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Corporate Law in the Shanghai People's Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State

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Abstract

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

¹ The author would like to thank the following colleagues and friends for their help in researching and assembling this article: Professor and East China University of Politics and Law ("ECUPL") Vice President Gu Gongyun, and Professors Li Xiuqing, Luo Peixin, Shi Tiantao, Tang Xin, Yang Zhongxiao, Wang Baoshu, Wu Hong, and Zhu Ciyun, and research assistant (and Luo Peixin student) Zhao Chenchen; and the following institutions for their support: the University of Michigan Law School and the University of Michigan Center for Chinese Studies, both in Ann Arbor, Michigan; the East China University of Politics and Law, Shanghai, PRC; and Tsinghua University School of Law, Beijing, PRC; and various justices, judges, officials and personnel at the Supreme People's Court of the PRC in Beijing and the Shanghai Higher People's Court system, including the Judges from the Shanghai Higher People's Court No. 2 Civil Division and District Courts – notably the Chief Judge of the Shanghai Higher People's Court No. 2 Civil Division Ms. Yu Qiuwei and the President of the Changning District People's Court Mr. Zou Bihua -- attending an open meeting on Company Law implementation in the Shanghai People's Courts held on Dec. 5, 2008 at ECUPL chaired by Vice President and Professor Gu Gongyun and Professors Yang Zhongxiao and Wu Hong. A special thanks to my colleague and friend Professor Li Xiuqing for all of her help in arranging for a fruitful sabbatical on the premises of ECUPL during the Autumn of 2008. In addition, the author wishes to thank the following for their very helpful review of and comments on working drafts of this article: Laura Beny; Donald C. Clarke; Jerome A. Cohen; Mary Gallagher; Tom Ginsburg; Don Herzog; Vic Khanna; Benjamin J. Liebman; Kyle Logue; Liu Sida; Curtis Milhaupt; Carl Minzner; Jonathan Ocko; Randall Peerenboom; Adam Pritchard; William Simon; Rachel Stern; Tang Xin; Frank Upham; Tim Webster; Mark West; and Madeline Zelin; and the participants in the "China Judicial Developments" Conference at the Columbia Law School on Feb. 20, 2009; the China Law Center Workshop at the Yale Law School on Mar. 3, 2009; and the University of Michigan Center for Chinese Studies Noon Lecture Series on Mar. 10, 2009. A Table of Cases and a Key to Case Source References useful for (i) the Table of Cases and (ii) the footnoted references to specific opinions in the main text (all in Chinese), appears at the end of the article. All translations of Chinese language materials into the English language are by the author.

negative side, a familiar paradox may be at work: with formal substantive law and institutional “modernization” promised and even partially delivered alongside equally apparent failures in the exercise of judicial autonomy, the result may be to de-legitimize the very institutions offered by the state and ruling Party as twin pillars of “modern” governance and “rule of law.”

INTRODUCTION

Political-legal reform in the People’s Republic of China (“PRC” or “China”) has lagged far behind the pace of economic system change and growth. Corporate law theorists hold that in transitional jurisdictions where the judiciary is politically weak or subject to oppressive influence, lacking in autonomy, or simply without technical competence, then company law and corporate governance must be largely “self-enforcing.”² By “self-enforcing,” theorists mean a corporate law design characterized by voting rules and transactional rights granted to firm investor-principals, and reliance on procedural protections, clear prohibitions and bright-line rules -- all meant to operate *ex ante* as substitutes for less precise judicial standards applied *ex post*. China’s first post-1949 company law of 1994³ was a textbook example of such a regime.⁴ Given the constraints acting on the PRC’s People’s Courts embedded in an authoritarian political system, and the burdens on China’s overworked public companies regulator, the China Securities Regulatory Commission (“CSRC”), the 1994 statute’s self-enforcing design and negligible allowance for judicial involvement were appropriate.

In late 2005, the national legislature of the PRC passed a wholesale reworking of the 1994 Company Law, effective as of January 1, 2006.⁵ In a head-spinning departure from the self-enforcing model of corporate law, the Company Law was suddenly filled with broad invitations for sophisticated judicial involvement. Although there had been undeniable improvements in the quality of the PRC People’s Courts up to 2005, few would have judged such progress a match for the significantly increased demands placed on the judiciary.

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

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

³ Adopted at the 5th Meeting of the Standing Committee of the Eighth National People’s Congress on Dec. 29, 1993 and effective Jan. 1, 1994, and amended by the 13th Meeting of the Standing Committee of the Ninth People’s Congress on Dec. 25, 1999 and the 11th Meeting of the Standing Committee of the Tenth National People’s Congress on Aug. 28, 2004 [hereinafter 1994 Company Law].

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

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

foreign participants in the global capital markets purchasing stock in PRC issuers – where Chinese law and legal institutions may serve different aims. To do so, I analyze full-length corporate law opinions for more than 200 cases selected from a much larger sample,⁶ a decade’s worth of cases analyzed in a 2003 Shanghai Higher People’s Court “Opinion” on the 1994 Company Law,⁷ and more than 760 disputes described in a 2007 report on cases implementing the Company Law in calendar year 2006⁸ -- -- all for a very wide diversity of Shanghai jurisdictions and procedural postures.⁹ I also rely on extensive discussions with Shanghai Court officials currently handling such disputes.

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

Generally speaking, case law in the Anglo-American legal system is itself the law... However, in a continental (civil) law system like China’s, law is constituted only by what the legislators promulgate as law; the decisions of the

⁶ Derived from annual Shanghai case collections reproducing opinions in civil and criminal cases aggregating over 500 case opinion sets (trial level and appellate level). *See* Key to Case Source References, *infra*.

⁷ Reviewing cases from the previous decade (1993-2003) [hereinafter Shanghai Company Law Opinion] in GONGSIFA YINAN WENTI JIEXI (DI SAN BAN) 231-6 (Shanghai Higher People’s Court ed., 2006) [hereinafter Shanghai Higher People’s Court 2006].

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

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

Chinese courts at present are not law, and such decisions are not in any way systematized.”¹⁰

Such scholars argue that there is no real value in studying Chinese cases and legal opinions, however unsystematically reported, because they are largely irrelevant in determining “what the law is.” In their view, the law is found in statutes and regulation promulgated by various legislative and administrative authorities and easily reviewed in abundant statutory collections. While it is true that judicial pronouncements on specific cases in China have no binding or persuasive effect on other decision makers in the same (regional) People’s Court system, much less across the national judicial or regulatory system,¹¹ a study of individual cases and the opinions they conjure is a very good way to understand how the People’s Courts apply China’s published norms. Perhaps more important, my study of cases and legal opinions reveals a great deal about how PRC judicial officers understand their role, and the degree to which they are competent in applying complex doctrines when much is at stake.

A second objection to my study might be that data composed of formal judicial opinions results in an ill-advised emphasis on adjudication results expressed at their most symbolic. But that symbolism and the articulated jurisprudence supporting specific results are critically important. If interested in the way in which Chinese judicial institutions operate in Chinese society, for Chinese citizens, and thus the degree to which they are understood to be competent, autonomous and/or independent, there is no better gauge than what the judiciary does formally and for public consumption.¹² Accordingly, this study examines how complex legal doctrines

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

¹¹ This is not to say that there have not been experiments in post-Reform China with case law as precedents – *e.g.*, the 2002 experiments in the Zhengzhou Zhongyuan District People’s Court (judges encouraged to review prior cases on point in arriving at judgments) and the Tianjin Municipal Higher People’s Court (prior cases, confirmed as “leading” cases by the People’s Court system, can be referred to in arriving at judgments, but cannot be the “basis” for arriving at present judgments). *See* JIANG SHIRONG, ZHONGGUO SIFA GAIGE YANJIU: PANLI YÜ FALÜ FAZHAN 151-2 (2006). *See also* Benjamin Liebman & Timothy Wu, *China’s Network Justice*, 8 CHI. J. INT’L L. 257 (2007) (People’s Courts judges relying on the decisions of People’s Courts in other jurisdictions) and Xin He, *Routinization of Divorce Law Practice in China: Institutional Constraints’ Influence on Judicial Behaviour*, 23 INT’L J. L. POL’Y & FAM. 83, 104 [hereinafter *Divorce Law Practice*] (People’s Court judges in family law cases rely on “precedents of upper level courts”). The careful reader will understand that hostility to case law precedents cannot remain the case forever, especially as the Chinese People’s Courts continue to exercise increasing autonomy with respect to cases featuring complex fact patterns and requiring standard-applying doctrines like the corporate law that is the subject of this writing. This development track is understood by PRC corporate law specialists and legal specialists and economists concerned with legal and judicial reform in China. *See* Luo Peixin, *Judicial Plights in the Context of the New Company Law of China*, THE DEVELOPMENT OF LAW IN ASIA: CONVERGENCE VERSUS DIVERGENCE, (Proceedings of the 3rd Asian Law Institute Conference, Shanghai, China, May 25-6, 2006) [hereinafter *Company Law Plights*] and *Huajie Minyuan: Sifa Ying Ti Zhengzhi Huachu “Huanchongdai”* [Assuaging Popular Anger: The Judiciary Should Be A “Conflict Resolution Area” Substitute], NANFANG ZHOUMO [SOUTHERN WEEKEND], Nov. 13, 2008, at E31 (edited transcript of discussion on the judiciary, rule of law and the legal and political system by Zhang Sizhi, Wu Ge, Shen Hong, Cai Dingjian, Chen Ming, Qiu Feng, Mo Luo and others in November 2008) [hereinafter *Assuaging Popular Anger*].

¹² The range of such formal action in this study is extremely wide, and thus indicates that the action itself is not merely formal. Most of the cases reviewed start at the District (or Basic) People’s Court level, whence they are

are applied by the judiciary in Shanghai and entirely for public consumption. Thus, I do not bother much with difficult suppositions addressed in a good deal of current scholarship on the Chinese People's Courts: *i.e.*, the reality of why People's Courts' act in the corporate law sphere, as difficult as that would be to generalize even in one (regional) People's Court system. For example, I make no effort here to divine the real influence of "Political Legal" or "Adjudication" Committees¹³ staffed by political cadres and non-lawyers, the extent to which judicial officials hearing specific pleadings actually decide cases or write the related opinions,¹⁴ political pressure or other factors at work in judicial responses or decision-making,¹⁵ the extent to which lower Court judges seek explicit guidance from higher-level People's Courts prior to rendering initial trial-level judgments, the effect of cadre incentive systems on judges, the injuries done by high-levels of corruption and decision-making dominated by *ex parte* interactions, or any of the varied order of "social processes" at work. With this focus I do not mean to disavow the idea that Chinese judicial institutions – and in fact the entire PRC legal construction program – operate on at least two levels: (i) the symbolic/formal/globally-convergent/legitimacy-seeking, and (ii) the authentic/informal/indigenous/administration-requiring.¹⁶

subject to appeal (to the intermediate level) at the litigants' initiative. Less frequently cases skip over the District level and proceed directly to an Intermediate People's Court, whence appeal is taken to the Shanghai Higher People's Court. In only one example in the sample, *Guangxi Xineng Science and Technology Limited v. Guotai Securities Co. Limited* (Shanghai Higher People's Court, 2003; upheld on appeal by the Supreme People's Court, 2003) (Shanghai Higher People's Court 2005: 211-2), does the case reach the Supreme People's Court. Indeed, many of the case opinions indicate seemingly endless re-hearings, often by the same court level (but by different panels of judicial officers). For instance, one 2004-6 case shows a dispute heard twice by the District People's Court, an appeal to the Intermediate People's Court, remand to the original District level, and then appeal again to the higher Intermediate People's Court (*Shanghai Bund City Real Estate Comprehensive Development Company v. Zhu Minzhao, Shanghai Guangtao Decorative Company, Shanghai Xucheng Enterprise Development Company and Fan Jianmin* (Shanghai Jiading District People's Court 2004, reheard by Shanghai Jiading District People's Court 2005, overturned by Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division) in 2006, sent back to the Jiading District People's Court 2006 and then appealed again to Shanghai No. 2 Intermediate People's Court for 2006) (HSHFY, 2006 Hu Er Zhong Min San (Shang) Zhong Zi No. 461)). The Chinese courts do not hold to the fact-law distinction between trial and appellate courts known in the United States, England and many non-Chinese jurisdictions. Accordingly, PRC appellate proceedings allow not only law pleadings, but *de novo* pleadings of law and fact. Yet, in the many cases reviewed for the study, only very few show reversal at the second level of adjudication. Certainly higher-level courts demonstrate how free they are to undertake factual investigations *de novo*, and often apply different law and/or remedies, but the final judgments rarely change. That being said, the proportion of reversals or differentiated judgments seems higher in corporate and commercial cases when compared to criminal prosecutions or criminal appeals. All of this supports the belief that the Shanghai People's Courts are not just "going through the motions" in corporate law adjudication and thus not operating merely in the "formal".

