}\) For Shanghai listings by foreign-domiciled issuers, see: Enoch Yiu, *Shanghai Bourse Studies
Listing of Multinationals*, SOUTH CHINA MORNING POST, Nov. 19, 2007, at __; Whole Bank, Not Just HSBC
Lau, *Beijing Set to Encourage Foreign Listings*, FINANCIAL TIMES, Jan. 17, 2008, at __; *NYSE Set to List on
Shanghai Exchange*, SOUTH CHINA MORNING POST, April 15, 2008; David Barboza, *Shanghai Exchange
http://www.nytimes.com/2010/04/16/business/global/16exchange.html?_r=0; and
*Shanghai Mayor Says Time Not Right for Exchange’s International Board*, BLOOMBERG NEWS, Jan. 16, 2012, available at

For CDRs, see Zhang Jiwei, *CDR Zoufeng [CDR Whirlwind]*, 39 CAIJING MAGAZINE, June 2001, at 58-60; and
summit-bny-mellon-sees-first-china-depository-receipt-listings-next-year/.

\(^{14}\) It is only fair to note that problem is apparent in the other direction too, whereby the company law
statute has a good number of provisions which might normally be considered the province of a securities law and
regulatory regime. See, for example, Zhonghua Renmin Gongheguo Gongsifa [Company Law of the PRC],
Indeed, the PRC securities regulator’s implemented policies, rule-making and enforcement practices – at times exceeding or breaching the constraints of formal legislation – embody very well the extraordinary power many of China’s agencies have in the PRC’s specific institutional context. This process has advanced so far in China that the consumer side of the legal regime -- defendant fiduciaries (and their counsel) and even Chinese courts -- continue to argue that claims for breach of legal duties at listed companies should not be heard in the People’s Courts applying corporate law, but before the PRC securities regulator applying only securities law and regulation.\(^1\)

While there are simply too many expressions of this phenomenon to catalogue completely here,\(^2\) a number of the most interesting examples are described below to help those less familiar with Chinese developments understand how profound the contrary orientation in the PRC is.

Reviewing these examples, corporate law specialists will note immediately that the PRC securities regulator – the China Securities Regulatory Commission (“CSRC”) -- has made these bold incursions into the corporate law domain via two distinct methods with immediately discernible, and different, prospects of effectiveness: (i) the filling-in of substantive corporate law doctrines which still have to be enforced by a state actor, whether the judiciary or a regulator (e.g., corporate fiduciary duties); and (ii) the establishment of “self-enforcing” mechanisms which are meant to be effective as between the

\(^1\) See Wang Dianxue, Shanghai Gongsi Dongshi Beifa Zhuanggao Zhengjianhui [Penalized Director of a Listed Company Sues CSRC]. XINJINGBAO [NEW CAPITAL NEWS], June 4, 2008 (plaintiff suing the China Securities Regulatory Commission (“CSRC”) to overturn a fine asserts that, although he is a corporate director, he has not breached the legal duties of directors set forth in the 2006 PRC Securities Law, in his view the exclusive source of such duties for directors of listed companies, preempting entirely the 2006 PRC Company Law and its legal duties for directors). Much earlier in March 1999, and before the coming into effect of China’s first Securities Law, the Pudong New District People’s Court (not a fiduciary or its counsel) took a similar view when it refused to hear China’s first public shareholder’s lawsuit – explicitly grounded in the 1994 PRC Company Law -- on the basis that “The plaintiff’s case regarding behavior in violation of securities 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 the People’s Courts.” See Jiang Shuzhen v. Hongguang Industry Co., Ltd. Directors et al., in XU ZHAOHONG & ZHENG HUI, ZHENGQUANFA ANLI JINGJIE [COLLECTED SECURITIES CASES] 58-64 (2001).

\(^2\) An attached Appendix lists some of the most important PRC regulatory enactments directly impacting corporate law and governance.
parties to a firm long before the state needs to be involved in enforcement, if at all (e.g., minority shareholder “class” negative veto rights). As discussed in more detail below, one of the many ironies of this development path in the PRC is that the CSRC and other Chinese bureaucracies have employed mandatory rules to make the nation’s company law more “self-enforcing”, even as the PRC Company Law between 1994 and 2006 has explicitly moved in the opposite direction, towards greater use of enabling default rules and ever-broader invitations to the Chinese judiciary to enforce standards ex post.17

a. Corporate Fiduciary Duties

It is no exaggeration to say that corporate fiduciary duties for orthodox corporate fiduciaries and even controlling shareholders initially came into Chinese corporate law from outside of the corporate law, and largely at the hands of the PRC’s early securities regulatory bureaucracy and then the CSRC. As I have detailed elsewhere, in June 1993 and before the PRC had an effective company law statute the PRC Commission on Restructuring of the Economic System (“CRES”), by a letter to the Hong Kong Securities and Futures Commission glossing language contained in a sub-statutory regulation, absorbed all then-current Hong Kong (and thus English) fiduciary duties jurisprudence into Chinese law, at least for PRC-domiciled firms issuing stock and listing in pre-Handover Hong Kong.18 When the language glossed in the 1993 CRES letter was subsequently dropped from the PRC’s first Company Law, effective in mid-1994,19 the CSRC reinstated the all-important language in a regulatory “addendum” applicable to Chinese firms suddenly subject to the fiduciary duties-deficient 1994 Company Law but issuing stock into Hong

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18 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, 210-11 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) (hereinafter, Doctrine That Dared Not) (the CRES letter stated that four Chinese characters (chengxin zeren) in the then-governing legal basis for joint stock company establishment (the CRES “Opinions on Standards for Companies Limited by Shares”) “… has the same type of meaning (juyou leiside hanyi) as fiduciary duty under Hong Kong law”, with the words rendered here as “fiduciary duty” in English in the otherwise Chinese language letter).

Kong. This language reinstatement through an agency rule-making was effected explicitly to recover and maintain the wholesale importation of corporate fiduciary duties into the law applicable to PRC-domiciled firms listing “overseas” (Hong Kong and beyond) previously accomplished in the 1993 CRES letter. Realists will understand this incorporation and then reinstatement as largely symbolic, and very easy for both the CRES and the Hong Kong Securities and Futures Commission to effect with little cost or immediate consequence. While that view has merit with respect to the events of 1993-4 and the effort to complete the PRC’s first “overseas” initial public offerings, this rhetorical absorption of a developed body of common law corporate fiduciary duties almost two decades ago was but the start of a sustained campaign by the Chinese bureaucracy to introduce and make fast the very notion of corporate fiduciary duties in Chinese law, culminating in formal adoption of these duties in Article 148 of the 2006 PRC Company Law.

After July 1994, and faced with an inadequate 1994 PRC Company Law lacking any explicit statement of corporate fiduciary duties (and only a vague loyalty provision and a scattering of duty of loyalty-related prohibitions), various state bureaucracies but primarily the CSRC continued to push corporate fiduciary duties into corporate law via Chinese regulations and administrative enactments binding on listed firms. For instance, the State Council Securities Commission (“SCSC”) and CRES accomplished this – with some real teeth -- for PRC-domiciled firms listing both overseas and domestically with the issuance of “mandatory” (for foreign listing firms) and “guidance” (for domestically listing firms) articles of association, each of which model firm constitutions are replete with

20 See Doctrine That Dared Not, supra note __, at 211.
21 See 1994 PRC Company Law, supra note __, arts. 59 (instructing “loyal” performance, protection of the interests of the company, and prohibiting acting for personal gain), 60 (prohibition against misappropriation of firm assets), 61 (prohibition against direct competition, and unapproved related party transactions), 62 (confidentiality), and 123 (applying the foregoing to companies limited by shares).
22 See, for example, the CSRC and State Economic Trade Commission’s 2002 Shangshi Gongsi Zhili Zunze [Principles for Listed Company Corporate Governance], Jan. 7, 2002, zhengjianfa [2002] 1, CSRC Laws and Regulations, at 925-29 (hereinafter, Listed Company Governance Provisions), art. 33 ("Directors should undertake their responsibilities loyally (zhongshi), in good faith (chengxin) and diligently (qinmian) in accordance with the best interests of the company and the entire body of shareholders").
23 The SCSC was a ministry-level body directly under the PRC State Council and originally superior to the CSRC. The SCSC was subsequently disbanded with the elevation of the CSRC to a ministry-level commission under the State Council.
declarations of the duties of care and loyalty owed by fiduciaries to the firm and its shareholders which did not then exist in Chinese corporate law. The acceptance of these corporate constitutions by Chinese firms and their shareholders was (and is) made mandatory by the CSRC’s notified practice of withholding any initial listing approval, or de-listing going forward, unless the issuer’s articles of association conform to the promulgated forms. Moreover, aside from the ability of shareholders to sue in something like contract for the breach of these governance provisions, there is evidence that the Chinese People’s Courts have enforced the terms of these “guiding” or “mandatory” articles of association as a kind of stand-alone legal-regulatory norm even in the rare case where a listed firm has not put in place conforming articles of association.

The same legal-regulatory alchemy was performed outside of the firm operations and management context via 2001 measures issued by the CSRC governing the acquisition of listed companies, which declared – again without any basis in Chinese corporate law at the time – that the target board of directors, supervisory board and high-level management had what amounted to fiduciary duties to target stockholders and the target firm in approving or recommending an external offer, and pre-decision process requirements which look suspiciously like those normally divined from the Delaware Supreme Court’s Van Gorkom decision. 

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25 See, for example, the 2006 Lu Jianming v. Shanghai Light Industry Machinery Co., Ltd. case opinions (Jingan District People’s Court, reversed on appeal by the Shanghai No. 2 Intermediate People’s Court) summarized at Corporate Law in the Shanghai Courts, supra note __, at 433-36.

