Financial Market's Development and Minority Shareholders' Protection in China: outlines of an evolving legal framework

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1) Minority shareholders' protection in transition economies

Economists have often argued that a legal framework providing for the minority shareholders' protection, usually measured by an "index" which takes account of the rules stated to contrast any opportunistic expropriation by management or controlling shareholders, is important in determining the size and the extent of a capital market[1].

For many decades of the past century the creation of such an environment was not important for the eastern planned economies that had a deep-rooted suspicion against every accumulation of wealth not controlled by the state or its officials and against any organized activity not firmly under its leadership. Their full state owned enterprises, although often formally incorporated in stock companies, didn't have any agency problem or, when they had, the problem was simply handled through internal state administrative procedure, since all were state bodies or state employees.

However, the deep political changes that have occurred into the planned economies since the early '90 have accelerated several reforms to promote the State-owned enterprises' reorganization.

After a timid start and an initial bank-based approach, most of those economies have opted for a progressive conversion towards a more market oriented system but this conversion has raised several dilemmas about the manner and timing with which to realize such a transition.

Dilemmas have been accentuated by the economists' widespread belief that because transition economies have a high rate of companies controlled by individual or small group of shareholders and a weak non-legal constraints on the powers of managers and controlling shareholders to act to benefit themselves, these economies should have stronger rules to protect minority shareholders than those provided by already developed-market economies[2].

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1 La Porta Raphael – Lopes de Silares Lorencio – Shleifer Andrei – Wishny Robert, *Investor protection and corporate governance*,, Journal of Financial Economics 58, 2000, 3.

2 Klapper Elora – Love Inessa, *Corporate governance, investor protection and performance in emerging markets*, Journal of Corporate Finance, Vol. 10 Issue 5, 2004, 703; Pistor Katarina – Xu Chenggang, *Governing Stock Markets in*

In China, the fastest growing major economy and the second biggest economy in the world, these dilemmas stem from the need to coordinate the growing pressure for effective creation of a more persuasive capital market with the persistent idea of maintaining a full or controlling ownership in most of the previous full state owned enterprises.
Although a lot has been rapidly done, a lot is yet to do.
By this point of view the Chinese legal system offers an interesting example of how the lawmaker directs its choice and how this factually works in presence of several and not always convergent features.
A lawmaking technique that for the effective absence of a former legal tradition[3] and the call for a rapid regulatory action shows a deep inclination of the Chinese legislator towards a "free riding" among the foreign rules, a regulatory arbitrage aimed to select and import those from time to time more in line with the prefixed objectives[4].
Yet before any spontaneous convergence[5], western laws represent a benchmark, especially for the market authorities, although several western rules are often adapted to divergent socialist principles.
This adaptation still puts in light a more multi-stakeholders idea of the corporation in which shareholders are not more important than the Party, the government and the employees.
This persistent state of mind often involves a deep cultural path-dependence when applying the newest rules.
Although China's listed companies have recently made massive steps to adopt a western corporate governance structure, their underlying structures and cultures are not totally aligned with this goal. As an important empirical study demonstrates[6], the protection of minority shareholders is not always accepted by directors and managers who owe their position to the State or the Party, because any concession of power to minority shareholders will diminish State or Party power[7].

Transition Economies: Lessons from China, American Law and Economics Review (Spring 2005), 7, 1, 184, full text also available at web site www.columbia.edu

3 For further details about the weak former legal framework, effectively stopped at the beginning of the past century, see: Minkang Gu, *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 6.

4 Minkang Gu, *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 6; Pitman B. Potter, *Globalization and Economic Regulation in China: Selective Adaptation of Globalized Norms and Practices*, Washington University Global Study Law Review, vol. 2, 2003, 120.

5 For further informations about corporate governance systems' globalization see Dignam Alan – Galanis Michael, *The Globalization of Corporate Governance*, Ashgate, 2009, 89.

6 Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 88.

7 See also Clarke Donald, *Corporate Governance in China: an Overview*, China Economic Review, issue 4, 2003, 494; Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal

However, despite this reluctant attitude towards minority shareholders, the Chinese Company Law reform (2005) has widely improved their protection and the Guidelines adopted in 2006 by the Chinese State Council to promote State-owned enterprises restructuring in non strategic sectors recommends the same goal[8].