¹³ Still alluded to informally by PRC officials as "*zhengfawei*" (Legal Political Committees) or now formally "*shenpan weiyuanhui*" (Adjudication Committees). See *infra* note ____.

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

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

¹⁶ See Nicholas C. Howson, *Rujia Zhi Si? [The Death of Confucianization?]*, 17 SHANGHAI SHUPING [SHANGHAI REVIEW OF BOOKS], Nov. 2, 2008, at 5, and Liu Sida, *supra* note ____, at 91 (addressing the establishment of an "Administrative Division" in a local level Hebei People's Court notwithstanding very few petitions for administrative review, "One might reasonably posed the question why the judicial reform bothered to establish the Administrative Division in the basic level courts. Indeed, given the institutional constraints of

This study is highly significant from at least two standpoints. First, for corporate governance specialists, it provides a more accurate view of how effective corporate governance has in the past, and might in the future, develop in China and other transitional political-economies. With the start of massive corporatization of state-owned and collectively-owned assets in the PRC starting in the 1990s, China and the world recognized that the achievement of effective corporate governance presents real difficulties.¹⁷ Those obstacles threatened to embed in China's corporate law, and corporate governance practices, systems that would work against aggregating capital for significant development, attracting investment from private and public capital markets, or creating market participants which in turn respond efficiently in a semi-marketized economy. Throughout it has been understood that all other available instruments of corporate governance must be supported by the application and enforcement of corporate law, usually *ex post*, by a competent judiciary.¹⁸ The 2005 amendments to the PRC Company Law were explicitly¹⁹ directed to this critically important amelioration of China's corporate governance system.²⁰ A review of corporate law adjudication in Shanghai over almost two decades thus provides data on how China's People's Courts have done in supporting better

administrative litigation, without considerations of legitimacy at the global level, the existence of the Administrative Division in Chinese basic-level courts would have become completely unnecessary. This clearly indicates the symbolic meaning of the judicial organization, *i.e.*, to create the outlook of a judiciary that is capable to check and balance the power of the government offices, as the judiciaries of the Western countries usually do. Meanwhile, the demand for economic growth produces an equally important type of legitimacy for the Chinese government. When these two types of legitimacy coincide in the judicial practice, the appropriated formal structure is decoupled from both. The decoupling of the judicial organization, therefore, shows the conflict and compromise between the two major types of legitimacy that are vital for the Chinese state.”)

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

¹⁸ See ZHONGGUO GONGSI ZHILI BAOGAO (2003 NIAN) (Shanghai Stock Exchange Research Center ed., 2003) [hereinafter China Corporate Governance Report]; Donald C. Clarke, *The Role of Non-legal Institutions in Chinese Corporate Governance*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 168-192 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) [hereinafter Non-legal Institutions]; and Benjamin Liebman & Curtis Milhaupt, *Reputational Sanctions in China's Securities Markets*, 108 COLUM.L.REV. 929 (2009).

¹⁹ See Cao Kangtai, *Guanyu “Zhonghua Renmin Gongheguo Gongsifa (Xiugai Caoan)” de Shuoming [Explanation Regarding “Company Law of the PRC (Amended Draft)”]* at 525-6 ZHONGGUO RENMIN GONGHEGUO ZHENGQUANFA, ZHONGHUA RENMIN GONGHEGUO GONGSIFA XINJIU TIAOWEN DUIZHAO JIANMING JIEDU (Gui Minjie ed., 2005) [hereinafter LAO Company Law Explanation].

²⁰ Thus, the present story for corporate governance specialists is also tangentially about identification of “functional” as opposed to merely “formal” convergence in business organization and corporate and securities law in a transitional political economic system like the PRC, a topic I have already explored in some detail connection with China's company law developments. See Ronald Gilson, *Globalizing Corporate Governance: Convergence of Form or Function*, 49 AM.J.COMP.L. 329 (2001) and Nicholas C. Howson, *The Doctrine That Dared Not Speak Its Name: Anglo-American Fiduciary Duties in China's 2005 Company Law and Case Law Intimations of Prior Convergence*, in 193-254 TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) [hereinafter Doctrine That Dared Not]. See also Iain MacNeil, *Adaptation and Convergence in Governance: The Case of Chinese Listed Companies*, 2 J. CORP. L. STUD. 289 (2002) and the conclusion to Professor Xi Chao's broader study of China's corporate law, CHAO XI, CORPORATE GOVERNANCE AND LEGAL REFORM IN CHINA 222 (2009) [hereinafter Corporate Governance and Reform].

corporate governance, and the real impact of formal change in substantive law that gives a greater role to court institutions.

Second, for legal institutional analysts this study offers a richer understanding of the function, operation and political-legal role of the judiciary in contemporary China's non-democratic, non-"rule of law" state, and the impact of substantive legal change and economic system change on the same institutions. The Chinese People's Courts are increasingly the subject of intense study by political scientists, sociologists, anthropologists and legal scholars.²¹ Some of this work focuses on specific areas of adjudicatory (or mediation) practice, including hot button issues like family law,²² labor rights,²³ environmental torts,²⁴ and even constitutional rights and administrative law.²⁵ One American scholar analyzes the incentives at work for Chinese judges, and their bureaucratic roles and responses.²⁶ And some address comparisons between the workings of formal judicial institutions and local or central arbitration commissions.²⁷ There is less writing on how the People's Courts act in the commercial sphere,²⁸

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

²² See *Divorce Law Practice*, *supra* note __.

²³ See Mary Gallagher, "Use the Law as Your Weapon!" *Institutional Change and Legal Mobilization in China*, in *ENGAGING LAW IN CHINA: STATE, SOCIETY AND POSSIBILITIES FOR JUSTICE* __ (Neil J. Daimant, Stanley B. Lubman & Kevin O'Brien eds., 2005); C.K. LEE, *AGAINST THE LAW: LABOR PROTESTS IN CHINA'S RUSTBELT AND SUNBELT* (2007) [hereinafter *Against the Law*]; and Xin He & Su Yang, *Street as Courtroom: State Accommodation of Labor Protest in Southern China*, [forthcoming 2009].

²⁴ See Rachel Stern's developing work on environmental litigation in China.

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

²⁶ This is Carl Minzner and his ongoing investigation of the workings of the cadre/judge "responsibility system" inside the People's Courts. See for example Carl Minzner, *Judicial Responsibility Systems for Incorrectly Decided Cases*, in [TITLE?] (Margaret Woo ed., forthcoming 2009) [hereinafter *Judicial Responsibility System*].

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

and seemingly no writing whatsoever on corporate law (or securities law) adjudication -- notwithstanding a corporatization project more than two decades old.²⁹ With respect to courts established in the embrace of authoritarian political regimes generally, two North American scholars have elaborated five primary functions: (i) social control and the containment of political opposition; (ii) bolstering regime “legality”; (iii) support of administrative compliance and coordination of competing factions; (iv) the facilitation of trade and investment; and (v) the provision of cover for controversial policies.³⁰ In this article I investigate how the Shanghai People’s Courts perform their more “horizontally-oriented” conflict resolution and investment facilitation functions, and to a lesser extent their regulatory and administrative compliance functions. This is a sphere of activity far less provocative for China’s rulers than other more explicit areas of “vertical” political-social control, such as enforcement of the criminal law or police action against anti-Party critics.³¹ This approach is not meant to ignore the political-ceremonial role the People’s Courts have even in corporate law adjudication. That role is as substantial today as it was in Chinese imperial history (via the magistrate), and is in the criminal law sphere in contemporary China, and corporate law adjudication in foreign jurisdictions.³² In fact, Company Law application in the Chinese People’s Courts has extremely significant implications for politics and governance in the PRC. Since 1994 the Chinese People’s Courts been given the power and technical bases to act in corporate and commercial law cases with a degree of expertise and autonomy far beyond the traditional role of Communist-era courts, and in cases where very significant material interests are at stake. Not only that, but the PRC courts are now increasingly asked to apply the newly-justiciable corporate law in disputes arising between independent commercial actors and other more privileged political-economic actors, thus challenging judicial institutions to act “independently” as well as “autonomously”. Consider for example a shareholder’s lawsuit against a company director who represents the interests of a state agency-related or municipal government controlling shareholder – or the controlling shareholder itself³³ -- for breach of corporate fiduciary duties, abuse of the corporation, shareholder oppression, or impermissible related party transactions. Here the PRC judiciary is called upon to protect legal rights and norms under the PRC Company Law against the superior power and influence of the government (or Party which controls the state), which power has for many years included absolute domination and funding-control of the People’s

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

²⁹ But see Doctrine That Dared Not, *supra* note __. See also Non-legal Institutions, *supra* note __, for a consideration of necessary judicial institutions substitutes in respect of public company corporate governance.

³⁰ Authoritarian Rule of Law, *supra* note __, at 4.

³¹ It is also a sphere where at least the Shanghai People’s Courts appear to engage in markedly lower rates of mediation. Of the total number of corporate law cases accepted by the Shanghai People’s Courts in 2006, for first hearing cases, 55.21% gave rise to judgment, 11.46% were concluded via mediation, and 33.33% were subject to some kind of Court order. For cases subject to re-hearing and/or appeal, judgments were issued in 43.41% of the cases, 55.13% were subject to Court order and a paltry 1.46% were resolved through mediation. Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 37-51. Sociologist Liu Sida notes that this percentage of mediation is significantly lower than in other civil cases in the PRC nationally (e-mail to author by Liu Sida, Feb. 2009).

³² Consider the clear “political ceremonial” role allowed the Delaware Court of Chancery in the most authoritative corporate law adjudication in the United States, embodied in that same Court’s high-flying rhetoric and articulation of legal standards matched with non-application of the standards it proclaims. See *In re The Walt Disney Company Derivative Litigation*, 2005 WL 2056651, *36 (Del.Ch.) (Aug. 9, 2005).