Finally, the CSRC injected corporate fiduciary duties into Chinese law not only for orthodox fiduciaries (directors, supervisory board members, and management) but also for the most provocative actor in the PRC political economy, controlling shareholders (most often a corporate identity of the state or party).\footnote{See CSRC, Shangshi Gongsi Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies], Dec. 1, 2002, zhengjianhuiling No. 10, available at http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=chl&Gid=42687, art. 33 (duty of target board, supervisory board members and high-level management not to harm the lawful rights and interests of the shareholders or the company) and chapt. III (which lays out Van Gorkom type requirements describing the requisite duty of care applicable to the target board). After the effectiveness of China’s 2006 Company Law, these Measures were amended to track the explicit language for both duty of loyalty (zhongshi yiwu) and duty of care (qinmian yiwu), see CSRC, Shangshi Gongsi Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies], July 31, 2006, zhengjianhuiling No. 35, CSRC Laws and Regulations, at 845-853 [hereinafter, Listed Company Acquisition Rules], art. 8. The not obvious doctrinal fact of controlling shareholders’ fiduciary duties was declared in the CSRC’s and State Economic Trade Commission’s 2002 Listed Company Governance Provisions (“Controlling shareholders have a fiduciary duty (chengxin yiwu) to the listed company and the other shareholders”). See Listed Company Corporate Governance Provisions, supra note __, art. 19.} For instance, in the 2004 CSRC regulation described immediately below which created negative veto rights for public shareholders as a body, the regulation states outright that the controlling shareholders and actual control parties of listed companies have fiduciary duties to the listed company and the other shareholders of the listed company.\footnote{CSRC, Guanyu Jiaqiang Shehuigongzheng Gudong Quanyi Baohu De Ruogan Guiding [Several Regulations Regarding Strengthening Protection for the Rights and Interests of Public Shareholders], Dec. 7, 2004, zhengjianfaziben [2004] 118, CSRC Laws and Regulations, at 929-30 (hereinafter, Public Shareholder Protection Regulations), art. 5(1) (declaring that control shareholders/parties have a “chengxin zeren”, the then-employed term of art expressing corporate fiduciary duties).}

b. Protections for “Public Shareholders” and Quasi-class Negative Vetoes

A very strong example embodying the incursion of securities regulation directly into the heart of China’s corporate governance regime is the issuance in December 2004 of “Regulations Regarding Strengthening Protection of the Rights and Interests of Public Shareholders,”\footnote{Public Shareholder Protection Regulations, supra note __.} which effectively re-defined public shareholders other than controlling shareholders (whether holding listed or unlisted shares) as a kind of class, and conferred upon that new quasi-class negative veto rights regarding certain decisions.\footnote{This negative veto is accomplished specifically by requiring that certain corporate actions be approved by both a majority of the general shareholders meeting and, in addition, a majority of the so-called “public shareholders” (shehui gongzhong gudong). The actions implicated include: any new issuance of stock to the public or convertible debt, or any rights offering (other than where the control party promises to take up the entire offering} This constitutes a regulatory initiative far beyond mere exhortations to good and better

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27 See CSRC, Shangshi Gongsi Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies], Dec. 1, 2002, zhengjianhuiling No. 10, available at http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=chl&Gid=42687, art. 33 (duty of target board, supervisory board members and high-level management not to harm the lawful rights and interests of the shareholders or the company) and chapt. III (which lays out Van Gorkom type requirements describing the requisite duty of care applicable to the target board). After the effectiveness of China’s 2006 Company Law, these Measures were amended to track the explicit language for both duty of loyalty (zhongshi yiwu) and duty of care (qinmian yiwu), see CSRC, Shangshi Gongsi Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies], July 31, 2006, zhengjianhuiling No. 35, CSRC Laws and Regulations, at 845-853 [hereinafter, Listed Company Acquisition Rules], art. 8.

28 The not obvious doctrinal fact of controlling shareholders’ fiduciary duties was declared in the CSRC’s and State Economic Trade Commission’s 2002 Listed Company Governance Provisions (“Controlling shareholders have a fiduciary duty (chengxin yiwu) to the listed company and the other shareholders”). See Listed Company Corporate Governance Provisions, supra note __, art. 19.


30 Public Shareholder Protection Regulations, supra note __.

31 This negative veto is accomplished specifically by requiring that certain corporate actions be approved by both a majority of the general shareholders meeting and, in addition, a majority of the so-called “public shareholders” (shehui gongzhong gudong). The actions implicated include: any new issuance of stock to the public or convertible debt, or any rights offering (other than where the control party promises to take up the entire offering
governance at listed companies generally (which are always a part of PRC law and regulation), and in fact directly determines mandatory shareholder constituencies and approval thresholds designed to frustrate or check oppressive or conflicted majority action. For those familiar with U.S. corporate law and jurisprudence, these PRC securities regulatory agency norms require for Chinese listed companies what is (i) commanded by state-level corporate statute, or (ii) arrived at via private ordering and only evaluated ex post by a state law court (e.g., Signal’s supermajority and majority of the minority offered in the roll-up merger of UOP evaluated by the Delaware Supreme Court in Weinberger).32

c. Related Party Transactions and Self-Dealing; Control Shareholders’ Duties

When faced with a deficient 1994 company law statute weak on regulation of related party transactions and the abuse of listed subsidiaries by controlling shareholders, the CSRC acted in 2003 and late 2005 to institute corporate governance changes explicitly designed to address these problems. In 2003, the CSRC with the State-owned Assets Supervision Commission (“SASAC”) (the latter a government department with very tenuous control over state-affiliated controlling shareholders) issued a notice addressing funds transfers by listed companies to their controlling shareholders and those shareholders’ affiliates, and listed company guarantees of the financial obligations of such controlling shareholders or those shareholders’ affiliates.33 The notice flat-out prohibits certain funds transfers from the listed company to the controlling shareholders or their affiliates, and the giving of external guarantees by the listed company for the benefit of its controlling shareholder or any 50% or more-owned subsidiaries of the latter.34 The 2003 notice then limits the aggregate amount of external guarantees by a listed company to less than 50% of net assets (in the most recent fiscal year),35 and forbids guarantees for

in cash); major reorganization of the assets of the listed company; repayment of any debt to the company by a shareholder with company stock; any overseas listing by a significant subsidiary of the listed company; and “any matter that has a major effect on the rights and interests of the public shareholders”. See Public Shareholder Protection Regulations, supra note __, art. 1(1)(i)-(v).

32 See Weinberger v. UOP, Inc. 457 A.2d 701 (Del.1983).
34 Id. arts. 1(2)(i)-(vi) and 2(1).
35 Id. art. 2(2).
any debtor carrying excess leverage.\textsuperscript{36} Perhaps most evocative in the present context, the notice institutes (admittedly weak) supermajority/direct shareholder approval requirements for all external guarantees – two-thirds of the board \textit{or} mandatory general shareholders meeting approval.\textsuperscript{37} These are “weak” because the controlling shareholder will control all or most of the directors and thus a supermajority at the board level is no significant block; just as the controlling shareholder will use its majority voting power in the general shareholders meeting to assure the required shareholders’ approval. These frailties were addressed, in part, with another CSRC notice issued only two years later, this time in tandem with the newly-establish China Banking Regulatory Commission.\textsuperscript{38} That jointly-issued notice reasserts value limits on any guarantees but most critically mandates that company articles of association set forth explicitly the approval authority of the board with respect to external guarantees, and further requires supermajority (2/3) approval by the board of directors for guarantees within that approval authority, or for external guarantees which must be submitted to the shareholders’ meeting, approval by the board (presumably a majority) and then majority approval by the shareholders \textit{but with the controlling shareholder and its affiliates not permitted to vote}.\textsuperscript{39} Moreover, both the 2003 and 2005 notices create a kind of \textit{ad hoc} veil-piercing mechanism (only recognized in PRC corporate law after January 1, 2006), providing for controlling shareholder joint and several liability on non-conforming external guarantees forced out of listed subsidiaries.\textsuperscript{40} Implicit in each of these CSRC notices is the idea that controlling shareholders have some kind of fiduciary duty to their dominated (listed) firms, in particular the (minority) holders of the public float. This implication is consistent with the CSRC’s long campaign to articulate fiduciary duties for controlling shareholders alluded to above.\textsuperscript{41}

\begin{itemize}
\item \textsuperscript{36} \textit{Id.} art. 2(3).
\item \textsuperscript{37} \textit{Id.} art. 2(3).
\item \textsuperscript{39} \textit{Id.} art. 1(3)-(4).
\item \textsuperscript{40} \textit{Id.} at art. 3, and Notice Regarding Several Issues Relating to the Standardization of Listed Company-Related Party Funds Flows and Listed Company External Guarantees, \textit{supra} note __, at art. 4.
\item \textsuperscript{41} See \textit{supra} notes __ and text.
\end{itemize}
d. Independent Directors

Even after the PRC’s company law drafters embarked on a muddled experiment – really no more than a declaration of affiliation – with German style “codetermination” and the establishment of a “supervisory board” in addition to a board of directors at all Chinese companies, in 2001 the CSRC instituted a conflicting system mandating that after July 1, 2003 one third of any listed company’s board be composed of “independent directors.”42 While many analysts and market participants see the PRC’s independent director system as just as flawed as the two-tiered boards that now dot the corporate landscape,43 the fact remains that the independent directors override of codetermination Chinese style came through a CSRC “guiding opinion” and formally non-binding CSRC corporate governance “principles”, yet absolutely enforced by the CSRC’s withholding of initial public offering or listing approvals for China-domiciled firms that did not conform. This is another example of the CSRC remaking basic corporate governance structures applicable to boards of directors entirely outside of the corporate law, or indeed “law” of any kind.

e. Class Negative Veto Rights -- Where Share “Classes” are Prohibited

In one of the most inventive expressions of the phenomenon asserted here, the SCSC and CRES 1994 Mandatory Articles of Association for Overseas Listing Companies for PRC-domiciled firms issuing stock in Hong Kong or foreign markets were drafted to provide negative veto rights for certain class shareholders under a national corporate law that explicitly prohibited different classes of stock (and even preferred stock). This was effected by Chapter IX of those Mandatory Articles of Association, which declared shares held by foreign public buyers to be a share “type” (leibie) – not the legally prohibited term “class” – and required a two-thirds supermajority approval of the share “type” holders


43 See Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 DEL.J. CORP. L. 125 (2006). The independent director system has given rise to a raft of extremely difficult, and very basic, problems for everyone involved, e.g., who or what precisely do independent directors owe a fiduciary duty to -- the listed firm, the general shareholders meeting, the general shareholders meeting exclusive of the deemed controlling shareholders, or abstract notions of fairness and transparency?
convened in a separate meeting for any resolution seeking to “change or eliminate type shareholders’ rights and interests” (a class/minority protection taken from the United Kingdom’s Companies Act-tradition affected class supermajority vote on “variation of class rights”). This mechanism has consistently empowered minority, foreign markets-purchasing, shareholders in PRC-domiciled firms with Hong Kong or overseas listings, and in one case ironically benefited the Chinese state controlling shareholder seeking to implement the forced consolidation of one of the PRC’s regional airlines and see off a competing (and target-preferred) bid by Singapore Airlines.

f. The 2007 “Articles for the Administration and Supervision of Listed Companies”

    The CSRC -- and the corporate law academics aiding it in the initiatives revealed here -- have not had complete success in re-making China’s corporate law and corporate governance regime. We know, for instance, that the CSRC failed in its behind-the-scenes attempt to change the company law directly, and have the 2006 PRC Company Law’s new veil-piercing provision set forth a lower standard for controlling shareholder liability (focusing on controlling shareholder/controlled subsidiary separateness and comingling).

