Chambers AND PARTNERS

CHAMBERS GLOBAL PRACTICE GUIDES

Corporate Governance 2025

Definitive global law guides offering comparative analysis from top-ranked lawyers

China: Law and Practice
Kevin Wang
Global Law Office

CHINA

Law and Practice

Contributed by:
Kevin Wang
Global Law Office

Contents

Global Law Office (GLO) was one of the first leading law firms in the PRC to take an international perspective on its business, fully embracing the outside world. With more than 600 lawyers practising in the Beijing, Shanghai, Shenzhen and Chengdu offices, the firm continues to set the pace as one of the most innovative and progressive legal practices in China. Over the last 40 years, GLO has helped set the agenda for change through precedents, including working on the first foreign general offer targeting Chinese companies on the Hong Kong Stock Exchange, the first state-owned red chip company listed in Hong Kong acquiring the controlling interest in an A-share company listed in China by means of a reverse takeover, and the first reverse merger case in which a red chip Hong Kong-listed public company span off part of its China business to list on a share market.

Author

Kevin Wang is a partner of Global Law Office, Shanghai. He has a PhD in Criminal Justice and specialises in AML and economic sanctions, white-collar crime defence, corporate governance and securities litigation. Kevin served as a compliance and risk manager for a Chinese securities firm and then as a senior financial crime compliance officer for a top Wall Street investment firm before joining Global Law Office. Possessing deep knowledge of the China local market, and with industry experience in the financial sector, his expertise in corporate liabilities defence, compliance tutoring, and response to regulatory inquiries and inspections helps multinational companies in handling complex investigation and litigation matters.

Global Law Office

35 & 36th Floor, Shanghai One ICC
No 999 Middle Huai Hai Road
Xuhui District Shanghai
200031
China

Tel: +86 212 310 8288
Fax: +86 212 310 8299
Email: global@glo.com.cn
Web: www.glo.com.cn/en

环球律师事务所
GLOBAL LAW OFFICE

1. Introductory

1.1 Forms of Corporate/Business Organisations

There are three principal forms of corporate/business organisation in China:

- companies;
- partnership enterprises; and
- individual proprietorship enterprises.

Only companies have the status of legal persons, and shareholders shall bear liabilities for a company to the extent of their respective subscribed capital contribution/shares. However, a shareholder who abuses the independent legal person status of the company or the shareholder's limited liabilities to evade debts, thereby prejudicing the interests of creditors of the company, shall be jointly and severally liable for the debts of the company.

Companies are categorised as limited liability companies and joint stock limited companies. Joint stock limited companies whose shares are listed and traded on a stock exchange are publicly traded companies.

1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements for companies are the Company Law of the People's Republic of China (the *"Company Law"*) and five judicial interpretations of the Company Law. In addition to the laws, judicial interpretations and regulations, the activities of a company and all participants (including shareholders, directors, supervisors and officers) are governed by the articles of association of the company.

Publicly Traded Companies

Provisions on the supervision and administration of publicly traded companies are numerous and complex. As publicly traded companies are a type of joint stock limited company, the provisions of Chapter 5 of the Company Law, regarding joint stock limited companies, apply to them, and particularly, they are also subject to the special provisions of Section 5 of Chapter 5 regarding the organisation of publicly traded companies. The organisation and activities of publicly traded companies are also regulated by the Securities Law of the People's Republic of China, the regulatory rules of the China Securities Regulatory Commission (CSRC) and the relevant stock exchanges.

1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Corporate governance requirements for companies with publicly traded shares mainly include the following:

- the company shall establish and maintain effective mechanisms of shareholder meetings, boards of directors, boards of supervisors, independent directors, board secretaries and special committees in accordance with the law;
- the company shall be encouraged to appoint officers in an open and transparent manner;
- the company shall establish fair and transparent standards and procedures for evaluating the performance of directors, supervisors and officers;
- the company shall establish a mechanism linking remuneration with the company's performance and individual performance;
- the company shall be strictly independent from its controlling shareholder and actual control persons in terms of personnel, assets,

financial affairs, organisational institutions, business, accounting and also their respective responsibilities and risks;
- decision-making procedures and information disclosure obligations shall be strictly performed in connection with related-party transactions in accordance with the relevant rules;
- the company shall establish and implement a management system of information disclosure – it shall make public disclosures on documents such as periodic reports, interim reports, prospectuses, offering prospectuses, listing announcements, acquisition reports, etc; and
- internal control and risk management shall be established.

Corporate governance requirements for companies with publicly traded shares are mainly stipulated in the Code of Corporate Governance of Publicly Traded Companies, which was issued by CSRC in 2018. Some requirements are mandatory, while others are voluntary. However, certain provisions seem to be voluntary, but in fact have become quasi-mandatory, because companies may be confronted with unnecessary complications if they have not strictly complied with them in the IPO procedure.

2. Corporate Governance Context

2.1 Hot Topics in Corporate Governance

The Company Law was revised on 29 December 2023, and the new rules came into effect on 1 July 2024, with the following hot topics in corporate governance arising:

- the reform of the registered capital system;
- the responsibility of the controlling shareholder and actual control person;
- the improvement of the legal representative system;
- the corporate governance structure about dual class equity;
- the competition between the centralism of the shareholders' meeting and the centralism of the board;
- the enrichment of shareholder derivative lawsuits;
- the protection of shareholders' rights; and
- the company autonomy and shareholder discretion in designing the company's articles of association.