³³ Permitted under the 2006 Company Law, where controlling shareholders explicitly have fiduciary duties to the corporation and by implication to the minority shareholders. See 2006 Company Law, Article 20.

Courts hearing the case.³⁴ As the PRC Courts act autonomously in this apparently mundane context of corporate and commercial law it must have significant implications for the exercise of the judicial power independently in other, more sensitive, contexts.³⁵

³⁴ This article does not focus on questions of (explicit) political independence. For a consideration of that aspect, *see* Shanghai Judicial Independence, *supra* note __, invoking as explicit examples of demonstrated judicial (political) independence: (i) the 2003 case where a District level Shanghai People’s Court says it will enforce the contractual rights of the occupier of a condemned industrial site against a local government agency (which offers as a defense against payment of compensation under the contract the idea that it signed the contract on behalf of the District People’s Government and did not perform accordingly in accordance with the “instructions of higher levels” (*shangji zhishi*)) because the contract was validly formed under law, and the rights arising thereunder shall “receive the protection of the law” (implicitly against the government) -- *Shanghai Kangpais Enterprise General Company v. Shanghai Municipal Administration of Industry and Commerce Huangpu District Branch, Shanghai Pushun Shunzhe Development Company and Shanghai Huangpu Market Development General Company*, (Shanghai No. 2 Intermediate People’s Court, 2001, upheld by Shanghai Higher People’s Court, 2003) (Shanghai Higher People’s Court 2005: 352); and (ii) the 2007 veil-piercing case which demonstrates Court action against the interest of what is almost certainly a large (and central) state player, but presents the more expected circumstance of the Shanghai People’s Courts acting against the interest of a *non-Shanghai* government political power -- *Shanghai Huaxin Electric Wire and Cable Company v. China Tietong Group Company* (Shanghai No. 2 Intermediate People’s Court (No. 4 Civil Division), 2007, upheld by the Shanghai Higher People’s Court, 2007) (HSHFY, 2007 Hu Gao Min Er (Shang) Zhong Zi No. 145). *See* also the cases noted *infra* notes __ and accompanying text, where the Shanghai People’s Courts lecture former collective leaders metamorphosed into directors and officers with fiduciary duties, and forbidding the use of corporatization and corporate law as a shield for misappropriation of public assets. With respect to the political independence inquiry, there seems to be general agreement that “about 80%” of all People’s Court judges are Communist Party members (*see* Wu Yulian (Hunan Higher People’s Court), *Faguan Sanzhong Shenfen [The Three Statuses of Judges]*, DONGFANG FAYAN, find at: <http://www.dffy.com/fayanguancha/sd/200810/20081012174522.htm> (October 12, 2008)). Yet, there continues to be a good deal of controversy and some mystery over the function of the so-called “Political Legal Committee” (*zhengfawei*) or “Adjudication Committee” (*shenpan weiyuanhui*) inside the People’s Court system generally, and with respect to judgments rendered on individual cases specifically. At their worst, such Committees – staffed with officers devoid of legal training -- are understood as purely Party political institutions deciding cases without reference to the considered views of the judges actually hearing the case and solely on political (or worse bureaucratic “quota”) grounds. At their sunniest, these Committees are merely lofty administrative organs inside a specific People’s Court system that issue policy guidance to the Court system under their jurisdiction. The truth is probably somewhere in the middle, and seems to vary among jurisdictions and the nature of the cases. It is certain that there is such a Committee for each of the three levels in the Shanghai People’s Court system – thus a Committee inside the Higher People’s Court, the Intermediate People’s Courts, and each Basic (or District) Level People’s Court. According to officials at the Shanghai People’s Courts, most corporate and commercial case opinions are first drafted and then “filed” (*beian*) with the Adjudication Committee. Yet the same officials noted that if a specific case is “particular” (*teshu*) – potentially impacting on social stability (*wending*) or “conflicting powers” – the panel actually hearing the case and its People’s Court level will seek the opinion of the Adjudication Committee before accepting or deciding a case. These same officials declared that the notion of “conflicting powers” does not accommodate political conflict or political-economic privilege, but instead “conflicting jurisdictions” (for instance CSRC regulation or the application of the corporate law by the Courts). It is difficult to know how realistic that appraisal is, and the extent to which Courts acting alone or under the power of the Adjudication Committees would not be very sensitive to the political background of the cases and litigants who appear before them. The normative dispute about politicization of the People’s Courts, and the Political Legal Committees, in China as joined between Beijing University Law School colleagues Zhu Suli and He Weifang is described at Liu Sida, *supra* note __, at 81 (footnote 4) & 92-3 and Not Taking Disputes, *supra* note __, at 203-4.

³⁵ I note that the study relates to a time period during which the rhetoric applied to the People’s Courts has shifted significantly, and in a direction which most outside observers understand as *away* from professionalism and autonomy. The Supreme People’s Court’s Second Five-Year Program for the People’s Courts released in late 2005 exhibited extraordinary emphasis on judicial professionalism and autonomy. Starting in late 2007, with a change in leadership at the top of the Supreme People’s Court (from Xiao Yang to Wang Shengjun), and confirmed in the March 25, 2009 Third Five-Year Program for the People’s Courts, the Supreme People’s Court now exhorts the

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

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

I. THE 2006 COMPANY LAW – A NEW JUSTICIABILITY

China's formal company law after 1992³⁶ was always an expression of the standard shareholder-oriented form of corporation and thus in formal terms a vindication of pre-2008 Global Financial Crisis declarations of the "end of corporate law history."³⁷ China's company law model was fashioned in this manner for two reasons. First, the Law was intended to respond

People's Courts towards a revived "mass line" (called "democratic") style. See *Judicial Reform Difficulties*, *supra* note __; *Judicial Mystification*, *supra* note __; Nicholas C. Howson, *Review of Xiaoqun Xu, Trial of Modernity: Judicial Reform in Early Twentieth-Century China, 1901-1937*, 57 AM.J.COMP.L. 518 (2009) [hereinafter *Trial of Modernity Review*]; and *Mass Appeal Courts*, *supra* note __.

³⁶ In actual fact, the 1994 Company Law was – with respect to indicia of "shareholder-orientation" -- a retreat from the better form of "Opinion on Standards for Companies Limited by Shares" of May 1992. See Nicholas C. Howson, *China's Company Law: One Step Forward, Two Steps Back? A Modest Complaint*, 11 COL. J. ASIAN L. 127 (1997) [hereinafter *One Step Forward*].

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

to the demands of domestic and globalized capital markets on Reform-era China -- where the purpose of corporate establishments was to attract finance from value-seeking shareholders wielding non-state, domestic and foreign, capital.³⁸ Second, the adoption of a shareholder-oriented company model was the continuation of China's century-long quest for "modernity" so often synonymous with the formal adoption of perceived state of the art institutions, laws and practices.³⁹

In form at least, the 1994 Company Law exemplified the so-called "self-enforcing" corporate law model.⁴⁰ The company statute and much of the elaborating regulation and mandatory forms promulgated by CSRC were characterized by voting rules and transactional rights granted to direct participants in the Chinese corporation, reliance on procedural protections and clear prohibitions with respect to disfavored transactions, and bright-line rules meant to operate *ex ante* – all as substitutes for judicial or administrative actor-articulated standards applied *ex post*.⁴¹ For instance, the 1994 Company Law required supermajority (two thirds) shareholder approval before *any* change to the company's articles of association.⁴² Likewise, the CSRC's 1997 "Mandatory Articles of Association for Overseas Listing Companies" provided for class-like shareholder negative veto rights,⁴³ and separate CSRC regulations issued in 2004 required disinterested "public" shareholder approval of related party transactions, including the wide-scale abuse whereby controlling shareholders burdened their dominated public subsidiaries with guaranty obligations benefiting such shareholders.⁴⁴ Consistent with this self-enforcing

³⁸ So, in fact a partial vindication of Professor Coffee's ideas of a decade ago. See John Coffee, *The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications*, 93 NW. U.L.REV. 641 (1999). This appraisal of the philosophical underpinnings of China's corporate law system remains true, even if China's first try at a modern company law statute in 1993-4 was in parts self-contradictory and simply incoherent. See One Step Forward, *supra* note ____.

³⁹ See WANG XIAOWEN, GONGSI LUN (1930); C.K. Lai, *The Qing State and Merchant Enterprise: The China Merchant's Company, 1872-1902*, in TO ACHIEVE SECURITY AND WEALTH: THE QING IMPERIAL STATE AND THE ECONOMY (J.K. Leonard & J.R. Watts eds., 1991); William C. Kirby, *China Unincorporated: Company Law and Business Enterprise in Twentieth-Century China*, 54 J. ASIAN STUD. 43 (1995); WELLINGTON K.K. CHAN, MERCHANTS, MANDARINS, AND MODERN ENTERPRISE IN LATE CH'ING CHINA (1977); DOU JIANMIN, ZHONGGUO GONGSIZHI SIXIANG YANJIU (1999) [hereinafter History of Chinese Corporate Thought]; Corporate Governance and Enterprise Reform, *supra* note ____; and Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494 (2003).

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

⁴¹ See The Doctrine That Dared Not, *supra* note ____.

⁴² 1994 Company Law, Articles 106 & 107.

⁴³ This at a time when PRC corporate law did not recognize different "classes" of shares (and so these mandatory corporate charters speak to different "types" (*leibie*) of shares). See Mandatory Articles of Association for Overseas Listing Companies, CLC, *supra* note ____, at p. 4-43. This Articles of Association-based provision alone proved effective in defeating a PRC central-government-disfavored Singapore Airlines bid to acquire something close to control of China Eastern Airlines Company, Limited in 2007. See Barry Naughton, *SASAC and Rising Corporate Power in China*, 24 CHINA LEADERSHIP MONITOR 1 (2007).

⁴⁴ CSRC, "Several Provisions on Protection of the Rights of Public Shareholders" [*Chinese title*], (2004) *zhengjianfa* No. 18, issued Dec. 7, 2004 -- which in the case of guarantees for affiliates notably came after an immediately useless 2003 CSRC and Ministry of Finance Notice stipulating merely super-majority *board* approval or majority *shareholder's meeting* approval: "Notice on Several Issues Concerning the Standardization of Funds Transfers Between Listed Companies and Their Affiliates and the Giving of Guarantees by Listed Companies" (*Guanyu Guifan Shangshi Gongsi Yu Guanlianfang Zijin Wanglai Ji Shangshi Gongsi Duwai Danbao Ruogan*

orientation, little in the 1994 Company Law invited judicial participation in sorting out corporate disputes, whether for external actors (*e.g.*, corporate veil piercing) or internal participants (*e.g.*, traditional corporate fiduciary duties).⁴⁵

The rationales supporting a self-enforcing design in early 1990s China – and many would say mid-2000s China – are easily understood. The PRC’s reforming judicial structures were and are widely perceived from abroad as being subject to political and other extra-legal pressures, and lacking in real sophistication or competence.⁴⁶ The criticisms openly leveled at the PRC People’s Courts from inside China then and now range even more widely, and include their perceived lack of political independence,⁴⁷ lower courts seeking guidance from higher courts prior to rendering judgments,⁴⁸ funding by and resulting deference to local government and Party organs,⁴⁹ inability to act against local governments whether to enforce central government policy or vindicate the asserted rights of citizen individual or groups,⁵⁰ powerlessness against the police and secret police,⁵¹ inability to accept cases which involve large numbers of plaintiffs and thus have implications for “social stability,”⁵² wide-ranging corruption,⁵³ lack of technical

Wenti de Tongzhi), (2003) *zhengjianfa* No. 56, issued Aug. 28, 2003), Paragraph 2(3) (“useless” because the board was dominated by the controlling shareholder, likewise the approving full shareholders’ meeting).