As outcome, protection has been improved in the last five years, mainly by the 2006 Takeover Code that has opted for a definitive convergence of the Chinese Takeover Market towards an "Anglo-Saxon" system of industrial restructuring via a stock market-based takeover mechanism rather than a bank-based system[9].

This paper aims to analyze whether and to what extent this evolving legal framework can be considered truly adapted to the growth capacity of a market now increasingly open to foreign investors[10].

2) Minority shareholders' protection in China: a brief historical review

Despite the new trend timidly started during the '80's[11], the creation of the legal environment above described was not the main concern of the Chinese Government when reopening the Shanghai domestic stock exchange[12] and opening the new Shanzhen stock exchange in 1990.

The real political goal was not to create a financial market, obviously impossible in the absence of listed companies and marketable securities. The government's aim was to transform the existing State Owned Enterprises (SOE) into stock companies, to establish a legislative authority for this incorporation and to prevent losses of state-owned assets during

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of Asian Law, 2007, vol.9, n.1, 112.

8 Clarke Donald – Murrel Peter – Whiting Susan, *The Role of the Law in China's Economic Development*, in Thomas Rawski and Loren Brandt (ed.), *China's Great Economic Transformation*, Cambridge University Press, 2008, 375.

9 Song Guoxiang – Meeks Geoff, *The convergence of the Chines and Western takeover markets*, (2009) full text available at SSRN:http: citeseerx.ist.psu.edu

10 Although at present the two domestic capital markets of Shanghai and Shenzhen, being the Honk Kong Stock Exchange a separate institution, are not fully accessible for foreign investors, these are expected to be fully opened to them by 2025: Rizzi Cristiano – Guo Li, *Entering the Chinese Market thorough "Takeovers" listed company acquisition and M&A: a new form of investment and a new method to expand a presence in China*, Diritto Commercio Internazionale, 2010, 281.

11 Fu Jeane, *Corporate Disclosure and Corporate Governance in China*, Kluwer Law International, 2010, 6; Zhang Lin, *Venture Capital and the Corporate Governance of Chinese Listed Companies*, Springer (London), 2011, 13; .

12 Shanghai Securities Exchange Co. Ltd, created in 1946 on the basis of Chinese Securities Exchange, ceased operations in 1949. Though treasury bonds and stocks resumed to be traded during the '80's, Shanghai Securities Exchange was opened only on December 1990. For further informations about its development see Shanghai Securities Market's Fact Book 2011, available at the web site www.sse.com.cn .

"corporatization"[13].
The first tentative provisions concerning the sell of state-owned shares to non-state controlled sectors (1992) showed clearly that the state policy was yet to maintain a large ownership in these enterprises and to use its control for different purposes, as the maintenance of employment levels or others politically motivated decisions, far from the shareholders' wealth maximization.
In this background, being the State the only one or the majority shareholder, the first Chinese Company Law adopted at the end of 1993 didn't effectively pay attention to the shareholders' rights, not even in listed companies[14].
The few mandatory rules providing their protection were not clear and not clearly associated with remedies[15].
This situation created several problems, since most of the above said not-business goals were not easily measurable or balance-able one against each other[16] and for the growing conflict between the state, controlling shareholder, and other shareholders.
A turning point came at the end of the '90's, when the 9th Five Years State Plan (1996) stipulated that the best way to restructure the SOE was to maintain only the larger and the 15th Communist Party Congress (1997) formally recognized that the State ownership should be maintained only in the strategic sectors[17].
This in turn led to a first Company Law amendment (1999) and to the 1999 Securities Law: although its provisions limited the shareholding of any individual in a listed company to just 1,5%, the financial market capitalization doubled in a year.
In 2001 the majority of SOE were successfully converted into stock companies and the Government approved the Share Structure Reform, a program to convert many of its non-tradable shares into free-floating shares listed on the two mainland securities stock exchanges[18].