The new revisions strengthen the protection of shareholders' rights and creditors' economic interests, improve the shareholder investment mechanisms, enhance compliance responsibility of corporate control persons and executives, and allow certain simplifications of the company governance structure.

The new Company Law specifically focuses on the issues arising from corporate control right competition, shareholder litigation and director responsibility. In addition, it defines the content scope of articles of association that can be agreed upon by shareholders. It still leaves gaps open on many practical issues and increases the need for professional advice and even legal battles for all relevant parties.

2.2 ESG Considerations

According to China regulatory rules, publicly traded companies shall disclose environmental information and fulfil social responsibilities such as poverty alleviation. ESG information disclosure is one of the obligations that publicly traded companies must fulfil, which requires them to incorporate *"environment"*, *"society"* and *"governance"* into the concept of enterprise development.

In 2024, China's stock exchanges issued more specific requirements on the sustainable development report for publicly traded companies. A combination of mandatory disclosure and voluntary disclosure should be adopted for ESG reports, and violations may cause regulatory or disciplinary actions.

3. Management of the Company

3.1 Bodies or Functions Involved in Governance and Management

In China, the principal bodies involved in the governance and management of a company include the shareholder meeting, the board of directors, the board of supervisors and the manager.

- The shareholder meeting is the key organ of authority, responsible for making decisions on fundamental issues and electing the main members of the board of directors and the board of supervisors.
- The board of directors is the executive function in corporate governance. The managers are appointed by the board of directors and the managers' functions are defined in the articles of association. Depending on their relevant authorities in this executive function, directors or managers may hold the central position in the company's day-to-day decision-making process.
- The board of supervisors is the supervisory organ, responsible for supervising the execution of business and the company's financial status. Without the board of supervisors, the company may also set up an audit committee in the board of directors to exercise the same functions and powers, in which case the board of directors actually has the supervisory responsibilities.

In general, the new company law allows the removal of supervisors from the corporate governance structure. It may also, however, raise the concern of self-supervision by the board of directors itself, leaving an open question on how to balance the board's power in such structure.

3.2 Decisions Made by Particular Bodies

Decisions of the Board of Directors

The board of directors shall decide on the following matters:

- determining the company's business plans and investment programmes;
- determining the establishment of the company's internal management departments;
- formulating the company's basic management system; and
- deciding on the hiring or dismissal of the managers and their remuneration.

The new Company Law deletes the board's function of formulating plans in respect of the company's annual budget and final accounts, which gives the company a discretion to transfer this function from the board of directors to the senior managers by an elaboration in its articles of association.

In addition, the board of directors shall exercise other powers prescribed by the articles of association and empowered by the shareholders' meeting.

Powers That the Shareholders' Meeting can Give to the Board of Directors

Based on the empowerment by the shareholders' meeting, the board of directors can decide on the following matters.

The below resolutions shall be adopted by a majority of all the directors:

- adopting resolutions on the issuance of corporate bonds;
- deciding on the company's purchasing its own shares to use shares for employee stock ownership plan or equity incentives;
- deciding on the company's purchasing its own shares to use shares for converting convertible corporate bonds issued by the company; and
- deciding on the company's purchasing its own shares because it is necessary for a listed company to protect the corporate value and the rights and interests of shareholders.

The following resolutions shall be adopted by more than two-thirds of all the directors:

- deciding on the issuance of new shares by not exceeding 50% of the issued shares within three years; but if non-monetary property is contributed as capital at an assessed value, such issuance shall be subject to the resolution of the shareholders' meeting; and
- deciding on the company's providing financial assistance for another person to acquire shares of the company or its parent company; however, the cumulative total of financial assistance shall not exceed 10% of the issued capital stock.

If the board of directors goes beyond the function stipulated in the law or the articles of association, and acts without any proper approvals by the shareholders' meeting, it will constitute a violation with potential damage to the interests of the company in judicial practice.

Decisions of the Shareholder Meeting

In general, the new revision to Company Law narrows the scope of functions of the shareholders' meeting, and creates more rooms for the board of directors, which was appraised by many commentators as a sign of encouraging professionalism in corporate governance.

The shareholder meeting is responsible for making decisions on fundamental issues, including but not limited to:

- electing and replacing directors and supervisors, and determining their remuneration;
- reviewing and approving plans for the company's dividend distribution and loss recovery;
- amending the articles of association of the company;
- making resolutions on any increase or decrease of the company's registered capital; and
- making resolutions on merger, division, dissolution or liquidation of the company, or change of the company form.

Protection of Bona Fide Counterparts

For the protection of the interests of bona fide counterparts and transaction stability, the Company Law stipulates the following special measures.

- For legal representatives, any restriction on their functions imposed by the company's by-laws or shareholders' meeting cannot be used as an excuse to deny the validity of the company acting against the bona fide counterpart.
- For directors, any restriction on functions of the board of directors in the articles of association cannot be used as an excuse to deny the validity of the company acting against the bona fide counterpart.
- If a people's court declares invalid, revokes, or confirms the untenability of a resolution of a shareholders' meeting or board of directors, a civil legal relation established between the

company and a bona fide counterpart based on the resolution shall not be affected.
- The company cannot use the company registration matter without formal registrations or modifications as an excuse against the bona fide counterpart.

The above provisions mean that, if the bona fide counterpart has justifiable reasons to believe that the company is properly empowered and acts based on such belief, the court shall assume that the actions between the company and the bona fide counterpart are valid.