    A second example shows much greater ambition on the part of the CSRC and its reform allies, making the resulting failure (at least to the time of this writing) greater too. In late 2007 and after the effectiveness of the 2006 PRC Company Law, the CSRC (with very significant input by China’s activist corporate governance academics) – acting through the PRC State Council’s Legislative Affairs Office -- submitted to the PRC State Council for review, and released for public comment, a draft omnibus

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45 See Barry Naughton, SASAC and Rising Corporate Power in China, 24 CHINA LEADERSHIP MONITOR 1 (2007). The author, when a practicing lawyer, used the same mechanism to create substantial negative veto rights for the George Soros interests in their 25% private investment in Hainan Airlines Co., Ltd. which never had an overseas listing and thus was not required to have in place the Mandatory Articles of Association for Overseas Listings Companies. As a self-enforcing check on the oppressive actions of the controlling shareholders and their insiders, the mechanism proved near foolproof.

46 See Chao Xi, Piercing the Corporate Veil in China – How Did We Get There?, 5 J. BUS. L. 413, 423-27 (2011) (describing how the CSRC’s proposed statutory language would have allowed for piercing to controlling shareholders on a showing of non-separation between shareholder and subsidiary and/or co-mingling of assets, not just the higher – and more difficult to apply -- standard of “abuse”).
regulation (or “tiaoli”) titled “Articles for the Administration and Supervision of Listed Companies” comprising 106 articles.\(^{47}\) Explained as an effort to rationalize all of the individual CSRC pronouncements impacting on listed company corporate governance noted here into a single administrative regulation (and, explicitly, to conform Chinese listed company governance mandates with post-Enron SOX innovations in the U.S.), the draft regulation (i) asserts CSRC jurisdiction over all corporate governance matters at companies with shares listed on the Shanghai or Shenzhen exchanges (in addition to securities issuance and trading matters, the traditional domain of a securities regulator), and (ii) covers seemingly every base imaginable, including: strict separation (financial, assets, personnel, management, business, etc.) between controlling shareholders and listed subsidiaries; orthodox fiduciary duties; board responsibility for monitoring officers and management (Caremark\(^{48}\) oversight duties); SOX-style certification of periodic reports (and financial statements therein) for directors, supervisory board members and senior management; the corporate fiduciary duties of controlling shareholders; related party transactions (including a requirement that at more than half of the independent directors approve major related party transactions); external guarantees forced from listed subsidiaries and approval of the same; maximum ratios of inside directors; the independent directors system; minimum ratios of independent directors on audit, compensation and controls board committees; a prohibition on directors delegating their vote to the chairman of the board; limitations on directors’ consent in lieu of meeting; the design and enforcement of mandatory articles of association; the general shareholders’ meeting and shareholder

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\(^{47}\) These draft regulations were released as the Shangshi Gongsi Jiandu Guanli Tiaoli (Zhengqiu Yijian Gao) [Articles for the Administration and Supervision of Listed Companies (Comment Draft)]; see supra note __, and LIU JUNHAI, ZHONGGUO ZIBEN SHICHANG FAZHI QIANYAN [RULE OF LAW FRONTIER FOR CHINA’S CAPITAL MARKETS] 164 (2012). The author has on file a copy of these draft Articles and the State Council Legislative Affairs Office’s accompanying explanation (likely drafted by the CSRC and its academic advisors), and transcripts from the various hearings convened for comments. In 2003, a very similar effort was pushed by many of the same Chinese academics, but through the medium of an expert-drafted Supreme People’s Court “regulation” (guiding), which would have substantially re-written the 1994 PRC Company Law to include many of the innovations seen in the 2006 PRC Company Law. See Supreme People’s Court, Guanyu Shenli Gongsi Jiufen Anjian Rugan Wenti De Guiding (Yi) (Zhengqiu Yijian Gao) [Regulation Regarding Several Problems on Hearing Company Dispute Cases (One) (Comment Draft)], issued Nov. 4, 2003, available at: http://www.chinacourt.org/public/detail.php?id=88551 (hereinafter, Omnibus Company Law Regulation). The passage and promulgation of the 2006 PRC Company Law in late 2005 effectively pre-empted the 2003 Omnibus Company Law Regulation, carrying a great many of its innovations into law.

voting (including proxy voting); mandatory cumulative voting; internal controls (and accountant

certification of such controls); limits on stock compensation; the mandatory retention of outside corporate
counsel; investor relations; post-issuance use of proceeds; asset reorganizations; prohibition on “financial

assistance” in takeovers (taken from the UK Companies Act, which ironically largely abolished the

prohibition after October 1, 2008); procurement of a fairness opinion in any acquisition; and procedural

remedies – such as a quasi-derivative action to allow shareholders to sue for rescission of illegal stock

grants to directors and officers (which already exists for shareholders seeking disgorgement of directors,

supervisory board members or senior management short swing trading profits under Article 47 of the

2006 PRC Securities Law),49 and more robust private rights of action (seeking explicitly-authorized civil

damages).

If issued as a departmental regulation by the CSRC or an administrative regulation by the State

Council, these Articles for the Administration and Supervision of Listed Companies would have

completely and fundamentally re-made the corporate and securities law applicable to companies with a

public float on either of the Chinese exchanges, and every aspect of the corporate governance system

binding on them. Indeed, the CSRC-drafted Articles, if finally issued as a State Council regulation,

would have created a second or addendum PRC Company Law by administrative regulation not

legislative act of the Chinese national legislature. As of this writing, this effort by the CSRC and its

academic allies to do an end-around “law”, and re-craft corporate law via securities regulation, has failed;

nonetheless, it stands as a monument to the continuing ambition of China’s securities regulator (and those

academics leading the effort) to use securities regulation to make every aspect of the corporate law in a

more perfect image, and perhaps a marker for future efforts (or indeed explicitly “legal” amendments)

under a future PRC government administration.50 And, of course, much of the substantive law and

49 See Nicholas C. Howson, Punishing Possession – China’s All-Embracing Insider Trading

Enforcement Regime, in INSIDER TRADING RESEARCH HANDBOOK 327, 330 (Stephen P. Bainbridge, ed.,

2013) (allowing shareholders to sue for disgorgement “acting in the company’s interest”).

50 The author is aware that some of the key academics working on the Articles for the Administration

and Supervision of Listed Companies (Comment Draft) had been invited in 2012 to leave their academic posts and

work full time at the CSRC to push through such changes, deemed a necessary step if the current Listing Council
regulation contained in the never-promulgated CSRC Articles is already applied and enforced via the diverse enactments reviewed here.

g. The Fate of CSRC Securities Regulation-based Reforms in PRC Corporate Law

The fate of the many corporate governance-related mandates actually instituted by the CSRC in the development of China’s corporate governance model has been very good, and includes: (i) post facto absorption into corporate statute in whole or in part (“legalization”); and (ii) non-absorption into Chinese corporate law but continuing effectiveness via the application and enforcement of PRC securities law and regulation (“continuing effectiveness but not legalization”). (It might also include, theoretically at least, reversal or elimination by subsequent company law enactment (“elimination”)). Examples of the legalization result abound, such as the provisions in the 2006 PRC Company Law which: articulate the fiduciary duties of care and loyalty for orthodox corporate fiduciaries; require recusal from board votes of conflicted directors; state in law the fiduciary duties of controlling shareholders (and thus provide a legal remedy for minority shareholder “oppression” or controlling shareholder self-dealing), require a cap on so-called external guarantees, recusal of controlling shareholders on shareholder votes for external guarantees, and a supermajority (2/3) vote for any external guarantee greater in value than 30% of corporate assets, or a majority of non-controlling shareholders for any external guarantee; mandate a supermajority shareholder vote (2/3) on the disposition of significant assets; and allow for different “classes” of shares. In some situations, the corporate law is crafted so as to absorb pre-existing CSRC-origin norms by simple, backwards-looking, statutory cross reference. This is how, for example, the mandatory independent directors system of 2001 is absorbed into Chinese corporate law post-2006 – by a

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51 2006 PRC Company Law, supra note __, art. 148.
52 Id. art. 125.
53 Id. art. 20.
54 Id. arts. 122 and 16.
55 Id. art. 122.
56 Id. art. 127.
statutory mandate\textsuperscript{57} that there must be independent directors, in accordance with “State Council” (read “State Council commission”)-issued norms, which in fact were already issued five years previous. The same is true for those corporate governance norms which see continuing effectiveness but not legalization. One example in this realm is the entire machinery, rights (including benefit of a mandatory offer for target shareholders) and obligations (including target board fiduciary duties) brought into Chinese law with the introduction of the CSRC’s Listed Company Acquisition Rules – the 2006 PRC Company Law merely provides a legal basis for such transactions (especially a corporate merger) with nothing else.\textsuperscript{58} Another example is the continuing effectiveness of the “type” (class) shareholders’ negative veto right on any corporate action which affects the rights and interests of such “type” shareholders in PRC-domiciled firms listing on the Hong Kong or overseas markets.\textsuperscript{59} On the theoretical “elimination” side, it is impossible for this observer to find even one example of a CSRC securities law-imposed norm that has been eliminated or significantly carved back by a subsequent corporate law enactment. Indeed, and now returning to the worried rhetoric of U.S. quack corporate governance theorists, the CSRC-led securities regulation re-construction of China’s corporate law embodies the strongest form of “ratchet” imaginable – it is wholly unidirectional and always results in permanent change in the parallel (and receiving) corporate legal system.