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13 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement*, in Taylor and Francis Books (ed.) *A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 3.

14 Minkang Gu, *Understanding Chinese Company Law*, II ed., Honk Kong University Press, 2010, 4.

15 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement*, in Taylor and Francis Books (ed.) *A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 4.

16 The problem of multiple objectives and multiple controllers was clearly signalled by Clarke Donald, *Corporate Governance in China: an Overview*, China Economic Review, issue 4, 2003, 492

17 Song Guoxiang – Meeks Geoff, *The convergence of the Chines and Western takeover markets*, (2009) full text available at SSRN:http: citeseerx.ist.psu.edu 6

18 For further details about the differences between A and B classes of shares listed on the two mainland stock exchanges see: Rizzi Cristiano – Guo Li, *Entering the Chinese Market thorough "Takeovers" listed company acquisition and M&A: a new form of investment and a new method to expand a presence in China*, Diritto Commercio Internazionale, 2010, 283.

The corporate governance developed significantly and, as outcome, the demand for investor protection increased for the same investors' interest[19] and for the government's goal to encourage individual investors to reduce the oppressive pressure of banking finance[20].
After a second Company Law amendment (2004), the second half of the decade was opened by reforms whose first declared goal was to normalize corporate governance of listed companies and to promote the development of the capital market.
The 2005 Company Law reform introduced measures to strengthen the "public or individual shareholders", so called to distinguish them from the holders of majority state owned blocks of shares and from the "strategic shareholders" holding around 5% to 10%[21].
Similar provisions were introduced in the reformed Securities Law (2005), in the Criminal Law (2006) and in several second level rules elsewhere located; they were followed by convergent Opinions issued by Chinese State Council, encouraging the development of Non- Public Ownership Economy[22].
The cumulative outcome of these changes has been substantial and from 1993 to 2008 the shares' market capitalization increased 34 fold and the tradeable share values increased 52 fold.

3) Outlines of minority shareholders' protection legal rules: develo1opment of a top down process

The massive request for stronger rules to protect minority shareholders has led the Chinese lawmaker to more radical options and the development of corporate governance standards follows from 2005 a more top down process than before.
Indeed, several formal devices of minority shareholders' protection are now provided by the Company Law 2005, by the Securities Law 2005, by the mandatory rules of the Chinese Securities Regulatory Commission (CSRC) and by the Listing Rules of the stock exchange markets.
Company Law provides several means of protection, including rules concerning shareholders duties and rights, rules governing the directors'

19 At the end of 2003 there were more than 72 million securities trading accounts in China and of the accounts trading shares on the Shenzhen Stock Exchange only 172.700 out of 33 million were held by institutional investors: Deng Jong, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, Harvard International Law Journal, Vol.46, number 2, Summer 2005, 347.

20 Clarke Donald, *Corporate Governance in China: an Overview*, China Economic Review, issue 4, 2003, 494

21 About this classification see: Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 90, footnote 2.

22 *Opinion of the State Council on Encouraging and Supporting the Development of Non-Public Ownership Economy*, promulgated in February 2007, May 2009 and May 2010, available at the web site www.english.gov.cn

appointment and duties and rules relating the statutory auditors' power[23].
Rules concerning the shareholders' duties set forth general provisions to avoid any unfair exercise of the rights elsewhere located in the same statute[24].
For example, art. 20 states that shareholders shall exercise their rights according to law and shall not abuse their rights to damage the interest of the company or other shareholders and that those who abuse so as to cause losses of the company or other shareholders shall undertake the liability for compensation.
Every unfair related party transaction is strictly forbidden by art. 21 which prohibits every exploitation of the company by the governing bodies and their substantial controllers[25].
These duties precede the stronger rights now provided for the shareholders, as for example the new art.153 which sets forth for the right to bring actions in court against the company's directors and officers to seek damages on behalf of the corporation for the violation of their duties to it[26].
However, a minimum share capital is often required.
For example, a minimum share capital of 10% is required by art. 183 to ask the court to dissolve the company if it has met such difficulty in its business operation that its continued existence will cause serious losses to the interests of the shareholders and the situation can't be rectified by any other means.
The new rules concerning composition and duties of the board of directors aim to reduce the typical agency's problems arising between minority and controlling shareholders and between corporate managerial bodies and shareholders[27].
Art. 123 provides that the appointment of independent directors is required for listed companies[28] while new art. 148 states that duties of care and

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23 The importance of protecting shareholders, including minority shareholders, is well expressed by art. 1, which provides that Company Law was enacted in order to "*protect the legitimate rights and interests of companies, shareholders and creditors*".