Protection of Stakeholders' Interests

For the protection of stakeholders' interests, the Company Law stipulates special procedural requirements as a precondition for the following activities of the company, which essentially reflects the multiple layers of competition among the interests of shareholders and external creditors, and those of majority shareholders and minority ones:

- if a company invests in other enterprises or provides guarantees for other external parties, the decision shall be made by the shareholders' meeting or board meeting, per the articles of association of the company; and
- if a company provides a guarantee for its shareholders or actual control persons, the decision shall be made by the shareholders' meeting; the aforesaid shareholders or the shareholders under the control of the aforesaid actual control persons shall not vote on the aforesaid matters; the decision shall be passed by more than half of the voting rights held by the other shareholders present at the meeting.

The Validity of Guarantees by the Company When Legal Representatives Violate Internal Procedures

Article 7 of the Interpretation of the Supreme People's Court of the Application of the Relevant Guarantee System of the Civil Code of the People's Republic of China stipulates that if the legal representative violates the legal procedure of the company providing the external guarantee and exceeds their empowerment to conclude a guarantee contract with the counterpart on behalf of the company, the validity of the guarantee contract shall be determined in accordance with the following criteria:

- if the counterpart is in good faith, the guarantee contract shall be effective for the company; externally, the company shall bear guarantee liability; internally, the company may claim indemnification against the legal representative at fault; and
- if the counterpart is not in good faith, the guarantee contract is not effective for the company.

The counterpart has the obligation to reasonably examine the validity of the company's resolutions. If the counterpart has evidence of its reasonable examination, the people's court shall determine that it acts in good faith, unless the company has evidence showing that the opposite party knows or should know that the resolution is forged or altered.

The criterion for judging the good faith of the counterpart, for a case involving a publicly traded company, is whether the counterpart enters into the guarantee contract based on the information publicly disclosed by the listed company.

3.3 Decision-Making Processes

Normally, meetings of the board of directors shall be convened and presided over by the chair of the board. When the board of directors votes on a resolution, each director shall have one vote.

Procedural Requirements for Board Meetings

For a limited liability company, the discussion methods and voting procedures of the board of directors shall be specified by the articles of association or by-laws, unless it is otherwise provided for by the Company Law.

In joint stock companies, the convening of board meeting shall follow special procedural requirements.

- The board of directors shall convene at least two meetings a year, which must be notified to all directors and supervisors ten days in advance.
- Shareholders representing more than a tenth of voting rights, or more than a third of the board of directors or the board of supervisors, may propose to convene an interim meeting of the board of directors.

For limited liabilities companies and joint stock companies, their board meeting shall follow some procedural requirements.

- No meeting of the board of directors can be held unless more than half of the directors are present.
- When the board of directors makes a resolution, it shall be adopted by more than half of all the directors.

Related-Party Transactions

For the management of related-party transactions, it is clarified that affiliated directors shall recuse themselves from voting; if the number of non-affiliated directors present at the board meeting is less than three, the related-party transaction shall be submitted to the shareholders' meeting for review and approval.

Voting Deadlock Solution

In practice, if there is a deadlock situation in decision-making, solutions should be clearly stipulated in the articles of association or internal corporate governance rules. For example, the chair of the board can have an additional second voting right, or some key directors can have a veto right.

With respect to the shareholder meeting, please see **5.3 Shareholder Meetings** regarding decision-making processes.

4. Directors and Officers

4.1 Board Structure

The board of directors in a limited liability company shall have at least three members, while there is no upper or lower limit for the number of board members of a joint stock limited company.

- Small companies, a company with a smaller scale or with fewer shareholders may only have one single director, but without the board of directors.
- For medium-to-large companies, if the board of directors has three or more members, it may include an employees' representative. The board of a limited liability company which has 300 or more employees and does not establish the board of supervisors shall include an employees' representative.

Audit Committee or Board of Supervisors

A company may set up an audit committee in the board of directors to exercise the supervisory

functions and powers to replace the board of supervisors or supervisor. The audit committee of a joint stock company shall have at least three members.

4.2 Roles of Board Members

The board of directors shall be presided over by a chair, and may have one or more vice-chairs. The chair shall be responsible for presiding over shareholder meetings, convening and presiding over meetings of the board of directors, and inspecting the implementation of resolutions of the board. A vice-chair assists the chair in their work. If the chair cannot or does not carry out their duties, such duties shall be carried out by the vice-chair; if the vice-chair cannot or does not carry out its duties, the duties shall be carried out by a director jointly elected by more than half of the directors.

A publicly traded company shall have independent directors and board secretaries. Independent directors shall be responsible for supervising the directors and officers, and shall report their work to the shareholder meeting annually. The board secretary shall be responsible for the preparation of shareholder meetings and meetings of the board of directors, custody of documents, management of shareholders' materials, disclosure of information, investor relations and other matters.

4.3 Board Composition Requirements/ Recommendations

Qualifications of Directors

Persons may not serve as a director of a company in any of the following circumstances:

- they are without civil capacity or have limited civil capacity;
- they have been sentenced to criminal penalties for corruption, bribery, embezzlement or misappropriation of property or for sabotaging the socialist market economy order, and less than five years has elapsed since the expiration of the period of execution, and less than two years has elapsed since the expiration of the probation period of suspended sentence;
- they have been deprived of their political rights for committing a crime, and less than five years has elapsed since the expiration of the period of execution;
- they have served as a director or manager of an enterprise that has been declared bankrupt and they bear personal responsibility, and less than three years has elapsed since the date of completion of the bankruptcy liquidation;
- they have served as the legal representative of an enterprise whose business licence has been revoked or has been ordered to close its business operations due to a violation of law and bear personal responsibility, and less than three years has elapsed since the date of the revocation of business licence or the date of the order of closing down; and
- they have been listed by the people's court as the persons subject to the enforcement for breach of trust obligations because they have a large amount of debt, which is due but has not been repaid.