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

⁴⁶ See Power and Politics, *supra* note __; Long March, *supra* note __; What Kind of Judiciary, *supra* note __; Restricted Reform, *supra* note __; Not Taking Disputes, *supra* note __; and China Judicial Independence, *supra* note __.

⁴⁷ See Judicial Reform Difficulties, *supra* note __; Assuaging Popular Anger, *supra* note __; and China Judicial Independence, *supra* note __.

⁴⁸ See Zhao Lei, Quxiao “Anjian Qingshi” Husheng Zai Qi [Calls Raised Again to Eliminate “Seeking Guidance in Cases”], NANFANG ZHOUMO [SOUTHERN WEEKEND], May 5, 2009, at <http://www.nanfangdaily.com.cn/epaper/nfzm/content/20090521/ArticelA03002FM.htm> [hereinafter Seeking Guidance] (stating that the Supreme People’s Court is drafting a prohibition on the practice).

⁴⁹ On Nov. 28, 2008, a proposal by the Central Legal-Political Commission to centrally-fund all People’s Courts – the “Opinions of the Central Legal-Political Commission on Several Issues in the Deepening of Reform in the Judicial System and Work Mechanism” -- was endorsed by the Chinese Politburo. If implemented, this may prove a very important step in creating a more independent judiciary in the PRC and unhooking the Courts from the power and influence of their current paymasters, the local governments and Party organs where they sit. See considered discussions of this proposed reform and its perhaps limited effect at <http://news.sina.com.cn/c/2008-12-05/015716785000.shtml> (Chen Huan, Dec. 5, 2008) and Wang Jianxun, *Celiang Shehui de Hexie Chengdu* [Measuring the Degree of Harmony in Society], DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Dec. 7, 2008, at D24 [hereinafter Measuring Harmony]. Yet, and as noted above, this proposed reform will have to do battle with the new “mass line” for PRC judicial institutions being pushed by the Supreme People’s Court and the Communist Party. See Judicial Reform Difficulties, *supra* note __; Judicial Mystification, *supra* note __; Trial of Modernity Review, *supra* note __; and Mass Appeal Courts, *supra* note __.

⁵⁰ See Assuaging Popular Anger, *supra* note __.

⁵¹ See Assuaging Popular Anger, *supra* note __.

⁵² See Xiao Han, *Qunti Peichang: Quanyi yu Yongan* [Mass Compensation: Rights and Stability], CAIJING, Oct. 13, 2008, at 152 [hereinafter Mass Compensation].

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

competence,⁵⁴ writing of opinions *before* judicial hearings and trials,⁵⁵ lack of due process and procedural consistency,⁵⁶ endless procedures, appeals, and frustrations which do not deliver a resolution or compensation much less anything resembling “justice”,⁵⁷ understaffing and over-stretched resources,⁵⁸ failure to provide long-promised public hearings of cases,⁵⁹ enforcement “chaos”,⁶⁰ and much more.

Given the perceived state of the Chinese judiciary and the resulting requirements for a self-enforcing model of corporate law, the extensive amendments to the 1994 Law announced in November 2005 were startling. The new Company Law unveiled in late 2005 expanded the original statute with two new chapters, reduced the original 230 Articles to 219, and added 44 new Articles, amended 91 Articles and completely eliminated 13.⁶¹ Most important, in the words of corporate law scholar Professor Liu Junhai the 2006 Company Law radically changed and augmented the “justiciability” (or “litigability” (*kesuxing*)) of China’s corporate statute and the entire corporate governance regime.⁶² Similar views issued from the No.2 Civil Division of the Supreme People’s Court in Beijing, that part of the Court bureaucracy charged with hearing corporate law cases, with its statement that the new form of Company Law “strengthened the justiciability of civil [law] rights protection” (*zengqiang minshi quanyi de kesuxing*).⁶³ The Shanghai Higher People’s Court echoed these academic and Court leadership pronouncements in 2007⁶⁴ and noted the concrete effect of such formal changes, saying that the amended statute “must affect the way in which corporate cases are heard by the judiciary.”⁶⁵

Behind this seemingly radical change of direction was the fact that corporate governance at China’s corporate entities – whether small privately-held close corporations and corporate

Higher People’s Court, the President of the Liaoning Province Higher People’s Court, and the many examples from the Intermediate and Basic (or District) level People’s Courts.

⁵⁴ See Judicial Mystification, *supra* note ___.

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

⁵⁶ See Assuaging Popular Anger, *supra* note ___.

⁵⁷ See Zhao Ling, *Zhongguo Zuimangde Fating [China’s Busiest Court]*, NANFANG ZHOUMO [SOUTHERN WEEKEND], Dec. 4, 2008, at A7 [hereinafter China’s Busiest Court]; and Assuaging Popular Anger, *supra* note ___.

⁵⁸ See China’s Busiest Court, *supra* note ___.

⁵⁹ See Assuaging Popular Anger, *supra* note ___.

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

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

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

⁶³ SPC Press Conference 2006, *supra* note ___, at 4-5.

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

⁶⁵ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note ___, at 37.

partnerships, or the largest corporatized SOEs now publicly-held companies with shares listed in Shanghai, Hong Kong, London, or New York – was not functioning. In the private, closely-held context, corporate establishments became the fertile setting for fraud, looting and asset stripping, minority shareholder oppression, and firm mismanagement. In the public company setting, notwithstanding mandatory PRC and foreign disclosure requirements, the power of PRC and foreign securities and Exchange regulation, and the ready threat of foreign securities class action suits, the situation proved even worse. Public companies were run as instruments meant to conveniently attract passive capital from the stock markets and serve the needs of a controlling shareholder (often an identity of the central or local government) and its insider appointees (just as often political cadres advancing through a *nomenklatura* (Party personnel) system divorced from the reach of corporate or securities law),⁶⁶ with ample opportunity for conflicted transactions or outright stealing of assets.⁶⁷ The deficit understood in the public company context contributed to both the perception and reality of dysfunctional capital markets, understood as either a “casino” (in the famous words of Chinese reform economist Wu Jinglian) or an insiders’ playground with an informational asymmetry overwhelmingly in favor of such insiders and their political masters.⁶⁸ As the Shanghai Stock Exchange summed up in an influential 2003 “China Corporate Governance Report,” China’s corporate governance regime and implementation were deeply flawed because of lopsided shareholding structures, the failure to divorce the government from enterprise ownership and control, weak self-regulation and enforcement, obstacles in the way of shareholders seeking legal protections, insider control of enterprises and personnel appointments, weak external governance mechanisms,⁶⁹ a failed information disclosure regime, lack of a fiduciary duties “culture” and supporting ethical commercial norms, and a passive media failing to communicate reliable information to the public.⁷⁰ As recognized by everyone from external analysts to the highest reaches of the PRC government,⁷¹ one of the ways to reverse this disturbing development path was to involve the

⁶⁶ Nicholas C. Howson, *China’s Restructured Commercial Banks – The Old Nomenklatura System Serving New Corporate Governance Structures?*, in CHINA’S EMERGING FINANCIAL MARKETS: CHALLENGES AND GLOBAL MARKETS 123-163 (Martha Avery, Cai Jinqing and Zhu Min eds., 2009).

⁶⁷ See STEPHEN GREEN, CHINA’S STOCKMARKET: A GUIDE TO ITS PROGRESS, PLAYERS AND PROSPECTS 118-153 (2003) [hereinafter China’s Stockmarket]; and LAO Company Law Explanation, *supra* note ___, at 528-530.

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

⁶⁹ Market for corporate control, creditors’ rights and a bankruptcy regime, institutional investors, and executive compensation.

⁷⁰ China Corporate Governance Report, *supra* note ___, at 20-32.

⁷¹ LAO Company Law Explanation, *supra* note ___, at 525-6.

judiciary and the legal system, as an adjunct to the over-stretched securities regulator and the perhaps equally over-taxed, but certainly technically deficient and politically-conflicted People's Procurate (China's public prosecutor).⁷² As the Shanghai Stock Exchange said in respect of public company governance:

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

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

Interestingly in light of the findings below regarding the relative absence of public company cases in the Shanghai Courts,⁷⁵ the initial response to these governance failures and the consequent push for judicial involvement came not from the People's Courts, the PRC legislature, or even the CSRC, but the new class of public shareholders themselves.⁷⁶ After

⁷² This was recognized explicitly in the public remarks by the President of the Changning District People's Court, who noted that the People's Court *had* to get involved in *ex post* standards application to attack phenomena like opportunism and shareholder oppression which are simply impossible to regulate *ex ante*. Remarks of President Zou Bihua, Dec. 5, 2008, notes on file with author.

⁷³ China Corporate Governance Report, *supra* note __, at 23.

⁷⁴ China Corporate Governance Report, *supra* note __, at 135. The Shanghai Higher People's Court recognized this in its own 2007 report on application of the Company Law. While admitting that the 1994 statute was "incomplete", it also emphasized that that the decade before 2006 saw problems with China's company law and corporate governance systems far more serious than mere incomplete, sloppy or contradictory drafting, including rampant fraud visited on shareholders, controlling shareholder opportunism, misuse of corporate limited liability to harm the legitimate rights of creditors, etc. As the Court somewhat poignantly observes, "the great tide of the marketized economy called out for... a company system which the Courts might actually be able to implement..." Shanghai Higher People's Court 2006, *supra* note __, at 1. See the lovely echo of this energy in a 2007 Shanghai case, where a defendant controlling shareholder's defense against piercing the corporate veil to the defendant -- to the effect that "the [piercing] claim is not a proper subject of litigation [as against administrative fiat]" -- is roundly rejected by the Shanghai No. 2 Intermediate People's Court and the Shanghai Higher People's Court, both of which endorse the idea that this is precisely the kind of remedy civil parties are to avail themselves of under the new 2006 Company Law: *Shanghai Huaxin Electric Wire and Cable Company v. China Tietong Group Company* (Shanghai No. 2 Intermediate People's Court (No. 4 Civil Division), 2007, upheld by the Shanghai Higher People's Court, 2007) (HSHFY, 2007 Hu Gao Min Er (Shang) Zhong Zi No. 145) (upholding the assertion and adjudication of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law).

⁷⁵ See *infra* notes __ and accompanying text.