24 Minkang Gu, *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 135.

25 Art. 21 aims to avoid any "tunnelling", the transfer of assets or profits out of the company to its controlling shareholders: see Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement,* in Taylor and Francis Books (ed.) *A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 4.

26 About the inadequate system previously provided by the former art. 111, substantially not applied by Chinese Courts, see: Huang Xiao, *Derivative actions in China: Law and Practice*, Cambridge Student Law Review, 2010, 246 Minkang Gu, *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 147.

27 Fore more details see: Minkang Gu, *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 169.

28 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement*, in Taylor and Francis Books (ed.) *A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 5.

loyalty are established for all board members and senior officers; line rules are set forth by the following art. 149 that prohibits many illegitimate behaviours.
Powers and responsibilities of the Board of Supervisors, for not less than one third of the members appointed by the employees, have been expanded and art.40 makes now more convenient to convene a board meeting.
Apart from the Company Law, stronger devices of minority shareholders' protection are set forth by the Securities Law 2005[29].
Most of its rules focus attention on their investors' status.
For example, to avoid any directors' misleading use of the contributions, its art. 15 provides that unless otherwise approved by a general shareholders meeting resolution, funds raised by the company thorough the issue of shares must be used for the purpose set out in the prospectus. The rule is strengthened by art. 20, which requires that any document prepared for the issue of securities must be truthful, accurate and complete; it should be noted that one of the most common problems in the companies' listing has been the use of fabricated information or false company account to support the listing of share issue[30].
The rule-making power conferred upon the Chinese Securities Regulatory Commission (CSRC) is an important source of second level legislation for all the Chinese listed companies and the mandatory rules of its several regulations also contribute to the improvement of the corporate governance standards.
For example, its new "Guide to Article of Association of Listed Companies " limits the number of inside directors to be no more than half of all members, states that the accounting firm serving as the independent auditor must be appointed by a resolution of the shareholders meeting, requires the companies to provide means for shareholders to vote also by mail or internet and entitles independent directors to propose convening a shareholders' meeting[31].
Several provisions concerning the voting right are improved by the "Rule for Shareholders' Meeting of Listed Companies" (2000), which states that the company provides shareholders with all the information they need to adopt an informed decision, orders a mechanism to insure that the votes will be counted honestly and provides for an independent tabulation team.
Other devices of minority shareholders' protection are provided by the "Guideline for Independent Directors to the Board of Directors" (2001), by the "Code of Corporate Governance for Listed Companies in China" (2001) and by the "Regulation for the Protection of Individual shareholders Right" (2004).

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29 Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 L isted companies*, Australian Journal of Asian Law, 2007, vol.9, n.1 92.

30 Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 L isted companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 96.

31 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008, 6.

For example, the "Corporate Governance Code for Listed Companies in China" CGCLCC proclaims several general principles regarding their protection[32].

Its Chapter 1.1 states that any listed company shall establish a corporate governance structure sufficient for ensuring the full exercise of shareholders' rights, that this structure shall ensure fair treatment toward all shareholders, especially minority shareholders and that shareholders shall have the right to know about and the right to participate in major matters of the company set forth in the laws and the rights to protect their interest and rights thorough civil litigation or other legal means in accordance with laws and administrative regulations.

In regard to the danger of abuse of power by dominant shareholders, the following Chapter 1.19 provides that they owe a duty of good faith towards the listed company and other shareholders, shall strictly comply with laws and regulations while exercising their rights as investors, and shall be prevented from damaging the listed company's or other shareholders' legal rights and interests thorough means such as assets restructuring, or from taking advantage of their privileged position to gain additional benefit.