\section*{III. Why China and the CSRC Have Taken This Approach}

\subsection*{a. Administrative Law Competence}

Under the principles governing the contemporary Chinese legal system, there is no question as to the legal authority of the CSRC to issue administrative regulations which impinge so directly upon what we may understand as corporate legal norms. The CSRC – as a “commission” directly under the PRC State Council -- has the authority to issue “departmental regulations” (“bumen guizhang” or just “guizhang” in the PRC legislative idiom). These regulations are a well-recognized species of administrative rule-making for ministries and commissions like the CSRC under the PRC State Council,

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{57} Id. art. 123.
\item \textsuperscript{58} Id. arts. 173-80.
\item \textsuperscript{59} See supra note \_\_ and text.
\end{itemize}
\end{footnotesize}
and have a very solid legal basis in the 2000 PRC Law on Legislation\textsuperscript{60} insofar as they are issued publicly.\textsuperscript{61} Moreover, the CSRC has specifically-delegated legal authority to make such departmental regulations regarding “the activities of securities issuers and listed companies”\textsuperscript{62} and there is nothing in the 2006 PRC Company Law or any other statute which forbids such regulation in the corporate governance sphere or appoints any other Chinese governmental institution as the primary or exclusive norm provider with respect to corporate law and governance. The only thing the CSRC cannot do, and here regardless of the subject of the regulation, is regulate or undertake enforcement outside of the bounds authorized to it in law.\textsuperscript{63}

b. “Corporatization Without Privatization” and Its Effects

The far more revealing question is “why?”. Why has the CSRC, alone and with other agencies, acted via administrative securities regulation to alter so significantly China’s corporate law and corporate governance regime, at least with respect to public firms? The layered answer to that question promises important insights about the real political economy of modern China, the nature of the firm post-“corporatization”, the most significant abuses visited on Chinese investors, the character of “law” in the PRC, and the relative competence, autonomy and political independence of key political-legal institutions like the courts.

Donald Clarke and I have tried to explain the “corporatization” program in the PRC, and its consequences for both the nature of Chinese firms and the nature of corporate law in contemporary

\textsuperscript{60} See Zhonghua Renmin Gongheguo Lifa Fa [PRC Law on Legislation], (promulgated by the Standing Comm. Nat’l. People’s Cong. Mar. 15, 2000, effective July 1, 2000), available at http://lawinfochina.com/Display.aspx?lib=law&ID=386, arts. 71-77. I thus reject the (mostly academic) attacks against the CSRC’s authority to regulate on corporate governance matters (for listed companies) reported by Professor Clarke in 2003, infra note \_\_ and text.


\textsuperscript{62} 2006 PRC Securities Law, supra note \_\_, arts 179(1) and 179 (3).

\textsuperscript{63} I have addressed this problem, specifically with respect to the enforcement of China’s narrowly crafted statutory insider trading prohibition by the CSRC and likely the People’s Procuratorate, in Nicholas Calcina Howson, Enforcement Without Foundation? – Insider Trading and China’s Administrative Law Crisis, 60 AM. J. COMP. L. 955 (2012).
The traditional PRC state-owned enterprise (or literally “enterprise owned by all the people” (quanminsuoyouzhi qiye)) (“SOE”) was not what many inside China and out mistook it for: a legal corporation simply owned by a single shareholder, the state (on behalf of “all the people”). Instead, it was a division or ring-fencing of productive assets by a state administration, without granting separate legal personality or competence to that accumulation of assets, or any financial separateness (and thus accountable profits, losses, or taxable gains) for it. It had party state-appointed managers who moved through a bureaucratic hierarchy into progressively more powerful political positions. It did not issue ownership interests in itself, like stock or equity. The “control” interest in such SOEs (the right to appoint management and appropriate gross revenues, and, once a tax system came into being, net revenues or profits) was vested in some identity of the state – often central line ministries, but also subordinate units of the government such as local bureaus of the same line ministries (e.g., the Hebei Provincial Bureau of Heavy Machinery), or local-level People’s Governments (e.g., the Chongqing Municipal People’s Government). “Corporatization” as commenced in the 1980s, confirmed along with the “modern enterprise system” in law with the 1994 Company Law, and most recently expressed in the 2006 PRC Company Law, sought to implement a “modern enterprise system” and abolish the SOE as an organizational form by converting SOEs into a legal form of “company” authorized and apparently governed by PRC company law: (i) a company limited by shares (“CLS”), a joint stock company form for widely-held firms; (ii) a limited liability company (“LLC”), for a smaller and closely-knit group of investors; or (iii) a wholly state-owned sub-form of the LLC (“WSOC”), a company owned by a state agency with no shareholders’ meeting and an optional board of directors.

See, for example, Donald C. Clarke & Nicholas C. Howson, Pathway to Minority Shareholder Protection – Derivative Actions in the People’s Republic of China, in THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH 243, 245-9 (Daniel Puchniak, Harald Baum & Michael Ewing-Chow, eds., 2012) (hereinafter, Derivative Actions in the PRC) (which the following paragraphs draw upon).

It is critical to understand that this process did not implicate “privatization” of the economy or SOEs, or any real withdrawal of the state (or the Communist Party behind the state) from the same, because a controlling equity interest in the converted SOE went to or was maintained by state entities. To the present day, the party state remains absolutely committed to retaining control over converted enterprises in a very broad range of sectors – not just the usual suspects for state control (e.g., defense, natural resources, infrastructure, etc.) but also non-national security and non-key infrastructure sectors that are simply profitable to central or local state or party insiders when financed with the aid of (relatively) passive public investors. Moreover, while former administrative channels of control at SOEs may seem to have disappeared along with abolition of the SOE form, in fact they often continue to be effective just behind the scenes, completely subverting formal legal norms described in company law.66

While this design for “corporatization without privatization” coupled with maintenance of central or local state (and behind them, Communist Party) control has impacted both closely-held LLC firm establishments and widely-held CLSs, it has had a very pronounced effect on the ownership, control, legal and governance structures applicable to the PRC’s listed CLS issuers (whether listing inside China, or in the Hong Kong Special Administrative Region or abroad) and the disempowerment of those companies’ minority (public), widely-dispersed, shareholders. These patterns of control and equity ownership have very important implications for China’s corporate law and the corporate governance regime as applied:

First, the strong prevalence of concentrated ownership in Chinese companies (especially listed firms) means that the key agency problem for PRC corporate governance is not vertical (between management insiders and a large body of disaggregated shareholders) but horizontal (between controlling shareholders and minority shareholders).67

66 See Nicholas C. Howson, China’s Restructured Commercial Banks: Nomenklatura Accountability Serving Corporate Governance Reform?, in CHINA’S EMERGING FINANCIAL MARKETS: CHALLENGES AND GLOBAL IMPACT 123 (Martha Avery, Cai Jinqing & Zhu Min eds., 2009) (detailing how party committees operated behind, and over, boards of directors at the PRC’s largest international issuers).

67 The same problem operates across the Taiwan Straits, in the Republic of China/Taiwan, and continues to elicit similar substantive law and institutional changes. See Christopher J. Guinello, The Revision of Taiwan’s Company Law: The Struggle Toward a Shareholder-oriented Model in One Corner of East Asia, 28 DEL. J. CORP. L. 92 (2003).
Second, the controlling shareholder and its insider appointees are not run-of-the-mill control parties/insiders, but most often are an identity of state or party organizations, representatives of central or local government institutions, or party nomenklatura appointments, giving them a heady mix of political and economic power, especially against disaggregated, non-politically privileged, minority shareholders. This means among other things that any attack against alleged misfeasance by such control parties – however carried, and employing whatever institution -- will be difficult or at the very least politically sensitive.

Third, the combination of a strong horizontal agency problem, and the nature of who and what the control parties are, means that China’s public companies have been run as vehicles to attract passive investment capital from information-deprived public investors entirely in the interest of those largely unaccountable controlling shareholders. The same firms have therefore represented a ready invitation to opportunism, “tunneling”, minority shareholder abuse and oppression, and outright fraud by the controlling shareholders and their appointed insiders -- an invitation taken up with particular gusto at CLSs with a public float, subject to little monitoring by or accountability to a passive, politically disempowered and disaggregated shareholder interest and thoroughly compromised judicial enforcement institutions. A ready example of the problem which does not rise to fraud or criminality, much addressed in the CSRC overlay of corporate governance regulation addressed herein, is the virtual habit of state-owned controlling shareholders of PRC listed companies forcing those listed companies to give financial guarantees for the obligations of other controlled subsidiaries of the controlling shareholder. For the minority shareholders of the listed firm this amounts to the coercive imposition of unrelated risk on the shoulders of the listed firm (and usually a redirection of value away from the listed firm when the guaranty is called upon default of the affiliate debtor) for the benefit of the controlling shareholder, and exclusive of any benefit to the listed firm or its public shareholders. In Anglo-American corporate law jurisprudential terms, this is classic “self-dealing” by the controlling shareholder and/or “oppression” of the non-controlling shareholder investors. As can be readily understood, the controlling shareholders have the opportunity to implement these schemes both via opportunistic use of the corporate form twisted
by the lopsided capital structure common under “corporatization”, and because of their rather significant political and economic power in the PRC context.

Fourth and finally, this process of “corporatization without privatization” has led to a very fundamental dilemma in the design and implementation (or not) of Chinese corporate governance and the legal structure supporting it.\(^6^8\) The state continues to operate enterprises in China and exercise control in furtherance of its goals, which -- good or bad -- must be understood as distinct from the narrower shareholder wealth maximization goal of all other shareholders, i.e., the minority shareholders. (Admittedly, the goals of the state control party and the minority shareholders may converge from time to time, in particular with respect to short-term shareholder gains; however, there is nothing in the corporatization program, or law formal and applied, which requires that the state control party exercise its control in the service of wealth maximization for all shareholders.) Thus, the state through its controlling shareholders in corporatized entities very openly exploits the minority shareholders, who have no other way to benefit from their investment in the corporatized firm. As long as Chinese ideology and national industrial policy continue to have state shareholders controlling corporate entities where there are any other shareholders, real protections for such minority shareholders present either (i) a constraint on the state’s ability to operate in a way that is the very reason the state has maintained control, or (ii) if those constraints are not to operate on state-controlled firms, then the necessity for separate corporate law regimes applicable to state-controlled corporatized firms, on one hand, and all other firms, on the other hand. There is no immediate prospect of a formal, separate, legal regime, for state-controlled firms. Indeed, the 1994 PRC Company Law, the 2006 PRC Company Law, and the “modern enterprise system” and “corporatization” policies were all proclaimed as major steps in the opposite direction, elimination of any distinction between state firms and non-state controlled companies. Instead, the history of non-implementation of China’s company law, especially to protect minority shareholders in public capital markets-financed and corporatized issuers, indicates recognition -- and push back against -- the idea of any

\(^{68}\) See Donald C. Clarke, Corporate Governance in China: An Overview, 14 CHINA ECON. REV. 494, 494-5 (2003) (hereinafter, Corporate Governance in China); and Derivative Actions in the PRC, supra note __, at 246-7.
constraint on the state’s ability to operate investee firms in the way in which it desires, again the reason for which it maintained control in the first place.\textsuperscript{69}

c. Legislative Competence and Autonomy; the Judiciary; Access to the Courts

The concerns sketched out in the preceding paragraphs the wholesale reformation of the defective 1994 PRC Company Law into the form now effective as the 2006 PRC Company Law, which added substantive claims (\textit{e.g.}, duty of care, controlling shareholders’ fiduciary duties, piercing of the corporate veil, etc.) and procedural innovations (\textit{e.g.}, a derivative action, the ability of shareholders to call special shareholders’ meetings, etc.) all designed to create or make more effective legal remedies for minority shareholders against politically powerful firm insiders and controlling shareholders.