Special Requirements for Chairman and Staff in Certain Industries

There are special senior position segregation requirements in specific industries. For an example, the chairman of a bank or an insurance company shall not concurrently serve as the CEO or the general manager for the institution. And members of commercial banks and state-owned companies may not take part-time jobs in other economic organisations.

4.4 Appointment and Removal of Directors/Officers

The directors who are not representatives of the employees shall be appointed and removed by the shareholder meeting. The employees' representatives shall be democratically elected by the employees through the employees' congress, through the employees' meeting or in other ways. The method of appointing the chair and vice-chair of the board of directors in a limited liability company shall be stipulated in the articles of association of the company.

In practice, the chair and vice-chair can be elected or recommended by the shareholder meeting or the board of directors. The chair and vice-chair of the board of directors in a joint stock limited company are elected by more than half of all the directors on the board of directors.

The manager shall be appointed and removed by the board of directors. The appointment and removal of the deputy manager and chief financial officer shall be recommended by the manager and decided by the board of directors.

Legal Representative

For the legal representative, the new revision to Company Law has special provisions.

- The legal representative of a company shall be a director or general manager who carries out business on behalf of the company.
- If a director or manager who serves as the legal representative resigns, they shall be deemed to have resigned from the legal representative position at the same time. If the legal representative resigns, the company shall appoint a new legal representative within 30 days from the date of resignation.
- The articles of association of a limited liability company shall specify the methods of appointing and replacing the company's legal representative.

The new revision to Company Law expands the scope of candidacy of legal representatives beyond chairpersons or the CEO, and resolves a potential difficult situation that the legal representative may not be available for performing duty if no successor to the chair or CEO is available. The new revision also encourages the diversity of members of board of directors. If there is no substantial interest relationship between the registered legal representative and the company, and the legal representative is not involved in any actual business operation, the legal representative can file a deregistration lawsuit.

4.5 Rules/Requirements Concerning Independence of Directors

As a general rule of fiduciary duty, directors must act with good faith and independently for the best interests of the company. Regarding the rules or requirements concerning independence of directors, the current regulations about independent requirements are mainly for the independent directors.

Independent Director Requirements

Independent directors of publicly traded companies are required to meet the general requirements for directors as stipulated in the Company Law, as well as the specific qualifications for independent directors under regulatory supervision rules applicable for publicly traded companies.

- Persons who work or provide services in the publicly traded company, its controlling shareholders, its actual control persons, or their respective subsidiaries and their related persons, or persons who have significant

business dealings with the above-mentioned enterprises, or persons who work in companies having significant business dealings with the above-mentioned enterprises, their controlling shareholders or their actual control persons shall not serve as independent directors.
- Persons holding the position of independent director shall have more than five years of working experience in law, economics or another field, and having no records of major breaching of promises or other illegal records.

In addition, there are limitations for some people with a conflict of interest to be an independent director. For example, within three years after resigning or retiring (leaving), leading officials in middle management of the company shall not be appointed as independent directors or independent supervisors of publicly traded companies to avoid potential conflicts.

4.6 Legal Duties of Directors/Officers

The principal legal duties of directors and officers of a company are the fiduciary duties – ie, the duty of loyalty and the duty of diligence. The new revision to Company Law clarifies, for the first time, the connotations of the duty of loyalty and the duty of diligence.

The Duty of Loyalty

The duty of loyalty requires directors and officers to take measures to avoid conflicts between their own interests and the company's interests, and not to take advantage of their powers to pursue improper interests, with the following important restrictions:

- directors and officers and their close relatives, and enterprises directly or indirectly controlled by them, and persons who have other affiliated relationships with them, shall not enter into contracts or engage in transactions with the company they are serving without the consent of shareholder or board meetings;
- without the consent of shareholder or board meetings, directors and officers shall not seek business opportunities that would have belonged to the company for themselves or others by taking advantage of their position; and
- without the consent of shareholder or board meetings, directors and officers shall not engage in business that is similar to the company's, for themselves or others.

Any income arising from the breach of duties of loyalty shall belong to the company.

The Principle of Business Judgement

The new revision to Company Law adds a specific interpretation of the duty of diligence, which indicates that the directors and officers shall act as reasonable business persons do. The principle of business judgement also leaves room for Chinese courts to determine what will be the reasonable level of business judgement for Chinese company directors.

4.7 Responsibility/Accountability of Directors

Directors are required to take into account the overall interests of the company and the interests of all shareholders when discharging their duties. In publicly traded companies, the directors are required to pay special attention to the interests of the minority shareholders, as well as other interested parties, such as creditors, employees, clients, suppliers and communities.

Director Accountability Exemption

In a joint stock company, the directors shall be responsible for the board resolutions. If a resolution violates laws, administrative regulations, the

articles of association or the resolution of the shareholders' meeting, and its execution causes serious losses to the company, the directors participating in the resolution shall be liable for loss compensation to the company.

However, if it is proved, as normally recorded in the board meeting minutes, that a director has expressed their objection at the time of voting, that director may be exempted from liability.