The two mainland securities exchange markets' listing rules also provide detailed rules of voting procedure and disclosure duties covering all related party transactions[33].

4) The persisting gaps

Despite the great progress above described, scholars have often reported the presence of several persistent gaps in the statutes and the provisions in the new laws are generally considered still not good enough to provide protection for the minority shareholders[34].

The lack of protection concerns several different features of the corporate governance.

For example, Company Law 2005 doesn't provide mandatory rules for a slate vote for the appointment of the members of the board of directors[35].

Even if listed companies opt into it, there are no rules that set forth a

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32 Available at the web site www.csrc.gov.cn.

33 Respectively available at the web sites (www.sse.com.cn) and (www.szse.cn).

34 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008 8; Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1 , 93;; Minkang Gu , *Understanding Chinese Company Law,* II ed., Honk Kong University Press, 2010, 3.

35 Indeed the 2005 Company Law adopts an "opt-in" approach, enabling companies to choose whether to implement the system of cumulative voting in the election of directors and supervisors, see: Chao Xi, *Institutional Shareholder Activism in China: Law and Practice*, International Company and Commercial Law Review, vol. 17, 2006, also available at web site www.efmaef.org

minimum board size, generally considered important for the substantial working of the slate vote. Without a slate vote, the independent directors required by art.123 tend to be appointed by majority shareholders and are beholding to them[36].
The minimum percentages of shares requested for the exercise of some voice rights are generally considered too high. For example, the percentages that entitle a shareholder to bring a derivative law suit against directors (1%), to make proposals at a shareholders' meeting (3%) or to call for an extraordinary meeting (5%).
Although these percentages are not really different from those provided by most of the western laws, in China their achievement is more difficult than abroad: indeed, the Chinese Company Law doesn't provide a procedure for shareholders to obtain a shareholders' list in order to solicit support for achieving the required percentage[37].
Redemption and appraisal rights of dissenting shareholders are limited by art. 143 only to merger and division; in the listed companies the problem is accentuated by the absence of shareholders general meeting special quorum[38].
There are not rules providing protection against under-priced stock issues, targeted sales of new shares or general attempt to dilute the vote of actual shareholders. This risk is often increased by the failure of the controlling shareholders to pay for their capital contributions.

5) The weak legal enforcement of the minority shareholders' protection

The well known opinion that the minority shareholders protection can be weakened by an unsuitable judicial context[39] may be easily applied to the Chinese situation.
Indeed, although the provisions in the Chinese laws appears "on the books" good enough for the protection of the minority shareholders, scholars have often observed that the legal enforcement of the their protection remains "de facto" problematic, since private and public mechanism of reaction could not be exercised easily[40].

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36 About the weak functioning of independent directors and supervisors in China see: Clarke Donald, *The Independent Director in Chinese Corporate Governance*, Delaware Journal of Corporate Law, Vol.31, n.1, 2006, 125.

37 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in T*aylor and Francis Books (ed.), *A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008, 8.

38 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008, 6.

39 La Porta Raphael – Lopes de Silares Lorencio – Shleifer Andrei – Wishny Robert, *Investor protection and corporate governance,*, Journal of Financial Economics 58, 2000, 3.

40 See: Fu Jeane, *Corporate Disclosure and Corporate Governance in China*, Kluwer Law International, 2010, 16; Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in*