However, notwithstanding this constructive legislative policy and the real achievement that is the 2006 PRC Company Law, at least three other factors were at work which required – and continue to require -- sustained securities administrative agency involvement in corporate governance law/rule-making:

First, there have been and remain serious issues pertaining to the technical competence of PRC legislators at the National People’s Congress, especially with respect to more complex areas like corporate law. The 1994 Company Law, while rightfully hailed as China’s first post-Communist Revolution company law, is a monument to bad, confused, and plainly uncomprehending drafting (especially when compared to the specialist agency-drafted CRES “opinions on standards” on CLSs and LLCs which served as China’s corporate organizing statutes immediately prior to the promulgation and effectiveness of the 1994 law).\textsuperscript{70} Moreover, it is apparent that the same powerful forces indicated here in the term “controlling shareholders” have worked vigorously to protect themselves or make the company

\textsuperscript{69} See, for example, Corporate Law in the Shanghai Courts, \textit{supra} note __ 400-16, and Derivative Actions in the PRC, \textit{supra} note __, at 254-56, 267-69 & 275-78 (both noting the complete absence of widely-held or listed company governance-related shareholder company law-related suits (other than securities law claims alleging fraudulent or misleading disclosure pursuant to a very limited allowance made under pressure by the PRC Supreme People’s Court) in the Chinese courts, and the partially-related hostility of the People’s Courts to any cases involving a large number of parties, resulting in large parts of the PRC Company Law being unimplemented).

of China less protective of minority rights. Professor Xi Chao of the Chinese University of Hong Kong Law Faculty, for example, has shown how during the drafting of the 2006 PRC Company Law, pressure was brought to bear (successfully) by SOEs and the state body responsible for state ownership positions in corporatized SOEs to substantially weaken the statutory basis for veil-piercing.\(^{71}\)

Second, while the situation is better than some observers surmise, there must be continuing doubts about the competence, autonomy and political independence of PRC judicial institutions called upon to implement, \textit{ex post}, corporate law standards or remedies.\(^{72}\) Said another way, even if state-of-the-art substantive provisions and procedural mechanisms are introduced into PRC company law – as they assuredly were in November 2005 with promulgation of the final 2006 PRC Company Law -- there is a continuing concern as to whether the PRC People’s Courts will be competent and powerful enough to adjudicate, implement and enforce such law with respect to any kind of PRC corporation, LLC, CLS or WSOC, much less accept or be permitted to accept, disputes concerning the same. This is a long-standing concern for transitional jurisdictions like the PRC, and an aspect that has justified advocacy by developed world corporate law theorists in favor of the design and implementation of “self-enforcing” company law,\(^{73}\) and the search for other – non-legal – institutions in China specifically that might support the heavy burden of enforcement of corporate governance norms by the judiciary and the CSRC.\(^{74}\)

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\(^{71}\) See Xi, \textit{supra} note \_, at 423-27 (describing the role of SASAC in sabotaging the CSRC’s more aggressive statutory veil-piercing proposal originally set forth in the Company Law Amendment’s Consultation Draft due to SASAC concern that the expanded doctrine would be applied to unlisted companies as well).

\(^{72}\) There is a voluminous and growing literature recounting corporate law adjudication in the Chinese People’s Courts. \textit{See}, for example, Corporate Law in the Shanghai Courts, \textit{supra} note \_ (corporate law adjudication in the Shanghai Higher People’s Court system between 1992 and 2008); Wang Jun, \textit{Gongsi Jingyinzhe Zhongshi He Qinnian Yiwu Susong Yanjiu – Yi 14 Sheng, Zhixiashi De 137 Jian Panjueshu Wei Yangben} [Analysis of Litigation Regarding Company Management’s Duties of Loyalty and Care — Using 137 Judgment Opinions from 14 Provinces and Directly Administered Municipalities], 5:28 BEIFANG FAXUE [NORTHERN JURISPRUDENCE] 24 (2011) (corporate fiduciary litigation nationwide); Derivative Actions in the PRC, \textit{supra} note \_ (the corporate derivative action); and Hui Huang, \textit{Piercing the Corporate Veil in China: Where is it Now and Where is It Headed?}, 60 AM. J. COMP. L. 743 (2012) (piercing of the corporate veil).


\(^{74}\) See Donald C. Clarke, \textit{The Role of Non-legal Institutions in Chinese Corporate Governance}, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 168 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) (analyzing the role played by markets (including the stock markets), commercial banks, asset management companies (that purchased bad debt from China’s commercial banks), independent directors, the
I should note in passing that the PRC judicial bureaucracy – i.e., not courts issuing opinions on adjudicated cases -- has played some role in implanting substantive corporate law doctrine and procedural innovations into China’s corporate law and governance system. Before 2005, this was done via the creation by individual Higher Level People’s Court systems of “opinions” on issues presented in litigation concerning the woefully deficient 1994 PRC Company Law.\(^{75}\) In many cases, these “opinions” (some entirely internal and non-public) read like detailed, revised, company law statutes, and are the primary source of critical corporate law claims and procedural architectures such as the derivative action, a shareholder oppression claim, piercing of the corporate veil, invalidation of directors’ or shareholders’ resolutions, settlement restrictions, etc. (none of which had a legal basis in the then-effective 1994 PRC Company Law).\(^{76}\) Importantly, none of these local court system opinions attempted to institute self-enforcing governance mechanisms like supermajority negative veto rights, etc. in the style the CSRC has for public companies. After the effectiveness of the 2006 PRC Company Law, the Supreme People’s Court has released three judicial “regulations” concerning the company statute, and has embarked on a “guiding cases” project, none of which, however, remake corporate governance norms in the same fashion as the CSRC regulation described here.\(^{77}\)

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\(^{75}\) See, for example, such detailed opinions issued by the: Jiangsu Province Higher People’s Court, Guanyu Shenli Shiyong Gongsifa Anjian Ruogan Wenti De Yijian (Shixing) [Opinions on Several Issues on Adjudicating Cases Applying Company Law (Trial Implementation)] (June 2003), in GONGSIFA YINAN WENTI JIEXI (DI SAN BAN) [COMPANY LAW ISSUES: PROBLEMS AND ANALYSIS (3rd EDITION)] 240-48 (Shanghai Higher People’s Court ed., 2006); the Shanghai Higher People’s Court (No. 2 Civil Division), Guanyu Shenli Sheji Gongsu Susong Anjian Ruogan Wenti De Chuli Yijian (Yi) [Opinions on Adjudicating Cases Regarding Corporate Litigation (One)] (2003), id. at 231-36; and the Beijing Higher People’s Court, Guanyu Shenli Gongsu Jijufan Anjian Ruogan Wenti De Zhidao Yijian (Shixing) [Guiding Opinion on Several Issues on Adjudicating Corporate Dispute Cases (Trial Implementation)] (Feb. 2004), id. at 236-40.

\(^{76}\) A group of PRC legal academics tried to hijack this process, but from the apex of the national judicial bureaucracy or the Supreme People’s Court, with the drafting and submission for approval of the 2003 Omnibus Company Law Regulation, supra note __, which attempted to rewrite the 1994 Company Law in its entirety. That effort was pre-empted by the passage of the 2006 PRC Company Law, which tracked many of the wholesale changes attempted through the Omnibus Company Law Regulation (e.g., derivative actions, corporate fiduciary duties (and specifically a duty of care, etc.)).

\(^{77}\) See ZUIGAO RENMIN FAYUAN GUANYÜ GONGSIFA SIFAJIESHI (YI), (ER) LIJIE YÜ SHIYONG [SUPREME PEOPLE’S COURT ON USE AND UNDERSTANDING OF COMPANY LAW JUDICIAL INTERPRETATIONS ONE AND TWO], 3, 7-11 (Xi Xiaoming ed., 2006) for the first and second Judicial Regulations on the Company Law (concerning how the People’s Courts should handle actions which straddle Jan. 1, 2006, and on shareholder petitions for judicial dissolution, respectively). The third Judicial
Third, is one result of the basic dilemma in China’s corporate governance project described above, the almost complete non-implementation of China’s company law for minority shareholders in public capital markets-financed corporatized issuers, arising from the system’s denial of any constraint on the state’s ability to operate public-invested investee firms in the way in which it desires, the reason for which it maintained control in the first place.78

d. The CSRC – The Indispensable Corporate Governance Institution

Each of the above-described factors:

• the political economy of China’s corporate landscape and the (likely intended) consequences of its “corporatization without privatization” policy;
• the political and economic power of China’s controlling shareholders and their appointed insiders;
• incomplete or deficient legislative drafting, or a legislative process manipulated to protect the power and discretion of large, state-tied, controlling shareholders;
• concerns about the role the Chinese judiciary can play in outlining and enforcing effective corporate governance norms; and
• non-implementation/enforcement of the corporate law to protect minority shareholders in the face of clearly understood exploitation by state controlling shareholders,

have worked together to leave the CSRC as one of the only state institutions in China capable of: (i) expert drafting of substantive provisions, in particular of the self-enforcing type; (ii) resistance against controlling state shareholders (and the political-economic systems backing them); (iii) substituting for an

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78 See supra notes __ and text.
inexpert, overly bureaucratic, or politically-cowed judiciary; and (iv) seeing to the institution of corporate governance norms to protect minority shareholders against exploitation by state control shareholders, at least with respect to PRC companies explicitly under the CSRC’s jurisdiction: firms issuing publicly-traded securities. Using its jurisdiction over the operation and governance of securities-issuers with listed stock, and faithful to its mission to protect at least the appearance of a level-ish playing field for China’s capital markets (to continue to attract the participation of private capital), the CSRC has been the primary, and best, workshop for expert substantive corporate governance provisions designed to resist incumbent state control parties, and in ways that avoid the risks of non-enforcement by an overmatched judiciary.