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

1998, and much to the judiciary's discomfort, they flooded the PRC courts with claims of false or misleading disclosure claims against securities issuers.⁷⁷ Those developments, and the pressure starting with public shareholders and belatedly supported by the CSRC, and channeled by the Supreme People's Court, resembled the effort almost 10 years later to make the PRC Company Law itself "justiciable". Yet, mere justiciability of the Company Law was not enough, for the institutions applying the corporate and commercial law had to be seen as acting autonomously, or even independently. As economist Chen Zhiwu noted in a Chinese language essay arguing for increased justiciability of shareholders' claims under China's corporate law and securities regulation, "if the judiciary [in China] does not have real independence, then investors will not be able to enjoy real and reliable legal protections."⁷⁸ And if investors do not enjoy, or perceive they may enjoy, "real and reliable" legal protections of their property interests in firms, the corporate and capital markets system will fail or at least not measure up to its historic task in ensuring efficient capital allocation and growth.

Although the new Company Law preserves or augments certain of the prior self-enforcing mechanisms imposed in the 1994 Law and CSRC regulation,⁷⁹ it also presents an entirely new world for the often dismissed PRC judiciary. A partial list of important changes

⁷⁷ See the *Jiang Shuzhen v. Hongguang Industry Company, Limited et al.* case of December 1998 (Shanghai Pudong New District People's Court, rejected in March 1999), reported at: XU ZHAOXING & ZHENG HUI, ZHENGQUAN ANLI JINGJIE 58-64 (2001) [hereinafter Collected Securities Cases]. The Supreme People's Court, pushed behind the scenes by a then very reformist and pro-rule of law CSRC, finally relented with a half-hearted permission in January 2003, allowing a shareholders' private right of action to sue for compensation on false or misleading disclosure claims (but only after determination of liability by the securities regulator or the criminal justice system), and without providing a civil action for stock manipulation, insider trading, or insiders' breach of corporate fiduciary duties. As noted below, the securities regulatory authority (and the state, through the People's Procurate) still monopolizes regulation of every other aspect of public company and securities regulation and enforcement aside from false or misleading disclosure – such as stock manipulation or insider trading. Only in the Fall of 2008 – in the midst of a "strike hard" campaign against stock manipulation -- did the CSRC first levy a fine exceeding US\$1.5 million for stock manipulation (coupled with confiscation of US\$2 million in illegal profits, and reference for criminal prosecution) in the Shoufang Financial Advisory-Wang Jianzhong "pump and dump" case. See Xin Shanlun, *Shoufang Zhangmenren Beifa Zhongshen Jinru – Zhengjianhui Tongshi Gei Wang Jianzhong Kaichu Geren Fa Mo Dan 2.5 Yi Yuan* [Shoufang Manipulator Penalized by Being Barred for Life – At Same Time CSRC Levies Against Wang Jianzhong Largest Fine for Individual and Confiscates RMB 25 Million Yuan], DONGFANG ZAobao [ORIENTAL MORNING NEWS], Nov. 22, 2008, at A23 [hereinafter Manipulator Penalized]. This fine and reference for criminal prosecution was the high point in a six month period which saw very vigorous enforcement by the CSRC against market manipulators, corrupt funds trading, false disclosure, insider trading, etc., including the public investigation of the trading activities of one of China's commercial superstars, the Chairman of the Guo Mei ("Gomei") electronics concern. See DONGFANG ZAobao [ORIENTAL DAILY NEWS], Nov. 24, 2008, at B-9 (detailing CSRC enforcement actions and fines levied between April 8 and Nov. 21, 2008). See *infra* notes ___ and accompanying text.

⁷⁸ Chen Zhiwu, *Sifa Duli, Panlifa Yu Gudong Quanyi Baohu* [Judicial Independence, Case Law and the Protection of Shareholders' Rights], in CHEN ZHIWU, FELIXING KANFEN 207 (2008). Dr. Chen might have crafted the statement to say "investors will not believe they enjoy real and reliable legal protections."

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

which constitute unprecedented invitations to private party litigation and extensive judicial involvement includes:

- *Ex post* corporate veil-piercing and liability for controlling shareholder oppression (Article 20);
- *Ex post* liability for related party transactions that injure the company (Article 21);
- *Ex post* invalidation of shareholders resolutions which violate law or administrative regulations (Article 22);⁸⁰
- Shareholders' right of action for *ex post* invalidation of board or shareholders resolutions or voting arrangements in violation of law or administrative regulations (Article 22);
- Shareholders' right to sue for financial information and accounts of limited liability companies (Article 34);
- Shareholders' right to put shares back to company in the event of non-distribution of dividends (Article 75);
- Shareholders' right to sue for appraisal rights if no agreement reached on put of equity in limited liability companies (Article 75);
- *Ex post* liability of directors for corporate actions which cause serious damage to the company (and the director has not recorded an objection) (Article 113);
- Shareholders' right to sue for declaration that stolen, lost or destroyed share certificates are void (Article 144);
- *Ex post* applied corporate duty of care and duty of loyalty standards (Article 148);
- Company's right to sue directors and officers for restitution of "earnings" gained after violation of duties of loyalty determined *ex post* (Article 149);
- Derivative action against company officers and directors, either by supervisory board members on behalf of the company, or as initiated by the shareholders directly if the supervisory board does not act (Articles 54, 119 & 152);
- Shareholders' direct right of action to sue directors, officers and supervisory board members for violations of law, regulation or company articles of association where shareholders' are injured (Article 153); and
- Court powers to declare companies bankrupt after conforming liquidation (Articles 181-191).

Perhaps the most significant provision in this impressive list is Article 153 of the 2006 Company Law, which effectively confers on shareholders of companies limited by shares⁸¹ a very broad right of action to sue senior management of companies limited by shares for *any* breach of law or regulation or the company's articles of association. This provision makes any breach of law, regulation or stipulated procedure by the company, or the senior management that directs it, actionable, so long as it causes injury to plaintiff shareholders. Some reputable PRC corporate

⁸⁰ A function specifically and properly assigned to the Delaware Court of Chancery sitting in equity under the Delaware General Corporation Law, Sec. 225.

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

law scholars even see in the 2006 Company Law the most robust invitation to judicial action imaginable, for instance divining a private right of action to sue for the creation and enforcement of CSR standards (Article 5) or even limitations on Communist Party involvement in firm management (Article 19).⁸² In sum, although the 2006 Company Law undeniably “modernized” China’s corporate law and governance system, and ironed out some of the incoherencies of the 1994 statute,⁸³ it also squarely addressed what many have seen as the central problem in governance reform: the role and power of the Chinese judiciary.

II. AUTONOMY DEMONSTRATED

“Autonomy” in the context of the PRC People’s Courts should be distinguished from two other important concepts: “competence” and “independence.” Competence is the easier concept to understand, and goes to the technical expertise of judicial institutions in evaluating fact- and law-complex disputes. For example, competence refers to the extent to which Chinese People’s Courts can adjudicate corporate fiduciary duty of care cases with the very confusing facts and difficult application of law those entail, or equally subtle and complex inquires allowing *ex post* corporate veil-piercing and disregard of a bedrock corporate attribute (shareholder limited liability).⁸⁴ The idea of autonomy is distinct from “independence”, although the two concepts may be stops on a single continuum. Autonomy in the PRC context is the ability of the judicial institution to act with its own institutional authority, even if in Chinese parlance it has no “legal basis” (*falü yijü*) to act.⁸⁵ Examples of demonstrated autonomy presented in this article are the many cases in which the Shanghai People’s Courts accept, hear and decide cases on corporate fiduciary duties, corporate veil piercing, invalidation of board or shareholders’ resolutions, and shareholder petitions for company dissolution when the PRC judiciary has no legal basis for such

⁸² Company Law Plights, *supra* note ____.

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

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

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

action.⁸⁶ Judicial independence is still another idea, and goes to the ability of courts and judicial officers to act independently of, and against the interest of, political or military power. For an example of how these three conceptual distinctions operate, or not, together, consider how a People's Court might invoke sophisticated corporate law doctrine and apply evidentiary analysis in proving *competent* to evaluate a veil-piercing claim, act *autonomously* in accepting and then actually piercing the corporate veil to assert liability against the controlling shareholder of a debtor company without an authorizing legal basis, and yet be unable to act *independently* in proclaiming much less enforcing that legal responsibility if the controlling shareholder is a far more powerful instrument of the state, Party or military.⁸⁷

I also note up front that judicial autonomy, however construed or implemented, may not be an undiluted good. This principle is especially true in a transitional economic and political culture such as the PRC's, with just-developing notions of professionalism, the public interest and ethics. In China, unconstrained autonomy may see judicial institutions departing from promulgated legal bases and regulatory controls as a result of corruption, bribery, or *ex parte* pressures.⁸⁸ This phenomenon is ever-present in contemporary China for all state institutions, not just the People's Courts. Nonetheless, given the absolute lack of institutional autonomy in the People's Court system historically, any demonstration of autonomy in the modern era should be deemed a generally positive development for the legal system and its institutions as a whole.

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

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

Prior to adoption of the 2006 Company Law, the Shanghai People's Courts took up the challenge offered them in the early 1990s and – in relative terms -- ran amok in accepting, hearing, adjudicating and pronouncing judgments on matters they were not formally authorized to accept. Specifically, they applied doctrines and procedural innovations such as corporate

⁸⁶ Which in the PRC context would be making those disputes justiciable in the Company Law, or by provision of an explicit framework via Supreme People's Court judicial "Regulations" (*sifa guiding*) (incorrectly called judicial "Opinions" (*sifa jieshi*)). See *infra* notes ___ and accompanying text.

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

⁸⁸ I am indebted to Mary Gallagher for this insight.

⁸⁹ Including application of the 2006 Company Law and remedies to pre-2006 claims, but with an "authorization-constraint" posited after January 1, 2006. See *infra* notes ___ and accompanying text.

fiduciary duties, corporate veil-piercing and derivative lawsuits all without explicit authorization in statute or judicial regulation, or even after authorization in statute, without the specific legal basis usually provided by Supreme People's Court Regulations.⁹⁰ The picture after 2005 and the passage of the 2006 Company Law is more complex and indicates some retreat on judicial autonomy.

As the apex of the bureaucratic system which is the Chinese judiciary, the Supreme People's Court in Beijing is empowered to issue three kinds of explanatory documents with the power of law or regulation: "Explanations" (*jieshi*), "Regulations" (*guiding*), and "Approving Responses" (*pifu*). Explanations provide substantive elaboration of statute or "Law" (*fa*) passed by the national legislature,⁹¹ such as the PRC Company Law. Regulations give judicial institutions at all levels direction on how to apply Law to certain cases or with respect to certain common problems, often focusing on procedural aspects. Approving Responses are the Supreme People's Court's answers to submissions regarding specific application of law problems arising from Provincial or Province-level Municipality⁹² Higher People's Courts and People's Liberation Army Courts.⁹³

As of this writing, the Supreme People's Court has issued only two Judicial Regulations concerning the 2006 Company Law, the first⁹⁴ on how the People's Courts should handle actions which straddle January 1, 2006, and the second⁹⁵ on shareholder petitions for judicial dissolution of companies.⁹⁶

Regulations can impact the application of a Law like the Company Law in at least four important ways: (i) providing a specific authorization for a claim or action already given a legal basis in Law; (ii) forbidding certain kinds of claims which Courts might be tempted to accept, even where there is a colorable legal basis in Law; (iii) providing new bases for justiciability

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

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

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

⁹³ Xi Xiaoming & Jia Wei, *Zhengquan Shichang Xujia Chenshu Minshi Peichang Zhidu [The Civil Compensation System for Misrepresentation in Securities Markets]*, 3 ZHENGQUAN FALÜ PINGLUN [SECURITIES LAW REVIEW] 33, 41-7 (2003). Thus, the two Supreme People's Court pronouncements on the 2006 Company Law issued as of this writing, universally -- and incorrectly -- referred to as "Judicial Explanations" (*sifa jieshi*) in common discussion, academic articles and journalist treatments, are actually "Regulations" because they seek to explain the application of certain parts of the Company Law (or in the case of the first set of Regulations, the use of both the 1994 Company Law and its 2006 successor) in the People's Court bureaucracy.