The private mechanism of self legal protection offered to the same minority shareholders is generally considered to be not suitable.
Pre-emptive substantial difficulties arise from the traditional mistrust generated by the same use of judicial authority, considered unethical in the Chinese business' environment.
The difficulty is emphasized by the lack of a complete Judicial Explanation of the Company Law by the Supreme People's Court, without which local courts will be factually impeded from hearing related causes.
Indeed, although China's legal system doesn't adhere to case precedent, the ruling from the Supreme Court in any given case are binding on all lower courts.
In 2006 the Supreme People's Court announced that its interpretation would be issued in several steps, but at the date of this paper (autumn 2011) only three Judicial Explanation have been adopted.
The first and the second were issued in April and May 2008 and their purposes were mainly to clarify the issues involved in the application of the Company Law in dissolution and liquidation matters: the Court stated that derivative action also apply to the situation.
The third, issued in February 2011, intended to provide clarification and guidance on a few major issues, including assumption of liability incurred at the pre-incorporation stage, defective contributions and corresponding liabilities, and trust arrangement between beneficial investors and nominal shareholders.
The absence of Judicial Explanation on the derivative suit mechanism now provided by art. 153 creates a deep gap[41] and most of the legal enforcement of the minority shareholders' protection depends on rules in this forthcoming interpretation[42].
Apart from the lack of judicial explanation, several difficulties arise by the same judicial environment[43].
Courts are often not active in hearing corporate and securities cases, because listed companies and their officers will maintain a certain political backing and courts are neither experienced nor politically powerfully to judge cases

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East Asia,, London, 2008, 12; Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 88.

41 About the importance of the derivative lawsuit as a remedial and deterrent device for policing and preventing management abuses and to protect minority shareholders, see: Deng Jong, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, Harvard International Law Journal, Vol.46, number 2, Summer 2005, 347.

42 De Jonge Alice, *Corporate Governance and China's H-Share Market*, Edward Elgar Publishing ltd., 2008, 91; Huang Xiao, *Derivative actions in China: Law and Practice*, Cambridge Student Law Review, 2010, 246.

43 The role of the legal environment in enforcing corporate governance is well explained by La Porta Raphael – Lopes de Silares Lorencio – Shleifer Andrei – Wishny Robert, *Investor protection and corporate governance*,, Journal of Financial Economics 58, 2000, 7.

involving complicated questions and so powerful defendants[44].
The minority shareholders' problems are improved by the weak functioning of the public devices of legal enforcement provided for listed companies.
Although CSRC is no more a toothless "watchdog" of the Chinese securities' markets as it was in the past, it is still widely hampered in its effort to close these gaps at least for the listed companies[45].
First, the Company Law does not provide the CSRC with any specific power to curb dominant shareholders' looting. Its principal legal weapon is to declare the concealment of the underlying transaction to be a "material omission" in the statutory report of the listed company, subjecting the company and its executives to some sanctions.
Second, as government agency operating under the State Council's control, CSRC doesn't have sufficient administrative authority to confront with the high-level of state's shareholders behind some listed companies[46].

6) Looking for a self-enforcing corporate law model

Scholars argue that the best legal strategy for protecting minority shareholders while preserving managers' discretion to invest is a self enforcing model of corporate law that structures the corporate decision making process to allow large outside shareholders to protect themselves from insider opportunism with minimal recourse to legal authorities, including the courts[47].
This option, that may partially compensate for weak minority shareholders legal enforcement, has been widely adopted by the Chinese lawmaker.
For example, the Company Law now requires both shareholders' general meeting[48] and board approval for self interested transaction, for providing a guarantee to controlling shareholders or other controlling persons.
It should be noted that under the former Company Law these acts were strictly forbidden but this rule didn't avoid them.
The same option has been more widely explored by CSRC.
In 2004 the Authority promulgated a series of important regulations to strengthen the role of the shareholders' general meeting[49]. Implementation of

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44 Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 94; Xiaoning Li, *A comparative study of shareholders' derivative actions*, Kluwer, 2007, 255.

45 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008, 13.

46 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia,*, London, 2008, 12.

47 Black Bernard – Kraacman Reiner, *A self-Enforcing Model of Corporate Governance*, Harvard Law Review, 109, 1996, 1911.

48 The shareholders' general meeting is defined by art. 99 as the highest company's authority: Minkang Gu, *Understanding Chinese Company Law*, II ed., Honk Kong University Press, 2010, 139.