As I have noted above, the CSRC and other bureaucracies have instituted corporate governance norms along two distinct pathways -- (i) the filling-in of substantive corporate law doctrines which must still be enforced by a state actor (e.g., the judiciary or a regulator), and (ii) the establishment of “self-enforcing” mechanisms which can be effective (e.g., at the general shareholders’ meeting) without immediate recourse to enforcement by any external institution. I should emphasize, then, that the sub-strain of CSRC action described herein which pertains to the filling-in of major doctrinal aspects of China’s substantive corporate law is not responsive to the major justifications for CSRC involvement listed above. For example, if a public authority like the CSRC is concerned about the political and economic power of controlling shareholders, or has doubts about the competence, autonomy and independence of the Chinese judiciary, the implantation of substantive corporate fiduciary duties (or controlling shareholders’ fiduciary duties) into China’s company law alone is not responsive to the problem (as effective articulation and enforcement of these norms will be deferred or frustrated by the resisting forces apparently animating the reform in the first place). Clearly, the CSRC as an expert agency has pursued these doctrinal initiatives to fill unconscionable voids in China’s developing corporate law and communicate something about the governance at, and monitoring of, PRC-domiciled firms issuing stock both domestically and internationally (e.g., the absorption of the entire body of Hong Kong (and English) fiduciary duties law in 1993 in conjunction with China’s first listings “overseas” in
Conversely, those CSRC initiatives which are “self-enforcing” are directly responsive to the full menu of issues/forces listed above, with much greater promise of effectiveness. For instance, the negative veto rights created for approval of related party “external” guarantees constitute a very effective response to the identified abuse, especially when compared to reliance on the doctrinal fill-in, a vague and unevenly-applied duty of loyalty standard applied ex post. Of course, academic analysts will question the viability of a “self-enforcing” design for China’s corporate law, given the spectacular demise of a highly-touted and U.S. legal academic-directed Russian experiment and broad recognition that even (initially) self-enforcing norms may have to be enforced (subsequently) by the state when firm participants do not comply with the allegedly self-enforcing rules. In response, I can only invoke my decades-long experience as a corporate law practitioner in the PRC to assert that self-enforcing mechanisms – like negative vetoes or super-majority approval rights – do work in China presently, and are extremely effective at constraining autocratic and politically-endowed controlling shareholders regardless of how they seek to implement that control, through the board of directors or the general shareholders’ meeting. Moreover, to the extent such mechanisms do function, that compliance is not reported and thus cannot be observed or quantified; only brazen non-compliance by firm participants will become apparent (via litigation or the financial press), and there is very little of that in evidence – all of which tends to confirm my own personal observations of how well self-enforcing norms function in China.

IV. Enabling to Mandatory – the State qua Regulator Battles the State qua Shareholder

a. The U.S.-Origin Quack Corporate Governance Critiques and the PRC

This article begins with a précis listing of the several critiques launched against SOX and Dodd-Frank-imposed “quack corporate governance”. Many of those attacks do not apply directly to the equivalent regulatory phenomenon seen in the PRC and detailed here, given China’s unitary national government and national corporate law (e.g., the U.S.-specific “state jurisdiction” and “legal systems

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79 See supra note __ and text.
market/laboratories of federalism” critiques – there is in fact no market for corporate law in the PRC.81 Others of the attacks do not track well onto the PRC’s still developing institutional structures (e.g., the “bad, panicked, uninformed, badly-informed and inexpert legislative process” or “opportunistic packaging of spurious preventatives” critiques – CSRC reforms are a remedy to a dysfunctional, inexpert, and often manipulated legislative process, and there is no harm in an institution like the expert CSRC acting strategically to implement critically-needed corporate governance protections when the national legislature cannot, or will not, or does not have the required technical competence).

However, there are other aspects of the U.S.-origin complaint against a securities regulation incursion into the corporate law domain which do sound in the PRC circumstance. Certain of these PRC-relevant U.S.-style critiques can be answered by pointing to the Chinese political economy in which PRC firms operate. For instance, unfettered “director primacy” in China may not be a “good”, but instead an evil that must be restrained at corporatized SOEs now 70% owned by state-owned controlling shareholders which appoint a majority of directors on a given board and the judicially-applied fiduciary duty constraint is weak. The same might be said for the “choice of regulatory approach cost” and “empirical studies demonstrates ineffectiveness” critiques, as there may be reason to think that a public-spirited regulator like the CSRC should be in the business of erecting additional costs in the face of overly powerful state-tied controlling shareholders and their insiders. (There is a longer rebuttal to the latter of these critiques, which goes to how one measures “effectiveness” in analyzing corporate governance reforms -- said another way, whether such effectiveness should be entirely based on measured firm value (or market cap) or profitability, or decision-making efficiency, as contrasted with enhanced protection of, and accountability to, minority owners by the erection of obstacles like super-majority voting rights,

81 As Jennifer Hill sensibly points out, the Romano/Bainbridge “legal systems market/laboratories of federalism” theory may not apply even in avowedly federal nations with state-level corporate law. See Jennifer Hill, Regulatory Show and Tell: Lessons from International Statutory Regimes, 33 DEL. J. CORP. L. 819, 820 (2008) (“Although Australia technically has a state-based system of corporate law, the Corporations Act 2001 effectively operates as a “federal” rule as a result of reference by each state of its powers relating to corporations to the federal government. This broad referral of powers by the states to the federal government constituted an attempt to unify and harmonize corporate law rules in Australia.... Thus, whereas state competition has been viewed as an essential contributor to efficiency in the U.S. corporate law, in the Australian context, it was considered an obstacle to efficiency.”)
negative vetoes, etc.) Similarly, the “cost of new compliance/cost compliance”, “unattractive to
domestic and foreign) securities issuers”, and “transnational effect” critiques may all be inappropriate for
the PRC circumstance, as the corporate governance provisions analyzed in this article may serve to
increase investor confidence (PRC and foreign) regarding China and make PRC issuers only more
attractive to the providers of capital investment through the capital markets.

b. “Distinct Legal Systems” and Corporate Law with Chinese Characteristics

Perhaps most interesting, and revealing of the nature of both corporate law and governed firms in
contemporary China, is the critique I assert above U.S. law academics pay too little attention to\textsuperscript{82} -- what I
call the “distinct legal systems” critique (coupled with the expressed fear of a unidirectional “ratchet”
effect). In the Anglo-American world, corporate law has changed significantly over more than 150 years.
Corporate law commenced with special legislative chartering of state-promoted, partially or wholly
privately-financed, firms engaging in quasi-public activities under mandatory and often immutable rules
(e.g., regional monopoly trading companies, and railway and canal-building firms, etc.). Today, we
observe general corporation codes which are enabling in orientation, providing something like a standard
form contract structured around default provisions, with very few mandatory or immutable rules working
on firm participants’ internal rights and obligations or the firm’s external activities. Indeed, corporate law
is now determined by a mixed application of some default provisions left unchanged by the participants,
specific arrangements crafted by \textit{ex ante} contracting-out of other default rules, and extremely broad
common law doctrines interpreted and enforced \textit{ex post} by a usually circumspect (and business judgment
rule-constrained) judiciary as prodded by private shareholder plaintiffs (and in the U.S. their attorneys
working with the benefit of contingency fee arrangements and liberal cost-sharing/class action rules).
Basic theories of the corporation have developed in parallel, from the 18\textsuperscript{th} and 19\textsuperscript{th} century idea that firms

\textsuperscript{82} Roberta Romano implies the distinction I draw here -- but goes no further -- when offering a way
to rescind the mandates she calls “quack corporate governance”, by suggesting (in her more moderate remedy) that
the mandatory be transformed into the default: “The easiest mechanism for operationalizing such a policy change
[rescinding the offending SOX mandates] would be to make the SOX mandates optional, \textit{i.e.}, statutory default rules
that firms could choose whether to adopt… Were the SOX corporate governance mandates to be treated as defaults,
corporations would be able to opt out by shareholder vote. \textit{See} Romano, \textit{supra} note __, at 1594-5.
were a creation of the state, to the 20th century “contractarian” conception of the company as a creation of private contract.

From this standpoint, securities law and regulation is substantially different from modern corporate law. Securities law is almost wholly built on immutable and mandatory rules (e.g., disclosure) or prohibitions (e.g., against insider trading or securities trading manipulation), with an expert administering agency and the courts left to interpret and enforce the meaning or reach of those rules/prohibitions alongside private shareholder plaintiffs. Indeed, securities law rarely functions to “enable”, and defers very little to private arrangements or any notion of ex ante contracting out of its strong norms, precisely because to be effective it must be mandatory and immutable.

For many analysts, it is the enabling, standard form contract and default rule-providing – and non-mandatory – character of corporate law that both defines and recommends it. Indeed, I believe that one thing animating the “quack corporate governance” critique in the U.S. (and aside from the ideological “legal systems market/laboratories of federalism” critique) is related to this: The notion that a corporate establishment and governance system predicated on private contracting in the embrace of well-understood and mostly majoritarian default rules must be protected at all costs, and against the imposition of mandatory rules which constrain the space for private agreement or alter the mutability of state-offered default prods. Why this keen concern about mandatory provisions? In my view, it arises from a bedrock confidence in developed economies that capital accumulates (i.e., it is invested by private parties), and will be efficiently allocated to useful projects, through an infinite variety of complex and often shifting arrangements regarding entity governance and investor rights (with respect to both firm governance and investor value recognition), which arrangements are in turn determined by different levels of information-availability, the value (both cash and know-how) brought to the table by specific investors, and innumerable other factors. Said another way, there is a strong belief that any attempt to significantly pattern or constrain those arrangements (and beyond what the public interest or basic accountability absolutely requires) will impede realization of the best, privately-negotiated, arrangements, and thus
fatally dampen capital formation.\footnote{See Frank H. Easterbrook, The Race for the Bottom in Corporate Governance, 95 VA. L. REV. 685, 688 (2009) ("Corporate law came to be enabling rather than directory in the United States because that serves investors’ interests, not because it serves managers’ interest. States that adopt inefficient regulation propel capital out of their jurisdictions.")} (Whether or not this is true as a general matter for all investors, which I doubt, it has to be true for the most powerful and sophisticated venture investors, who have the knowledge and bargaining leverage to ask for and achieve specific, self-interested, investment and governance terms.) An offshoot of this line of thinking, and especially strong in the U.S. with its libertarian tradition, is the quasi-ideological concern which recoils at the thought of too much intervention by the state or any other external player into the “self-ordered” or “private” realm.