4.8 Consequences and Enforcement of Breach of Directors' Duties

If directors or officers breach their duties, they may face the following consequences:

- internal disciplinary action;
- shareholder lawsuit;
- administrative punishment; and
- civil liability and criminal punishment.

Shareholder Derivative Lawsuits Against Directors or Officers

If directors or officers breach their duties and thereby cause losses to the company or its wholly-owned subsidiaries, the shareholder(s) of the limited liability company, or shareholders individually or collectively holding 1% or more of the total shares of a joint stock company for 180 consecutive days or more, may request the board of directors or board of supervisors in writing to file a lawsuit against the responsible directors or officers.

If the board of supervisors or board of directors does not file a lawsuit or in an emergency, shareholders satisfying the aforesaid conditions have the right to file a lawsuit in their own name representatively, in the interests of the company.

If a shareholder brings a lawsuit against a director, an officer or other persons in accordance with the above procedures, the company shall be listed as a third party to participate in the lawsuit.

Circumstances of Director or Officer Breaching Fiduciary Duty

There are legal bases for shareholder derivative lawsuits against directors or officers for breaching corporate governance requirements:

- directors or officers shall be liable for compensation if they injure the interests of the company by taking advantage of their connection relationship;
- responsible directors and officers shall be liable for compensation if they fail to promptly perform the obligation of checking and supervising the shareholders' fulfilment of capital contribution obligation;
- responsible directors and officers shall be jointly and severally liable for compensation with the shareholder if the shareholder withdraws their capital contribution and causes losses to the company;
- responsible directors and officers shall be liable for compensation for losses caused to the company if the company distributes profits to shareholders in violation of the law;
- responsible directors and officers shall be liable for compensation if the company provides financial assistance for another person to illegally acquire shares of the company or its parent company and causes losses to the company;
- responsible directors and officers shall be liable for compensation for losses caused to the company if registered capital is reduced in violation of the law; and
- the director with obligations of liquidation of the company shall be liable for compensation if they fail to perform their liquidation

obligations in time and cause losses to the company.

Shareholder Direct Lawsuit Against Directors or Officers

If directors or officers violate any law, administrative regulations or the company's articles of association, thereby harming the interests of a shareholder, the shareholder may directly file a lawsuit, in their own interests.

Company Lawsuits Against Directors or Officers

A company can directly sue its directors or officers for their failure to fulfill their duty of loyalty and diligence.

For example, Article 13 of Provisions of the Supreme People's Court on Several Issues Concerning the Application of the Company Law of the People's Republic of China (III) stipulates that if a shareholder fails to fulfil the capital injection obligation at the time of the company's capital increase, the company can request the directors or officers who fail to monitor or manage the process to pay the capital; after the directors or officers repay the capital, they may claim indemnification against the defendant shareholders.

With respect to the shareholder direct lawsuits against company itself, please see **5.4 Shareholder Claims**.

Class Action Lawsuit in Securities Litigation

Directors and officers of publicly traded companies, along with the company and other responsible parties, may also be held accountable for misbehaviour including false statements, breach of promises, insider trading and market manipulation, and shall be responsible to compensate the investors who have suffered losses as a result of such conduct, according to the following special procedures of shareholder representative lawsuits under the Securities Law of China. The lawsuits are similar to class action lawsuits in western developed markets but with special procedures.

- If an investor protection institution holds shares of the company, the institution may file a lawsuit in its own name in the interests of the company with no limitations on the shareholding ratio and holding period.
- If the parties on one side of the actions are numerous with the same type of claims, they may legally recommend and select representatives to participate in the actions; the people's court may issue an announcement to notify the investors to register during a certain period.
- An investor protection institution, authorised by 50 or more investors, may participate in actions as a representative, except for investors who have expressly indicated their reluctance to participate in the actions.

Furthermore, the China Supreme People's Court issued a judicial interpretation in 2022 stipulating that such civil litigation does not need to wait until an administrative authority or criminal court makes a formal finding on the wrongfulness of the alleged misconduct.

4.9 Other Bases for Claims/Enforcement Against Directors/Officers

There are other bases for claims or enforcement against directors or officers according to new revisions of Company Law, which already cause attention from the public.

Claims Against Legal Representatives

If the legal representative causes damage to others due to the performance of their duties:

- externally, the company shall bear civil liability; and
- internally, the company may claim indemnification against the legal representative at fault.

That means, for the protection of the legal representative in the performance of their duty, normally the plaintiff is required to first bring a case against the company itself instead of the legal representative.

Liability to Third Parties for Directors or Officers Performing Duties

If a director or an officer acts in their official capacity and causes damage to other third parties, the company shall be liable for compensation.

Directors and officers who have malign intention or act with gross negligence shall also be liable for compensation.

Either the company or its directors or officers can be listed as defendant in the lawsuit.

In reality, it is expected that both the company and its directors and officers will be listed as co-defendants at the same time as a result of litigation strategy. It is more clear, however, that the company will normally bear the responsibility first. It will be the company's decision on whether to claim indemnification against directors, officers or the legal representative.

Claims Against Controlling Shareholders and Actual Control Persons (Shadow Shareholders and Shadow Directors)

In addition, the new revision to the Company Law adds the following liabilities of controlling shareholders and actual control persons. To some extent, this revision tries to solve some serious governance problems caused by Shadow Shareholders or Shadow Directors who are manipulated by controlling shareholders or actual control persons in practice.