49 Available at the web site www.csrc.gov.cn.

or application for several matters can only be made upon its approval.
For example, those rules apply to the issuing of shares and convertible bonds, to assets restructuring for which the total consideration for those has a premium of at least 20% of the audited net book value, to repayment of debt owed to the company by a shareholder using the company's share and to other relevant matters in the development of the company which have a material impact on minority shareholders[50].
To strengthen the minority shareholder' voting rights, the Regulation states that when voting on those matters, a company shall provide to its shareholders a network voting platform.
In order to improve the corporate governance standard, the CSRC also attempts to enlist assistance from the financial intermediaries both at the share issuing and during takeover activities[51].
As chief underwriter of a public issuance, the "sponsor" must comply with the principles of honesty and due diligence in conducting its review of the issuer's offer.
The Takeover Rules obligates the offerer to retain a financial consultant who will issue its expert opinion on whether the offerer has fulfilled its duties under the Rule.

7) Conclusion: towards a class action system of investors' protection?
Despite the framework above described, it's a widespread opinion that small and medium sized shareholders maintain little interest in seeking to improve the corporate governance's standards in Chinese listed companies, since they tend do adopt a short-term policy in relation to their shareholdings[52].
The arising problems are accentuated by the policy adopted by the Institutional investors[53].
The Securities Investment Funds often appear unconcerned to listed companies' governance, share few interest in common with individual investor and have even been involved in market manipulation and other scandals; the local Social Insurance Funds have several governance problems for themselves[54].
Scholars have observed that in such context a high "index" of minority

50 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 15.
51 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 16.
52 Tomasic Roman – Andrews Neil, *Minority Shareholder Protection in China's Top 100 Listed companies*, Australian Journal of Asian Law, 2007, vol.9, n.1, 108.
53 Chao Xi, *Institutional Shareholder Activism in China: Law and Practice*, International Company and Commercial Law Review, vol. 17, 2006, also available at web site www.efmaef.org
54 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 28

shareholders' protection is important, but their protection remains problematic in China.

The most common belief is that they face to many difficulties when seeking redress against directors because the company may not be willing to pursue them in its own right[55]: the most critical consequences of such "isolation" concerns issues like the cost of litigation, recovery of expenses and security deposit[56].

This situation has led towards a different approach and the investors' protection during the shareholding acquisition seems indeed not less important than the improving exercise of their voice's rights.

The same opinion is appreciated on the judicial side[57].

Nevertheless, this different approach requires a collective device of protection and it's widespread opinion that since government bodies such as CSCR are not allowed to file public-interest suits against subordinate bodies, which they already supervise, the non-profit organizations may offer an important alternative[58].

Indeed, shareholders' non-profit organizations have effectively emerged in Korea, Japan and Taiwan, where they have played an important role as corporate law enforcement agents, and some scholars argue that they could play the same role in China[59].

However, although some organizations have been formed in China for claiming the compensation for false statement, their role appears to be meaningless without a class action procedure, which is generally considered to be the best enforcement mechanism to address gaps in the supply of investor or customers protection.

The demand for its introduction is continuously growing and not only in the minority shareholders' protection context. Different issues not far from the western idea of companies social responsibility, as well as environment, consumers or workers protection, are involved in it.

As a consequence, it's commonly stated that class action should represent the

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55 Huang Xiao, *Derivative actions in China: Law and Practice*, Cambridge Student Law Review, 2010, 246.

56 Tang Xin,*Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 13.

57 In 2003 the Supreme People's Court promulgated the "*Several Provisions for Trial of Civil Damages Case Arising from Misrepresentation in the Securities Market*", which provides a judicial safeguard against infringement of investors' interests in Chinese private securities litigation. For further details see: Deng Jong, *Building an Investor-Friendly Shareholder Derivative Lawsuit System in China*, Harvard International Law Journal, Vol.46, number 2, Summer 2005, 350.

58 The role of the groups was mainly studied by Olson Mancur, *The logic of collective action: Public goods and the theory of groups*, Harvard University Press, 1971,

59 Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 28

new challenge for the Chinese lawmaker[60].

60 Feinerman James, *New hope for corporate governance in China*, in Clarke Donald (ed.), *Chinese legal system: new developments, new challenges*, Cambridge University Press, 2008, 36; Tang Xin, *Protecting Minority Shareholders in China: a Task for both Legislation and Enforcement, in Taylor and Francis Books (ed.) A decade after the Crisis: Transforming Corporate Governance in East Asia*,, London, 2008, 28