None of the above is meant to deny that – even in developed world economies -- there are areas where these two distinct legal systems must converge on the same object of affection: the large, widely-held, corporation with listed shares.\footnote{Indeed, there are major Anglo-American tradition jurisdictions which have abandoned any real distinction between corporate law and securities law norm vehicles, such as Australia, where both corporations law and securities law are embodied in the same piece of legislation, some items of corporate law are mandatory and some items of securities law are at least permissive (but not enabling), such as the Australian Securities Exchange (ASX) corporate governance-related “comply or explain” rules, which also feature in the Dodd-Frank statute, supra note __. Professor Hill explores some of this, and in particular how much more protection institutional shareholders in News Corp. enjoyed under mandatory Australian corporate/securities law (in the Australian Corporations Act) and the ASX Listing Rules (regarding norms delivered by the Listing Rules, and relating to super-voting shares, shareholders’ meetings and voting, takeovers, and best practices principles) than under enabling Delaware corporate law, U.S. securities law and New York Stock Exchange (NYSE) regulation before News Corp.’s shift of domicile to Delaware and its primary listing to the NYSE in her contra-convergence study: Jennifer G. Hill, Subverting Shareholders’ Rights: Lessons from News Corp’s Migration to Delaware, 63 VAND. L. REV. 1 (2010).} This limited convergence occurs because shareholders (and potential shareholders) of large public firms experience the most extreme kind of information asymmetry, and thus mandatory disclosure (and some mandatory process) is imposed via securities regulation to redress a pernicious imbalance, force standardized information disclosure which might not occur if disclosure was voluntary,\footnote{There is, of course, a very rich (and long-standing) debate about whether mandatory, standardized, disclosure is desirable or necessary given the incentives which might support purely voluntary disclosure by issuers. See, for example, Frank Easterbrook & Daniel Fischel, Mandatory Disclosure and the Protection of Investors, 70 VA. L. REV. 669 (1984) and Meritt B. Fox, Retaining Mandatory Securities Disclosure: Why Issuer Choice is Not Investor Empowerment, 85 VA. L. REV. 1335 (1999). I do not engage with that interesting debate here, other than to note that the normative cases with respect to mandatory or voluntary disclosure in the PRC capital markets have to take account of China’s specific institutional context and political economy, which are radically different form the landscape over which these interesting battles have been fought for so many years.} and not incidentally maintain the attractiveness of public capital markets which are in turn critical to capital formation. Examples of this quite appropriate incursion of securities
regulation-origin mandatory rules into the normally more contractually-determined corporate law realm can be seen with respect to the shareholder voting process (proxy solicitations and the real shareholders’ meeting), existential decision-making by shareholders (tender offers), and breach of fiduciary duties by insider trading where a deep market and anonymous trading in that market give rise to an information asymmetry that is complete and otherwise without remedy (insider trading).

So, how does the contemporary Chinese accommodation highlighted in this article fit into this discourse about two legal systems: contractarian-friendly/enabling corporate law vs. mandatory securities law (which I emphasize is distinct from the overarching U.S.-specific preoccupation between state corporate law and federal securities law)? For many of the reasons highlighted here, in 1993-4 the Chinese Communist Party-led government began its experiment with company law-making decidedly in the “mandatory” and not the “enabling” mode. Indeed, that orientation was but a continuation of China’s earliest, from the late Qing to 1949, identities of corporate law specifically, and law generally. All of that in turn is consistent with the Chinese state’s (and before that, the imperial Chinese court’s) desire to control or monitor very closely potentially independent capital accumulation and business activity, and benefit from it. Only with the passage of the 2006 PRC Company Law did China move – formally at least – away from a business regulation philosophy and in a new direction: towards an enabling statute which allows for increasing private contracting-out of default rules ex ante alongside

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86 See Corporate Governance in China, supra note __, at 496, 500 (“…and the [1994] Company Law is thus clearly more concerned with regulating and suppressing than with fostering and nurturing.”… “The policy choice in the current [1994] Company Law is clear; the rules are almost uniformly mandatory.”)


88 See Liang Zhiping, Explicating “Law”: A Comparative Perspective of Chinese and Western legal Culture, 3 COLUM. J. CHINESE L. 55, 61, 89 (1989) (“Prohibitions and commands emphasize the function of law; punishment, however, is primarily the means by which realization of this function is guaranteed.”… “Law was never perceived as a means of preserving rights, freedom, justice, since these were completely alien concepts in ancient China. Law was punishment…. According to traditional ideas, law was above all a tool of suppression. It was also one of countless methods of governing, which could be used and constituted at will by the ruler.”).

89 See Kirby, supra note __, at 44 (“The history of this first modern Chinese law [company law] is to some degree a barometer of the state’s assumptions towards the economy over the course of the twentieth century…. [T]he Chinese state would be the prime beneficiary of the adoption of the corporate form of business activity. But the first assumption of the [early twentieth century] Qing reformers, that the modern corporation on a Western model would be the essential vehicle for private Chinese economic development, would prove quite mistaken.”); and Madeleine Zelin, The Firm in Early Modern China, 71 J. ECON. BEHAVIOR & ORG. 623 (2009).
continuing self-enforcing mechanisms, and which creates very significant work for the judiciary applying standards (like fiduciary duties) *ex post*. In fact, this development in the direction of a formally “enabling” corporate law system and away from a directive, business regulation, orientation, has been celebrated widely in the PRC among academics and People’s Court officials alike. For example, a 2007 commentary on a 2003 case (where the Shanghai No. 1 Intermediate People’s Court had to choose between statutory rights of first refusal due to existing shareholders and the rights of a good faith purchaser under a fraudulently-approved securities purchase contract) by the Shanghai Higher People’s Court appears to channel Frank Easterbrook directly:

First and foremost, the thing we must clarify is this: the jurisprudential logic underlying the giving of priority to the [right of first refusal] over the purchase rights of the transferee is absolutely not because the former right is in statute and the latter is merely a contractual right. This is because statutory rights are not always superior to contractual rights – in fact, it is just the opposite. Approaching it systematically and adhering to the orientation which protects private ordering, regulation of the market requires that application of the law fully respect the freedom to contract to encourage successful transactions…. There is significant meaning in this.  

(At the same time, the close proximity in time of China’s corporate governance system to a strong business regulation-orientation makes the distance between the CSRC mandatory norms described here and increasingly-enabling corporate law much less, certainly as compared with the same leap that the SEC or U.S. Exchanges attempt to perform -- not just across the borders of law, but also federal and state jurisdictional lines.)

But herein lies the rub: as China’s corporate law has moved in one direction, the mandatory norms imposed by the CSRC and other agencies described in this article have pushed the applied law of corporate governance in precisely the opposite direction. The reasons for this administrative agency

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90 Commentary regarding the case reported as “A Investment Company v. Wang and Other Shareholders”, (Shanghai No. 1 Intermediate People’s Court, on appeal 2003), in 2005 NIAN SHANGHAI FAYUAN ANLI JINGXUAN [2005 SELECTION OF SHANGHAI COURT CASES] 106-109 (Shanghai Higher People’s Court, ed. 2007); with the quoted portion of the commentary at id. at 111 (emphasis added).

91 Interestingly, my own research has shown how the Chinese People’s Courts – contrary to some expectations and certainly the doctrinal rhetoric quoted from the A. Investment Company v. Wang case commentary above -- have mimicked this trajectory, adjudicating some enabling provisions of the 1994 and 2006
counter-strike (and incursion into a notionally separate domain of law and regulation) are clear and once again reveal in stark terms the very real political economy of China and its corporatized SOEs. For, describing modern PRC company law as “enabling” appropriately conjures another use of that term, something like the “enabling” of a drug addict or mafia chief acting in furtherance of a recognized public or social evil. Given lopsided capital structures and the dominant horizontal agency concern described above, the unconstrained power of state controlling shareholders (and their appointed insiders), a radical information asymmetry between such controlling shareholders and public (both retail and even institutional) capital providers, an “enabling” company law design in China is in fact a wide invitation for dominant shareholders to oppress and disadvantage far weaker actors in the firm, especially where minority shareholders have very little power to bargain for effective protections or obtain any price discount to reflect their disadvantaged position. Therefore, mandatory provisions designed to protect, even minimally, the basic rights of minority capital providers are, in a word, mandatory.