⁹⁴ At ZUIGAO RENMIN FAYUAN GUANYÜ GONGSIFA SIFA JIESHI (YI), (ER) LIJIE YÜ SHIYONG 3 (Xi Xiaoming ed., 2006) [hereinafter SPC Company Law Regulations]. See the use of these Regulations in a post-January 1, 2006 case in *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 185) (contested shareholder resolutions passed at dissident special shareholders' meeting that occurred before Jan. 1, 2006, and thus Courts will only apply 1994 Company Law to party claims).

⁹⁵ At SPC Company Law Regulations, *supra* note ___, at 7-11.

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

over and above what is set forth in Law; and (iv) prodding the People's Court to re-start acceptance and adjudication of cases they have voluntarily or by instruction ceased accepting. For an example of the first category, Supreme People's Court Regulations issued in January 2003 provided a specific legal basis for shareholders' claims against issuers, controlling shareholders, underwriters and accountants arising from false or misleading disclosure in the public stock markets.⁹⁷ That this authority is invested in judicial Regulations is also exemplified by the fact that the new PRC Bankruptcy Law remains basically unimplemented in the Chinese judiciary because there are no Regulations on that Law.⁹⁸ In the second, restrictive, category, are the same January 2003 Regulations alluded to above permitting shareholders' suits for false or misleading disclosure which also explicitly prohibited acceptance of shareholders' claims on other aspects of securities markets fraud, such as stock manipulation or insider trading;⁹⁹ similarly, the 2nd Judicial Regulations on the 2006 Company Law issued in May 2008 forbid the acceptance of shareholder petitions for dissolution of PRC companies based on factors outside of those listed in the statute.¹⁰⁰ In the third, liberalizing, category, are the parts of the same 2nd Judicial Regulations on the 2006 Company Law which provide for expanded justiciability of creditors' claims against firms in liquidation.¹⁰¹ For the fourth category, Regulations which "prod" the People's Court into action or a re-start of adjudication work voluntarily abandoned, a good example is the continuing strife over settling a Regulation which might re-commence

⁹⁷ *Zuigao Renmin Fayuan Guanyü Shenli Zhengquan Shichang Yinxujiachenshu Yinfa de Minshi Peichang Anjian de Ruogan Guiding* [Supreme Peoples Court Several Regulations Regarding Civil Compensation Cases Arising from False Disclosure in the Securities Markets], Jan. 9, 2003, *fashi* No. 2, at CLC, *supra* note __, at 5-25 – 5-29 [hereinafter Misrepresentation in Securities Markets Regulations].

⁹⁸ The Supreme People's Court started work on Regulations on the Bankruptcy Law in October 2007, and the Regulations are expected to be issued sometime in 2009. See <http://chinacourt.org/html/article/200707/11/256034.shtml> (reviewed December 2008). This does not mean that the Courts do not accept *any* bankruptcy cases, only that they have great difficulty in handling these cases to a conclusion.

⁹⁹ Misrepresentation in Securities Markets Regulations, *supra* note __. The Supreme People's Court subsequently removed this restriction in May, 2007, and has permitted actions on claims other than misrepresentation, including claims for insider trading and manipulation (but always subject to the prerequisite rule set forth in the 2003 Supreme Court Regulations). See *Zhengquan Minshi Peichang: Zhengjianhui Bu Cha, Fayuan Bu Shen* [Civil Lawsuits for Damages in Securities Cases: if the Securities Regulatory Commission Does Not Investigate, the Courts Will Not Try the Case], CAIJING, September 11, 2007, available at <http://www.caijing.com.cn/2007-09-11/100029938.html> (reviewed May 2009).

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

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

adjudication of creditors' actions on non-performing loans sold by commercial banks to Asset Management Companies, and then on to third party purchasers of discounted bundles of such debt.¹⁰² To date, the Supreme People's Court has managed to produce only a document which is far weaker than a Regulation (or Explanation or Approving Response)¹⁰³ merely *urging* subordinate People's Courts to start accepting creditors' claims on such transferred non-performing loans.¹⁰⁴

Significant controversy continues regarding the normative effect of Supreme People's Court pronouncements. In the view of many judicial officers and academics, these Supreme People's Court Regulations not only craft and make concrete the application of Laws promulgated by the National People's Congress, but are a condition precedent to application of a specific Law by any institution governed by the Supreme People's Court. Thus, many Chinese academics, lawyers and judges hold firmly to the idea that important provisions of the 2006 Company Law, such as corporate fiduciary duties, veil-piercing, or the derivative law suit mechanism, may not be employed or even invoked until Regulations specifically addressing the provision in question have been issued. The Supreme People's Court naturally supports this view as it assures competence and coherence in application of new Law, but also buttresses the Court bureaucracy's central position and authority. This relation is seen in an utterance by an official at the No. 2 Civil Division of the Supreme People's Court just after the 1st Judicial Regulations on the new Company Law were issued in May 2006: "after implementation of the "Company Law" [starting January 1, 2006], the litigation type cases the People's Courts will

¹⁰² Because of a 2004 report by the head of the Hubei Provincial Higher People's Court warning of "irregular activity" and the "loss of state assets" through such transfers of non-performing loans, the People's Courts simply stopped accepting, hearing or ruling on such cases in early 2005. In February of 2005, central departments under the State Council (including the Supreme People's Court, the State Assets Commission, the Ministry of Finance, the China Banking Regulatory Commission and the People's Bank of China (China's central bank)) produced a draft proposal of considerations on the question, but only in April of 2006 did the Supreme People's Court produce a "comment draft" for the proposed Regulations. In October 2007, that draft was reported, over the strenuous objections of some of the key central players listed above, to the State Council for approval, which approval was never rendered because of the controversy between leading departments. By October of 2008, the Supreme People's Court was still unable to produce a final set of Regulations on the important question, and only able to muster "Important Meeting Minutes" (*huiyi gaiyao*) after a contentious and rather secretive meeting on Hainan Island attempting to address the State Council's concerns on the matter. See Zhang Yuzhe & Zhang Man, *Buliangdaikuan Chuzhe Xin Guiding Liangnan [Two Difficulties for New Regulation of Non-performing Loan Arrangements]*, CAIJING, Nov. 24, 2008, at 60-1 [hereinafter *Two Regulation Difficulties*].

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

¹⁰⁴ See Ye Doudou, *Buliangdaikuan Zhuanrang Susong "Jiedong" [The "Unfreezing" of Litigation Relating to Transfer of Non-performing Loans]*, CAIJING, Dec. 8, 2008, at 28, and also at <http://caijing.com.cn/2008-12-04/110034693.html> (reviewed December 2008). This last example is both a good expression not only of how the People's Court bureaucracy works via Regulations and internal notices on substantive adjudication matters, but also an excellent demonstration of: (i) how the subordinate Courts react, on their own, in cases which touch on overtly political concerns (even where the rights and interests of the strongest international financial institutions are directly concerned -- as many purchasers of bundles of discounted non-performing loans from the Chinese Asset Management Companies were foreign investment and commercial banks increasingly frustrated in their efforts to collect on the transferred debt); (ii) the normative authority of a Supreme People's Court pronouncement calling for the re-start of case acceptance and decision when encountering articulated, voluntary, subordinate-level refusal, and (iii) the ongoing resistance from local-level Courts even in the face of central-origin instruction and policy direction.

have to hear shall increase greatly, and many issues *will have to be the subject of judicial explanation* in accordance with legislated principles”.¹⁰⁵

Although Supreme People’s Court Regulations, Explanations and Approving Responses play an important role, sub-national court systems also issue their own “Opinions” on specific Laws.¹⁰⁶ For example, in June 2003 the Shanghai Higher People’s Court issued its own internal¹⁰⁷ “Opinion of the Shanghai Higher People’s Court on Handling Certain Issues Regarding Hearing Company Law Related Cases”¹⁰⁸ addressing the 1994 Company Law form, only the first part of which is directed to procedural rules and standards for the application of the Company Law.¹⁰⁹ The Opinion explicitly bars *Shanghai* People’s Courts’ from consideration of certain cases. Thus, with respect to shareholders’ petitions seeking judicial invalidation of board or shareholders’ resolutions the Shanghai People’s Courts are instructed to “temporarily” *not* accept cases where the subject entity is a company limited by shares with listed capital.¹¹⁰ The Shanghai Company Law Opinion also strongly counsels caution and conservatism in applying novel doctrines to corporate law disputes.¹¹¹ Yet the same Shanghai Company Law Opinion conversely works to expand the scope of the Shanghai Courts’ adjudicatory powers, for instance by setting forth extremely detailed instructions on judicial veil-piercing¹¹² and derivative

¹⁰⁵ SPC Press Conference 2006, *supra* note __, at 4 (emphasis added).

¹⁰⁶ Such Court-system specific instructions/opinions are not unique to Shanghai. See for example in the Company Law sphere similar documents issued with respect to application of the 1994 Company Law by the Beijing Higher People’s Court (February 9, 2004) and the Jiangsu Province Higher People’s Court (June 3, 2003), collected at Shanghai Higher People’s Court 2006, *supra* note __, at 236- 248). Judges, scholars and lawyers in the PRC often allude to the high quality, “modernity” and coherence of the Jiangsu Province Opinion on the 1994 Company Law.

¹⁰⁷ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 47.

¹⁰⁸ At Shanghai Higher People’s Court 2006, *supra* note __, at 231-6.

¹⁰⁹ The second and third parts review implementation problems “in recent years” and offer unified approaches to frequently-encountered difficulties.

¹¹⁰ Shanghai Company Law Opinion, *supra* note __, Part I, Section B, Paragraph 2. This instruction was reversed in conjunction with the 2006 Company Law, although pretty grudgingly. See *infra* notes __ and accompanying text. See further notes __ *infra* and accompanying text on the more generalized rejection of cases involving companies limited by shares cases and listed companies.