- The other shareholders shall have the right to request the company to acquire a controlling shareholder's equities, who abuses shareholder rights with prejudice to the interest of the company or other shareholders, at a reasonable price.
- The controlling shareholders or actual control persons of the company who do not serve as its directors but attend to the company's affairs shall also undertake duties of loyalty and diligence.
- The controlling shareholders or actual control persons instruct a director or officer to engage in any act against the interests of the company or shareholders, the controlling shareholders or actual control persons shall be jointly and severally liable.
- From the perspective of actual shareholders having significant influence over the company's operation and management, it is worthwhile to further explore the issue of recognising them as substantive directors, or recognising them as having the same liquidation obligations as directors.

4.10 Approvals and Restrictions Concerning Payments to Directors/Officers

According to the Company Law, remuneration, fees or benefits payable to directors are decided by the shareholder meeting. Payments to the manager are decided by the board of directors, and payments to the deputy manager and chief financial officer are decided by the board of directors upon proposals by the manager.

In a publicly traded company, when the board of directors or the remuneration and assessment

committee is evaluating the performance of a director or is discussing their compensation, the director shall not participate in such evaluation or discussion. The remuneration distribution plan for officers shall be approved by the board of directors, explained at shareholder meetings and fully disclosed.

Incentive Payment and Deferred Payment

Financial institutions such as banking and insurance institutions have deferred remuneration requirements for directors, officers and key positions. In general companies, this kind of mechanism can also be stipulated through the articles of association to limit such incentive payment.

4.11 Disclosure of Payments to Directors/Officers

According to the Company Law, a joint stock limited company shall regularly disclose to its shareholders the remuneration, fees or benefits payable to directors and officers. A publicly traded company shall disclose the appointments, changes of shareholding and annual remuneration of its directors and officers in its annual report.

5. Shareholders

5.1 Relationship Between Companies and Shareholders

Shareholders mainly have the following rights with regard to the company.

- The right to income:
  (a) dividend claims;
  (b) residual claims;
  (c) pre-emptive rights for new shares;
  (d) dissenting shareholders' right to request repurchase of shares; and
  (e) pre-emptive rights for shares sold by other shareholders in limited liability companies.
- Voting rights and related rights:
  (a) voting rights;
  (b) rights to attend shareholder meetings;
  (c) rights to propose to convene interim shareholder meetings and meetings of the board of directors; and
  (d) rights of proposal.
- The right to know and other rights.

Shareholders' Obligation

The shareholders' principal obligation to the company is to invest capital in accordance with their committed payment schedule provided in the articles of association of the company.

Shareholders' Civil Liabilities

Shareholders who fail to fulfil their investment obligations may bear civil liabilities, and directors, officers and promoters may also be jointly liable.

- After the formation of a company, no shareholder can withdraw the capital investment. Directors and officers have the responsibilities of managing the capital. If losses are caused to the company by late payment or capital withdrawal, the directors and officers shall be held jointly and severally liable.
- If a shareholder fails to complete its capital contribution on schedule, the company shall issue a written demand to the shareholder to demand payment of capital contribution. If the shareholder fails to perform the obligation after expiration of the grace period, the shareholder shall forfeit the rights to the unpaid equity or shares on the date of issuance of the notice.
- Acceleration of contribution – if the company is unable to pay off its due debts, the company or creditors of the due debts shall have

the right to require the shareholders to pay the capital contributions before expiration of the period of payment of capital contribution. For *"the right to require the shareholders to pay the capital contributions"* in the new Company Law, the shareholders could still be ordered to pay the creditors directly in the current judicial practice.
- The other promoters shall be jointly and severally liable with the promoter who fails to pay the subscription in accordance with the shares they have subscribed for, or when the actual value of the non-monetary property as capital contribution is significantly lower than the the shares subscribed for.
- In the case of an equity transfer where the capital contribution is not due after the implementation of the new Company Law, if the transferee fails to fully pay the capital contribution on time, the original shareholders shall bear supplementary liability to the creditors for the portion of the insufficient capital contribution.

Shareholders' Criminal Responsibilities in Capital Contribution

According to the Criminal Law, shareholders who fail to fulfil their investment obligations may bear criminal responsibilities for making a false capital contribution or withdrawing the contributed capital. According to a legislative interpretation, the rule only applies to companies that legally implement the paid-in system of registered capital. Shareholders of joint stock companies shall pay more attention to this criminal liability of capital contribution.

The Boundaries of Shareholders' Rights: Piercing the Corporate Veil

The shareholders shall not abuse the independent legal person status of the company and limited liabilities of shareholders to damage the interests of the company's creditors.

- Shareholders, instead of the company itself, may be directly held jointly liable if evidence shows shareholder and company personality confusion, excessive dominance or control by shareholders in company management, or that the capital is significantly insufficient.
- If shareholders use two or more companies under their control to evade debts, each company shall be jointly and severally liable for the debts of any company.
- The company which has only one shareholder which cannot prove that the property of the company is independent of their own property, shall be jointly and severally liable for the debts of the company.

In the case of company personality confusion, the denial of personality may result in the parent and subsidiary being jointly and severally liable for each other's debts because the boundary between the shareholders' property and the company's property is unclear. This approach of *"reversely piercing the corporate veil"* should be limited to the specific situation of legal personality confusion.