A decade ago one of the best observers of corporate governance developments in China, Don Clarke, was not sanguine about the role the CSRC might play in supporting better and more effective corporate governance in China. His concerns then quite properly focused on resource constraints at the CSRC (already fully occupied with market regulatory tasks, merit regulation for issuers, and patrolling disclosure into the capital markets), and its basic legal authority to intervene in the corporate law sphere:

The prime candidate here [as an institution able to play a role in corporate governance reform] would seem to be the CSRC; however, it is hampered by significant disabilities. First, its staff is small relative to the scale of its tasks…. The CSRC… must enforce merit requirements that attempt to ensure the investment quality of the business as well as disclosure requirements. Moreover, its very authority to make and enforce rules regarding corporate governance has been challenged as insufficiently grounded in legislation. So far the challenge has been only academic, but at some point a suitably motivated court might agree.92

Professor Clarke then went on to question the viability of the CSRC advocating for substantive corporate law doctrine, like fiduciary duties, or participating in a meaningful way in their enforcement:

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92 Corporate Governance in China, supra note __, at 504.
It is very unlikely that the CSRC, which does not even have the status of a regular government administrative agency, can by itself create a private right of action for shareholders against directors. It has engaged in a limited number of disciplinary actions against directors, but any norm that relies solely on administrative enforcement is going to be of limited value, given the CSRC’s resource constraints.\footnote{\textit{Id.}}

The answer to those concerns lie in what Professor Clarke uncharacteristically failed to imagine a decade ago: (i) for the CSRC, virtually costless (or non-resource depleting) corporate governance reform mechanisms: \textit{i.e.}, self-enforcing norms (\textit{e.g.}, class supermajority voting rights and supermajority of the non-controlling shareholder group votes, etc.) and structural reforms which enhance firm monitoring but implicate only firm-level costs (\textit{e.g.}, independent directors); (ii) a revised 2006 Company Law which now fully incorporates a good number of the substantive legal doctrines and procedural mechanisms/private rights of action the CSRC has tried to sell into the body of China’s corporate law (\textit{e.g.}, fiduciary duties for orthodox corporate fiduciaries and even controlling shareholders, the derivative action, etc.), and (iii) a constantly-developing judiciary which is increasingly effective in enforcing these key legal doctrines and/or exclusively-CSRC origin corporate governance norms.

c. Regulatory Expansion of Private Autonomy in the Statist Political Economy

Outside of Professor Clarke’s well-informed but ultimately unrealized worries about the real effectiveness of CSRC-led and instituted regulatory reform of Chinese corporate governance, other observers – especially those in the West -- may have a separate, more philosophical, concern with the practices revealed here, that being alarm at profound “state” incursion into a realm of “private” “freedom”. As noted above, I believe this largely philosophical concern fans some of the more strident “quack corporate governance” attack in the U.S. Surely that concern, directed at governance structures in a liberal democracy like the U.S., has only greater purchase when focused on a largely authoritarian political system like the PRC.

For China, however, as we fill in the specific PRC context, we are called upon to reappraise what may be called the “spheres of freedom” concern, and understand that our worries may be completely backwards. Indeed, an understanding of the CSRC’s impact on China’s corporate governance regime
since the 1990s should cause those most exercised about state incursion on spheres of autonomy to celebrate the injection of mandatory norms into China’s increasingly contractarian company law regime. Writing more than a decade ago, Professors Bill Alford and Shen Yuanyuan described a still common vision about “law” and its power in the PRC’s reform era:

> Law… [is] increasingly seen in both academic and policy circles as critical to the attainment for Chinese of fuller economic, political and social freedoms. In part, the prominence accorded to law is attributable to its perceived potential, however imperfectly realized to date in the PRC, to facilitate the above described transfer of power from state to society by limiting the spheres of life over which the former has authority and providing constraints as to the manner in which such authority is to be exercised. No less importantly, law is extolled for the vital role it has to play, once the state has receded, in establishing the proverbial “level playing field” on which a new society is to be grounded. In contrast to the avowedly political and highly particularistic manner in which the Chinese state historically reached into citizen’s lives, law is commended for being facilitative, rather than determinative, providing a neutral framework through which citizens, each endowed with the same rights and each entitled to invoke the uniform procedural protection that formal adjudication is intended to provide, may work things out for themselves….

But Alford and Shen then very wisely cautioned against an automatic or total embrace of “law” as an instrument for the protection of private freedoms:

> Compelling though the rationales for a drastically circumscribed role for the Chinese state may be, they do not provide us with a sufficiently nuanced metric for thinking about freedom in the PRC. Without slighting the values to which this vision speaks, we need soberly to confront difficult questions regarding… the ways in which even the most seemingly neutral rules intended to do no more than structure autonomous decision-making, may shape outcomes and have an impact on freedom.  

Professors Alford and Shen were writing about the Marriage Law, but we may apply their nuanced and skeptical view to the development of corporate law in China. If we recognize a distinction between the state as an over-bearing economic actor spawning a parade of controlling shareholders, on one hand, and the state as a (potentially) publicly-interested regulator, on the other, we may perceive a new vision of the CSRC’s serial mandatory-type regulatory incursions into the province of mostly-enabling legal corporate governance. For, in the PRC’s “corporatization” program we are confronted

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94 William P. Alford & Shen Yuanyuan, Have You Eaten? Have You Divorced? Debating the Meaning of Freedom in Marriage in China, in REALMS OF FREEDOM IN MODERN CHINA __ (William C. Kirby ed., 2004) (and, later, “We would do well,… to be mindful of the perhaps singular capacity of the state to curb private abuses of power and structure an environment in which freedom might be widely enjoyed.” Id. at __).
with a notional and mostly rhetorical retreat “under law” (the enabling Company Law specifically) of the state, a “retreat” which in fact cloaks the reassertion or maintenance of concentrated power (the state metamorphosed into a politically privileged controlling shareholder), in a situation where the control parties make sure formally-conferred “legal” protections for the exploited minority are not utilized (e.g., the absence of listed company corporate governance cases in the Chinese courts, and blocks against multi-party actions of any kind). The only effective remedy for this deprivation of even limited autonomy and basic fairness embodied in the structurally-determined exploitation of minority shareholders, and the inability of the system to apply and enforce whatever “legal” protections are on offer, is state intervention of another sort: the injection by a state institution into enabling corporate law of immutable substantive doctrines and mandatory corporate governance mechanisms designed to protect those who will suffer such deprivations, and constrain the awesome powers vested in the continuing control parties. That is precisely the path pursued by the CSRC (and certain other bureaucratic actors) over the last several decades, while at the same time effecting a thoroughgoing and perhaps aesthetically displeasing cannibalization of China’s corporate law – a kind of legal systems “hostile takeover” which I suggest here is both absolutely necessary and almost completely benign.

d. Conclusion

In sum, while at first blush the CSRC program described in this writing seemingly offends against the bedrock principles of the highly articulate anti-“quack corporate governance”-constituency, settled ideas of what enabling corporate law should be in modern capitalist economies, and equally strong concerns for always-endangered realms of private “freedom” or autonomy, on reflection it accomplishes something far more positive. It provides effective mechanisms for the protection against exploitation of minority shareholders (which, as demonstrated above, is the necessary consequence of China’s “corporatization without privatization” program), and thereby makes financing easier for those seeking to raise capital (whether repackaged SOE or truly “private” entrepreneurial firm), investment more attractive for those interested in contributing capital, and the allocation of capital more efficient overall – precisely
the same policy goals invoked when advocating the merits of enabling corporate law and autonomous private action under it.

Certainly, the applied remedy described herein – mandatory provisions injected via administrative agency fiat into an enabling corporate law regime to confer greater power on minority investors and thus spur investor participation in the capital markets – seems freighted with irony or contradiction. Yet, as I hope to have demonstrated here, it is a very good response to the circumstances presented by China’s unique political economy, and the particular evils arising from the “corporatization without privatization” of Chinese SOEs, with retention of absolute power by party-state forces metamorphosed -- by operation of “law” no less -- into controlling shareholders of the new, dominated, corporation.

Some will complain that the remedy applies to a very small subset of all firm establishments in the PRC – approximately 2,500 listed companies and 100 securities firms in a country with more than 550,000 LLCs and 100,000 CLSs. This concern is well-founded in 2013, but fails to take account of two ongoing developments: First is the CSRC’s initial move, effective January 1, 2013, asserting regulatory jurisdiction over unlisted but deemed “public companies” (CLSs with more than 200 shareholders, or which have issued shares “to the general public” (shehui gongzhong) and “in a public manner” (yi gongkai fangshi)). If successful, this extension of CSRC regulatory authority will result in a large portion of the approximately 100,000 CLSs in China being subject to the corporate governance

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95 These approximate numbers were provided to the author by corporate and securities law specialist Professor Tang Xin of the Tsinghua University Law School in April 2013.
96 See CSRC, Feishangshi Gongzhong Gongsi Jiandu Guanli Banfa [Supervisory and Administration Measures for Non-listed Public Companies], Sept. 28, 2012, zhongguo zhengquan jiandu guanli weiyuanhui ling 85 [2012], effective Jan. 1, 2013, available at http://www.csrc.gov.cn/pub/zjhpUBLIC/G00306201/201210/t20121011_215689.htm, at arts. 2(1) and 2(2). These Measures certainly foresee substantial intrusion into the corporate governance system applicable to such unlisted “public companies”, for instance with respect to mandatory articles of association for such firms (chapt. II (“Corporate Governance”), art. 6: “The CSRC shall, in accordance with law, make specific stipulations regarding the mandatory provisions [“bibei tiaokuan”], the same linguistic formulation used for the Mandatory Articles of Association for Overseas Listing Companies, supra note __, and stronger than the term used for the Guidance Articles of Association for Listed Companies, supra note __ (“zhiiyun”, or “guidance]) of the articles of association for public companies and regulate the development and amendment of the articles of association of public companies”). Of course, a question remains as to how the CSRC will enforce the adoption of these mandatory corporate constitutions, or indeed any provision of the Measures for Non-listed Public Companies or subsequent regulation based in the Measures, without the threat of a withheld listing or de-listing available to it with respect to listed CLSs.
norms described here. Second is the process revealed in this writing: the way in which CSRC regulation applicable in the first instance to only listed companies and securities firms eventually finds its way into China’s basic corporate law applicable to all business enterprises domiciled in China (other than WSOCs). While the latter process provides no immediate or irrevocable assurances to the most impatient reformers, it does augur well for a better and more effective legal corporate governance system in the not too distant future.
Appendix – Selected PRC Regulatory Enactments Affecting Corporate Governance


CSRC, Guidance for Board Secretary Work at Companies Listing Overseas [Jingwai Shangshi Gongsir Dongshihui Mishu Gongzu Zhiyin], April 8, 1999, zhengjianfexingzi [1999] 39


CSRC, Measures for the Administration of Acquisitions of Listed Companies [Shangshi Gongsir Shougou Guanli Banfa], Dec. 1, 2002, zhengjianhuiling No. 10


CSRC, *Guidance Articles of Association for Listed Companies* [Shangshi Gongsi Zhangcheng Zhiyin], Mar. 16, 2006, zhengjiangongsizi [2006] 38


CSRC, *Measures for the Administration of Listed Company Major Assets Reorganization* [Shangshi Gongsi Zhongda Zichan Chongzu Guanli Banfa], April 16, 2008, zhengjianhuiling No. 53


CSRC, Decision Regarding Amendment of Several Regulations on Listed Company Cash Dividends [Guanyu Xiugai Shangshi Gongsi Xianjin Fenhong Ruogan Guiding De Jueding], Oct. 9, 2008, zhengjianhuiling No. 57