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

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

actions,¹¹³ neither of which had any legal basis in the 1994 statute or any subsequent Supreme People's Court pronouncement.¹¹⁴ Finally, the Shanghai Opinion on the 1994 Company Law highlights important values which must be vindicated in application of the same Law.¹¹⁵

Local-level People's Courts in fact do more. One senior Shanghai Higher People's Court official acknowledged to me that the Shanghai People's Court system issues what the official loosely called "judicial explanations" (*sifa jieshi*), sometimes publicly, most often internally. Perhaps most interesting from an institutional perspective is the official's view that such local-level instructions, while normatively not as authoritative as Supreme People's Court Regulations, are in reality far more determinative in the actual handling of cases at the non-central (*e.g.*, Shanghai Municipal) level.¹¹⁶ The same Higher People's Court judge also stated that such local-level documents are in many cases issued before the national-level Supreme People's Court instructions see the light of day, and thereby gain authority by virtue of their prior existence and the relative void in central instruction. The phenomenon described by the Shanghai official

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

¹¹⁴ The only colorable basis was an "Approving Response" from the Supreme People's Court in the late 1990s, responding to an urgent request from the Jiangsu Province Higher People's Court, entitled "With Respect to External Economic Contract Disputes Arising at Chinese-foreign Equity Joint Ventures, and the Foreign Party that Controls the Joint Venture has a Conflict of Interest with the [Technology] Seller, The Chinese Party Should In Whose Name Bring Suit in the People's Courts". See GONGSIFA XINXING HUAINAN ANLI PANJIE 114 (Beijing Higher People's Court ed., 2007) [hereinafter New Company Law Issues]. As the perfectly descriptive title indicates, the Supreme People's Court allowed derivative actions in a very limited circumstance: where the foreign partner in a Chinese-foreign equity joint venture – while also a technology licensor (or "seller") to the joint venture – exercised control over the venture (through its majority registered capital interest and resulting chairmanship of the board and power over the corporate seal or "chop") and blocked the corporate legal person from suing the foreign partner *qua* technology provider for non or deficient performance, then the Chinese partner could bring suit "in the name of" the venture itself. The author knows from personal experience that this Approving Response was applied in an extremely limited manner, and did not function to provide a basis for derivative actions where the non-performing partner *cum* vendor in the Chinese-foreign joint venture context was Chinese as opposed to foreign, much less in the context of any other kind of enterprise legal person establishment like a "company".

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

¹¹⁶ Remarks of Shanghai Higher People's Court judge, October 2008, notes on file with author.

actually seems well-accepted in the PRC, where many judges, scholars and even lawyers point to the high-quality and technical accomplishment of some local-level, preemptively-issued, judicial explanations – such as the highly-regarded Jiangsu Province Higher People’s Court “Provisional Opinion” on application of the Company Law of June 3, 2003.¹¹⁷ Overall, the use of local-level Court “Opinions” or other instructions to expand the authority and asserted competence of a specific People’s Court systems shows two things. First, it shows non-central consideration and instruction for corporate law adjudications every bit as rich as Supreme People’s Court directions. Second, it demonstrates how local-level People’s Court bureaucracies do not wait for Supreme People’s Court Judicial Regulations on many apparently non-justiciable items. These pronouncements, and their demonstrated effectiveness, in turn provide a useful barometer of the bureaucratic autonomy exercised by the Shanghai People’s Courts as a bureaucratic agency, even before that agency’s Courts move onto specific adjudicatory tasks.

A final category of non-central government origin instruction distributed by and inside the People’s Court systems, usually internally, pertains to general adjudication tasks and not the application of a specific Law or regulatory system under Law. For example, during the worldwide financial crisis commencing in the second half of 2008, when many of China’s export-oriented producers and suppliers located in the Shanghai-Yangtze River Delta area experienced extreme financial difficulties, the Shanghai Higher People’s Court issued an eleven-point document entitled “Several Opinions on an Active Approach to Economic Development During the Financial Crisis.” That document exhorted the Shanghai People’s Courts to conform to national social policy, and exercise heightened sensitivity to the impact of decisions on distressed industries, allow reduction or elimination of litigation fees, protect the ability of distressed litigants to file their claims equally under law (*i.e.*, exempting them from litigation fees and deposits), and emphasize speedy adjudication of distressed enterprises labor rights and compensation cases, and enforcement proceedings.

A very micro-level identity of the same kind of instruction was seen on December 2, 2008 when a single Intermediate People’s Court, the Shanghai No. 1 Intermediate People’s Court, issued *its own* complementary ten-point document explaining how it would conform to the policy commands enunciated by the Higher People’s Court’s eleven-point plan, including unified and accelerated financial crisis-related case acceptance, hearing and enforcement, a sensitivity to the capacity of enterprises to bear enforcement actions or asset attachment, and attention to what case law opinions identify as one of the highest values in PRC company law adjudication: finding a way for distressed enterprises with any future potential to keep operating even if technically in default of specific obligations or insolvent.¹¹⁸ In these lower-level, non-Law specific, People’s Court system pronouncements, opinions and notices, the PRC judiciary’s function as a unified bureaucracy-administrative agency is clearer – one easily contrasted with an autonomous court system which hears and decides on specific cases based on applicable law and in formal disregard of national or regional policy concerns.

These various species of bureaucratic instruction are critical in evaluating the relative institutional autonomy of the People’s Courts in the PRC. The mere existence of local-level

¹¹⁷ Shanghai Higher People’s Court 2006, *supra* note __, at 240-8. Note, the Jiangsu Opinion is deemed persuasive by non-Jiangsu Courts not in institutional terms, but because of its coherence and utility.

¹¹⁸ See Accelerated Hearings, *supra* note __.

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

This high degree of autonomy is precisely what seems to be at work in the Shanghai People’s Courts’ Company Law adjudication before 2006 and, with important qualification, beyond. Just as in respect of the application of orthodox corporate fiduciary duties by the Chinese courts nationally,¹¹⁹ there is evidence that the Shanghai People’s Courts accept and dispose of corporate law claims even when the Company Law provides no legal basis for such case disposition, and/or there is no Supreme People’s Court Regulation addressing the issue.¹²⁰ Before 2006 and with the absence of explicitly-named corporate fiduciary duties of care and loyalty in statute, much less standards for evaluation of such duties or business judgment rule protection, the Shanghai People’s Courts proved able to accept and handle fiduciary duties claims and doctrine, both in divining and directing remedies for breach of corporate fiduciary duties generally¹²¹ and competently explicating a fiduciary’s duty of care.¹²² In one pre-2005

¹¹⁹ See Doctrine That Dared Not, *supra* note ____.

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

¹²¹ The Shanghai Courts do this in many cases where there is also a breach of contract in evidence, which less autonomous judicial institutions might have happily relied upon before invoking more controversial notions of corporate fiduciary duties. For the application of corporate fiduciary duties before 2005 *see: Shanghai A. Company v. Wang X.* (Shanghai Hongkou District People’s Court, 1995, settled while under appeal before Shanghai No. 2 Intermediate People’s Court, 1996) (Ma Qijia 2006: 96-8) (shareholder *cum* corporate director who acted in violation of a shareholders agreement expressed in a shareholder’s resolution acted (i) beyond his corporate-contractual scope of authority and (ii) in violation of the obligation under Article 59 of the 1994 Company Law of “directors, supervisory board members and general managers to abide by the company articles of association, and faithfully [or “loyally”] perform their functions”, in amending corporate articles of association and using corporate funds to establish a subsidiary company in the same business); *Shanghai X. Electronics Company v. Mr. A, et al.* (Shanghai No. 2 Intermediate People’s Court, 2003) (Shanghai Higher People’s Court 2007: 114-117) (Japanese director of Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC-invested limited liability company because of Japanese partner’s sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director’s personal account without joint venture board approval or joint venture investor (shareholder) approval); and *Shanghai Jingfa Enterprise Development Company v. Shanghai Haining Petroleum Products Company* (Shanghai No. 2 People’s Court, upheld on appeal at the Shanghai Higher People’s Court, 2003) (Shanghai Higher People’s Court 2005: 299-309) (in shareholder deadlock case, director representing one shareholder’s interest who extracts funds to fund that shareholder’s (and corporate vehicle’s) business activities is in breach of fiduciary duties, even before the Company Law provides for the same).

¹²² As the (the civil law tradition’s) “cautious and diligent management” of entrusted assets. *See Guangxi Xineng Science and Technology Limited v. Guotai Junan Securities Co. Limited* (Shanghai Higher Peoples Court, 2003; upheld on appeal by the Supreme People’s Court) (Shanghai Higher People’s Court 2005: 211-2) (assets management contract case – not a *corporate* fiduciaries or trust case – but where contract standard is divined to include this duty of care standard, the same standard as that described by the Shanghai Higher People’s Court in its *post*-January 2006 discussion of application of the corporate law (*see* Shanghai Higher People’s Court 2006, *supra* note ___, at 4)); and *Shanghai Jingfa Enterprise Development Company v. Shanghai Haining Petroleum Products*

case¹²³ providing evidence of substantial autonomy, the Board Vice Chairman and Factory Operations Director of a factory transformed into a limited liability company in August 1997 formed three competing companies in March 1999, November 2000 and (after his resignation of all positions at the original company) May 2001. The limited liability company sued for breach of duty of loyalty pursuant to Article 61 of the 1994 Company Law,¹²⁴ and damages calculated based on the wayward director/officer's unjust enrichment (not the harm suffered by the company).¹²⁵ The Shanghai Nanshi District People's Court and an unidentified appeals-level Intermediate People's Court seemed completely unrestrained in handling the fiduciary duties claims all the way through to appeal.¹²⁶

After the adoption of the 2006 Company Law and explicit inclusion of corporate fiduciary duties at Articles 148 and 149, the Shanghai Higher People's Court likewise seems perfectly able to describe fiduciary standards which are to be employed by Shanghai judges even in the absence of Supreme People's Court Regulations on the application of such doctrines.¹²⁷ Similarly, even before 2005 the Shanghai Courts¹²⁸ were apparently long in the business of

Company (Shanghai No. 2 People's Court, upheld on appeal at the Shanghai Higher People's Court, 2003) (Shanghai Higher People's Court 2005: 303) (in shareholder deadlock case, director representing one shareholder's interest who extracts funds to fund that shareholder's (and corporate vehicle's) business activities is in breach of "shareholder's duty of loyalty, and duty of due care of a good manager (*shanliang guanli*) of, and cautious attention (*qinshen zhuyi*) to company's property and interests").

¹²³ *Shanghai Shenmao Dianci Factory v. Wang Longbao, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company* (Shanghai Nanhui District People's Court, 2004, upheld Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division), 2004, overturned Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division) 2006, on re-hearing) (Shanghai Higher People's Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) .

¹²⁴ Article 61 expresses the non-competition thread of duty of loyalty, reading: "The directors and manager may not engage in the same type of business as the company, whether for their own account or that of others, nor may they engage in activities which are harmful to the interests of the company."

¹²⁵ Authorized by 1994 Company Law, Article 61: "If a director or the manager engages in [the same type of] business or activities [as the company], the revenue so obtained [by the director or manager] shall belong to the company."

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

¹²⁷ The Shanghai Higher People's Court document goes a step further in divining substantive standards, or the beginnings of such standards, for application of fiduciary duties law when the Company Law is silent on just such standards: "In addition, [the amended Company Law] strengthens directors, supervisory board members, and senior management personnel duties of loyalty and care. The amended Company Law places great emphasis on the two above-described [sets of] duties for directors, supervisory board members and senior management personnel.... stressing that directors and senior management personnel etc. must strictly abide by the principles of good faith (*yanshou chengxin yuanze*), must take as their point of departure [in decision-making] the interests of the company, and should perform their jobs cautiously and diligently". See Shanghai Higher People's Court 2006, *supra* note __, at 4. Some of this is taken from the CSRC's elaboration of fiduciary duties standards in CSRC regulation and CSRC-promulgated Guidance Articles of Association for Listed Companies, see Doctrine That Dared Not, *supra* note __, but -- as in that regulation and standard form material applicable to securities-issuing companies -- fails to describe a risk-encouraging, business judgment rule-protected, duty of care.