5.2 Role of Shareholders in Company Management

Ownership of companies is somewhat separated from management rights. The managers are responsible for the operation and management of the company while, as owners of the company, shareholders do not normally participate directly in the daily operation and management of the company. Their management in a company is indirect, which means they exercise their rights in a collective manner by participating in shareholder meetings and voting on proposals in accordance with the procedures provided by

laws and the articles of association of the company. The shareholders may make decisions on fundamental issues and elect the main members of the board of directors by exercising their voting rights and thereby control the company.

As a common business practice, share repurchase plays an important role in adjusting the shareholding structure of enterprises and protecting investors' rights.

If both parties agree on the period during which the investor requests the other party to repurchase, the period should be recognised in accordance with the principle of good faith even though the reasonable expectation is no more than six months since the triggering event for repurchase happens.

5.3 Shareholder Meetings

Generally, shareholder meetings are convened by the board of directors and presided over by the chair of the board.

- If the board of directors is unable or fails to perform its duty of convening a shareholders' meeting, the board of supervisors shall convene and preside over the meeting.
- If the board of supervisors does not convene and preside over the meeting, the shareholders representing more than one-tenth of the voting rights in a limited liability company, or shareholders who individually or collectively hold more than 10% of the company's shares for more than 90 consecutive days in a joint stock company may convene and preside over the meeting on their own.

However, a decision may be made without convening a shareholder meeting if shareholders unanimously agree in writing (all shareholders sign and seal on the resolution documents).

Voting Rights Required for Adopting a Resolution by Shareholder Meeting

If there is no special provision in the articles of association of the company, all the shareholders shall be notified 15 days before a shareholder meeting is held, and the shareholders shall exercise their voting rights at the meeting in proportion to their capital contribution.

Normally when the shareholders' meeting makes a resolution, it shall be adopted by shareholders representing more than half of the voting rights.

Specially, some resolutions shall be approved by shareholders representing more than two thirds of voting rights:

- deciding on the amendment of the articles of association, increases/decreases of registered capital, mergers, divisions, dissolution or changes of the company form;
- a publicly traded company purchasing or selling significant assets, or guaranteeing an amount exceeding 30% of the company's total assets within one year; and
- issuing classified shares different from the rights of ordinary shares.

There are special voting approaches such as cumulative voting, which can also be used in the shareholders' meeting according to Chinese Company Law.

5.4 Shareholder Claims

Shareholders, on behalf of the company or its wholly owned subsidiaries, can file derivative lawsuits against a company's directors, officers or others outside the company for the company's losses. The specific procedure can be seen in **4.8 Consequences and Enforcement of Breach of Directors' Duties** regarding shareholder lawsuits against directors or officers.

Shareholder Direct Lawsuits

Shareholders can file shareholder direct lawsuits against the company itself based on civil liability for torts.

- If the company refuses to provide shareholders access to inspecting or copying legal documents or materials of the company without justifiable reasons, the shareholders may file a lawsuit to the people's court; specifically, the legal documents or materials include: the articles of association, the register of shareholders, the minutes of shareholders' meetings, the resolutions of the board of directors, the resolutions of the board of supervisors, financial accounting reports, accounting books, accounting records, and related materials of wholly-owned subsidiaries; and according to the new revision of the Company Law, shareholders are allowed to entrust intermediaries to act on their behalf.
- In cases where a shareholder requests confirmation that a resolution of the shareholders' meeting or board meeting is not established, invalid or revoked, the company shall be listed as the defendant.
- In a case where a shareholder requests a company to distribute profits, the company shall be listed as the defendant; if the shareholder fails to submit a resolution of the shareholders' meeting specifying a specific distribution plan, the people's court shall reject their claim, except when the company does not distribute profits in violation of the law and causes losses to other shareholders.

5.5 Disclosure by Shareholders in Publicly Traded Companies

In some situations, a shareholder or actual control person of a publicly traded company shall inform the board of directors and co-operate with the company in performing information disclosure obligations:

- of a relatively significant change in the control of the company, or the shareholding of shareholders who hold more than 5% of the company's shares, or the actual control person;
- of a relatively significant change in the situation of engagement in business identical or similar to the company that is taken by the company's actual control person and other enterprises controlled by the actual control person;
- if the controlling shareholder was prohibited from transferring their shares by a court ruling or judgment;
- if more than 5% of the company's shares held by any shareholder are pledged, frozen, judicially auctioned, kept in custody or established in trust, or their voting rights are restricted, or there is a risk of being forced to transfer ownership; and
- of a plan to significantly restructure assets or business of the publicly traded company.

The CSRC also requires that, where any shareholder of the company applying for an IPO has a shareholding structure consisting of two or more layers and is a company or a limited partnership with no actual business activities, the ultimate beneficial owner of such shareholder should be disclosed, in the case that the buy-in price of such shareholder is apparently abnormal.

6. Corporate Reporting and Other Disclosures

6.1 Financial Reporting

Publicly traded companies are subject to periodic financial reporting (annual, midterm and

quarterly reports) and interim financial reporting requirements.

Directors/Officers Responsibilities in Financial Reporting

The contents of the periodic report shall be examined and approved by the board of directors. The directors and officers of the company shall sign written confirmation opinions on the periodic report, and the board of supervisors shall submit written review opinions on the periodic report.

If the directors or supervisors are unable to guarantee the authenticity, accuracy and completeness of the periodic report or have objections, they shall vote against or abstain from voting. Directors and officers are not absolutely relieved of their responsibility if they cannot closely follow the principle of prudence during the report preparation and disclosure.

Gatekeeper Responsibilities

China securities regulations also strengthen the gatekeeper responsibility of intermediary institutions, which generally include securities companies and their personnel as sponsors and/or underwriters, securities service agencies, law firms, accounting firms, and asset evaluation agencies.

In practice, shareholder class action lawsuits can be filed against the company, directors, officers and intermediary institutions for their breach of duties in cases of false statements, breach of promises, insider trading and manipulation of the market.

6.2 Disclosure of Corporate Governance Arrangements

There are some requirements for publicly traded companies to disclose their corporate governance arrangements in the midterm report and annual report.

In the midterm report, a publicly traded company shall disclose its corporate governance arrangements, including:

- the annual shareholder meeting and interim shareholder meetings held during the reporting period;
- the removal of directors, supervisors and officers, as well as the reasons for doing so, during the reporting period;
- whether the dividends distribution plan and the plan for conversion of capital reserve fund to share capital comply with the articles of association and provisions for review procedure, and have adequately protected the legitimate interests of the minority investors, and whether the independent directors have issued opinions; and
- the implementation of an equity incentive plan, employees' stock holding plan or other incentive measures for employees during the reporting period.

In addition to the arrangements mentioned above, a publicly traded company shall also disclose the following in its annual report:

- the measures that the controlling shareholder and actual control persons take to guarantee the independence of the company;
- the situation of engagement in business that is identical or similar to the company that is taken by the controlling shareholder, actual control persons and other enterprises controlled by them;
- the implementation of and changes to the arrangements on difference in voting rights during the reporting period;

- basic information on and annual remuneration of directors, supervisors and officers;
- meetings of the board of directors held during the reporting period and the performance of each director;
- the membership of the special committees under the board of directors, and meetings of special committees held during the reporting period;
- opinions of the board of supervisors on supervision matters during the reporting period;
- employees of the company's parent company and its main subsidiaries;
- the construction and implementation of the internal control system during the reporting period; and
- management of its subsidiaries during the reporting period.

6.3 Companies Registry Filings

The new revision to the Company Law takes dual approaches to capital contribution for limited liability companies and joint stock companies, which means:

- for limited liability companies, the subscribed capital shall be paid fully by its shareholders within five years from the date of the company's establishment; and
- for joint stock companies, the paid-in capital system applies (promoters shall pay in full for their subscribed shares before the date of the company's establishment).

Joint stock companies established by public offering are required to submit a capital verification certificate from a capital verification institution when applying for company registration.

It should be noted that a company shall provide official registry with necessary information for company registration and licence. The company shall also formally file registration or modification documents for its registration matters before it can leverage them against any bona fide counterparts.

7. Audit, Risk and Internal Controls

7.1 Appointment of External Auditors

A company shall prepare a financial statement at the end of each fiscal year, which shall be audited by an accounting firm in accordance with relevant law. According to the articles of association of the company, the decision to hire or dismiss the accounting firm that undertakes the company's auditing business shall be taken by the shareholder meeting or the board of directors. When the shareholder meeting or the board of directors votes on the dismissal of the accounting firm, the accounting firm shall be allowed to state its opinions.

7.2 Requirements for Directors Concerning Management Risk and Internal Controls

Small Companies

The key requirements for directors in connection with internal controls in small companies are based on Internal Control Norms for Small Companies issued by the Minister of Finance in 2017.

- Compared with the principle of comprehensiveness, importance and balance of internal control of large and medium-sized companies, the special principles of internal control for small companies are risk oriented and focus on substantial risks.
- Compared with the complex internal control measures of large and medium-sized companies, key position separation, internal authorisation and approval process, accounting and

financial control, documentation and invoice control are essential for small companies.

Large and Medium-Sized Companies

The board of directors shall be responsible for the establishment and implementation of internal controls. The board of supervisors shall supervise the establishment and implementation of internal controls by the board of directors. Managers shall be responsible for organising and leading the day-to-day operation of the company's internal controls. A company shall establish a special department or designate an internal department to be specifically responsible for organising and co-ordinating the establishment and implementation of internal controls and daily work.

Publicly Traded Companies

Special requirements for directors in connection with the risk management and internal controls in publicly traded companies include the following.

- In respect of corporate governance structure, a publicly traded company shall have independent directors and board secretaries, and its board of directors shall establish an audit committee; it may also establish special committees on strategy, nomination, remuneration and assessment.
- In respect of voting rights, the board of directors, an independent director or shareholders holding 1% or more of the voting shares of a listed company or an investor protection institution may, as a proxy solicitor, publicly request the shareholders of the listed company to authorise it to attend a shareholders' meeting and exercise the shareholders' right. The company and the convenor of the shareholders' meeting shall not set a minimum shareholding limit on the voting rights of shareholders. The solicitor shall disclose solicitation documents, and the listed company shall provide co-operation.
- In respect of information disclosure, a publicly traded company shall disclose the assessment report on internal control approved by the board of directors, and the audit report on internal control over financial reporting issued by the accounting firm at the same time as the annual report. The specific contents of periodic and interim reports can be seen in **6.1 Financial Reporting** and **6.2 Disclosure of Corporate Governance Arrangements**.
- For independent directors, the specific discussion can be seen in **4.5 Rules/Requirements Concerning Independence of Directors**.

Overall, with the new Company Law, Chinese companies are given more autonomy in their corporate governance, which leaves more room for them to design their articles of association and to determine the best rules for themselves. It also creates more battlefields for participants in Chinese companies' corporate governance.

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Rob.Thomson@chambers.com