¹²⁸ With many other PRC People's Court nationally, see GONGSI SHENPAN SHIWU YÜ DIANXING ANLI PINGXI 142-154 (Beijing No. 1 Intermediate People's Court No. 4 Civil Division ed., 2005) [hereinafter

corporate veil-piercing,¹²⁹ autonomous action ratified by the local Shanghai-level Opinion of June 2003.¹³⁰ This specific area of autonomous action by the Shanghai People's Courts is definitively confirmed in a Shanghai Higher People's Court 2006 policy statement which praises

Adjudicating Company Law Cases], and for Shanghai-based plaintiffs. For an example of a Shanghai plaintiff in a non-Shanghai People's Court trying to pierce the corporate veil, see *China Eastern Airlines Company Limited Xiamen Enterprise Department v. Xiamen Municipal Renshan Airlines Ticket Agency Company and Xu Yimin* (Xiamen People's Courts, 2002) (Wang Xiaochuan 2006: 65-8). This is an especially egregious case, where the Xiamen People's Court notes a whole series of share transfers and serial corporate establishments designed to avoid creditor obligations, undercapitalization, bad faith, etc., and states that regardless of what statute allows the defendant controlling shareholder simply cannot be allowed to injure the lawful rights of good faith creditors. Accordingly, and on the basis of "equality, good faith and good faith" described in Article 4 of the General Principles of the Civil Law, the defendant controlling shareholder is adjudicated as having direct liability to corporate creditors. This use of Article 4 of the General Principles of the Civil Law is noted *infra* in the section describing the Shanghai People's Court own equity court-style adjudication practices which seek to provide justice and fair outcomes for PRC corporate case litigants.

¹²⁹ See *Xishan City Chemical Products Manufacturing Company v. Shanghai Aoshi Enterprise Company, Wan Yunhui, Tang Weijun, Shi Hong, Ni Shang and Shanghai Municipality Qingpu District Audit Bureau* (Shanghai District People's Court initialing hearing case and Intermediate People's Court upholding not identified, 2000) (Wang Xiaochuan 2006: 293-9) (trade creditor pierces corporate veil of limited liability company to assess joint and several liability of several shareholders, including initial promoters who have fraudulently undercapitalized the company and their subsequent transferees, for trade payable of RMB 2.9 million yuan, but liability of defendant shareholders to third party creditor is on appeal limited to difference between actual capitalization and subscribed-for capitalization; in the case, even the state Audit Bureau that licenses the accounting firm which certified the original non-contributions has liability for contribution); *Shanghai Guanghua Copper Materials Company v. Shanghai Boer General Company and Shanghai Boer Foodstuff Company* (Shanghai Yangpu District People's Court, reversed by Shanghai No. 2 Intermediate People's Court 2000) (BJFI, 2000 He Er Zhong Jing Zhong Zi No. 1209) (corporate veil pierced to assert liability of non-contract party because of common Legal Representative, shared premises, etc.); *Shanghai Sitong Power Equipment Company v. Fujian Zhongli Real Estate, and Mr. [Japanese Kanji] Shi Chuan Fang Zheng* (Shanghai No. 1 Intermediate People's Court, 2000) (BJFI, 2000 Hu Yi Zhong Jing Chu Zi No. 163) (court recognizes the possibility of piercing the corporate veil, but refuses to pierce to the Japanese natural person behind a debtor wholly foreign owned enterprise ("WFOE") because original loan contract is illegal and without effect, and natural person defendant has no investment or equity in corporate defendant (making invalid a pledge guaranty agreement of equity in WFOE by natural person)); *Shanghai Bonded Production Materials Market China Communications Products Exchange Center v. Shanghai Baoan Enterprise Company* (Shanghai Pudong New District Peoples Court, upheld on appeal at the Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 278-86) (liability of former investors in joint operation (note, not corporate) guarantor upheld); *Shanghai Bund City Real Estate Comprehensive Development Company v. Zhu Minmao, Shanghai Guangtao Decorative Company, Shanghai Xucheng Enterprise Development Company, and Fan Jianmin* (Shanghai Jiading District People's Court 2004, reheard by Shanghai Jiading District People's Court 2005, overturned by Shanghai No. 2 Intermediate People's Court No. 3 Civil Division in 2006, sent back to Shanghai Jiading District People's Court 2006, and then appealed again to Shanghai No. 2 Intermediate People's Court 2006) (HSHFY, 2006 Hu Er Zhong Min San (Shang) Zhong Zi No. 461) (ruling on a March 18, 2003 corporate veil piercing by the Shanghai Hongkou District People's Court (2002 Hong Zhi Zi No. 3301) because shareholders of company in existence from 1995 to 2003 have either depleted capital or not fully capitalized it; that initial veil piercing in favor of creditor reversed by Intermediate People's Court because of evidentiary questions about who is a shareholder, and whether the shareholders' held themselves out as actually capitalizing the company); *Fan Jinxing v. Fu Chenghua, Hengli Environmental Protection Technology Company, Hongdu Enterprise Company, and Liu Quande* (Minghang District People's Court (No. 2 Civil Division), 2004) (HSHFY, 2004 Min Min Er (Shang) Zai Chu Zi No. 5) (corporate veil of guarantor pierced to investors who have falsified capitalization of guarantor).

¹³⁰ The Shanghai Company Law Opinion explicitly allowed Shanghai People's Courts to rule whether or not corporate investors were obligated to recapitalize companies when faced with claims from tort or contract creditors, or simply be adjudicated as deprived of limited liability protection (regardless of the corporate form established) with respect to such creditors. See Shanghai Higher People's Court 2006, *supra* note __, at 9.

the new Company Law's explicit addition of a corporate veil-piercing mechanism as statutory ratification of doctrine already "implemented for many years".¹³¹

There is also evidence that the Shanghai Courts applied the veil-piercing doctrine robustly. One 2000 case shows two levels of the Shanghai judiciary supporting a very aggressive corporate-veil piercing remedy, through to the shareholders at the time of suit but also to *former* shareholders who had some time before transferred their shares to good faith purchasers.¹³² In a second case decided in 2003, the Shanghai Higher People's Court acted not only autonomously but with some political courage by allowing piercing on a sensitive land condemnation and relocation case through to a *government* department which controlled the hollow corporate form established to sign the condemnation compensation contract the plaintiff land occupiers wished to enforce.¹³³ Never mind the Shanghai People's Courts' lack of technical competence. More noteworthy is how they acted without authorization in statute, without any instruction from the Supreme People's Court under formal Regulation, and without any other indication of the all-important "legal basis." The Shanghai Higher People's Court ruefully recognizes this high degree of autonomy (and the prevalence of the abuse it was meant to check) when celebrating the 2006 Company Law veil-piercing mechanism:

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

As noted by both the PRC State Council and the National People's Congress at the time of passage of the 2006 Company Law¹³⁵ and the Shanghai Higher People's Court in a 2006 policy statement¹³⁶ one of the major policy aims behind the amended Company Law of 2006 was enhanced protection of third party creditors. It should come as no surprise then that the Shanghai People's Courts continued to use the veil-piercing doctrine after January 1, 2006, only with the

¹³¹ Shanghai Higher People's Court 2006, *supra* note __ at 6-7.

¹³² Those original shareholders were determined by the Courts to have acted fraudulently by falsely capitalizing (or not capitalizing) the company at the time of their initial investments. See *Xishan City Chemical Products Manufacturing Company v. Shanghai Aoshi Enterprise Company, Wan Yunhui, Tang Weijun, Shi Hong, Ni Shang and Shanghai Municipality Qingpu District Audit Bureau* (Shanghai District People's Court initialing hearing case and Intermediate People's Court upholding not identified, 2000) (Wang Xiaochuan 2006: 293-9).

¹³³ *Shanghai Kangpais Enterprise General Company v. Shanghai Municipal Administration of Industry and Commerce Huangpu District Branch, Shanghai Pushun Shunzhe Development Company and Shanghai Huangpu Market Development General Company*, (Shanghai No. 2 Intermediate People's Court, 2001, upheld by Shanghai Higher People's Court, 2003) (Shanghai Higher People's Court 2005: 349-56).

¹³⁴ Shanghai Higher People's Court 2006, *supra* note __, at 7.

¹³⁵ LAO Company Law Explanation, *supra* note __.

¹³⁶ Shanghai Higher People's Court 2006, *supra* note __.

slightly stronger legal basis provided by a new statutory provision (albeit with continued lack of specific authorizing Regulations).¹³⁷

It is also likely that the Shanghai People's Courts' allowed the equivalent of derivative lawsuits before the 2006 Company Law provided the explicit basis for such suits.¹³⁸ Only "likely" because there is ample evidence of such cases nationwide in the same period,¹³⁹ Shanghai judges proclaim their abundance,¹⁴⁰ and the Shanghai Company Law Opinion provides detailed application rules for such actions,¹⁴¹ and yet there are only a few reported cases permitting derivative suits in Shanghai specifically before January 1, 2006.¹⁴² In the period before that date, the existence of such cases once again demonstrates the autonomy of the PRC People's Courts because the acceptance and adjudication of such cases was not authorized in

¹³⁷ One example of veil-piercing from 2007 demonstrates this, and is incidentally another elaboration of political independence by the Shanghai People's Courts because the piercing reaches to a centrally-funded SOE in Beijing. See *Shanghai Huaxin Electric Wire and Cable Company v. China Tietong Group Company* (Shanghai No. 2 Intermediate People's Court (No. 4 Civil Division), 2007, upheld by the Shanghai Higher People's Court, 2007) (HSHFY, 2007 Hu Gao Min Er (Shang) Zhong Zi No. 145) (RMB 32 million yuan creditor pierces to the Beijing-based SOE parent of a Shanghai limited liability company debtor where the parent has undercapitalized the debtor by RMB 38 million yuan, specifically upholding the assertion of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law). A second 2007 proceeding, a criminal prosecution, shows both the lower-level Shanghai People's Court and the Shanghai Higher People's Court on appeal engaging in classic corporate veil-piercing to fix criminal liability on an SOE cadre/manager guilty of diverting funds to a limited liability company established with his wife and several confederates, but operated and capitalized solely by the defendant cadre. See *PRC v. Xue Henghe* (Shanghai Rail Transport Intermediate People's Court, upheld by Shanghai Higher People's Court, 2007) (Shanghai Higher People's Court 2008b: 447-52) (diversion of assets from "enterprise department" subsidiary entity of SOE to defendant-dominated limited liability company is criminal diversion of state-owned assets by individual defendant). In this case, it is perhaps somewhat disturbing how the People's Courts pierce the corporate veil without the benefit of Article 20 of the 2006 Company Law, and instead rely on the incoherent Article 4 of the 1994 Company Law, which *inter alia* provides that those who capitalize corporate entities will enjoy profits, major decision-making power, and management rights in accordance with the proportion of their equity contributions.

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

¹³⁹ See *Doctrine That Dared Not*, *supra* note __, at 237-242 ("Beijing Self-dealing Case"); and *Adjudicating Company Law Cases*, *supra* note __, at 74-85, 172-183 (some of the cases may be Shanghai proceedings, although this collection of derivative suits does not identify the jurisdiction where the cases arise).

¹⁴⁰ Statements of Shanghai Higher People's Court judicial officials and Changning District People's Court President, Dec. 5, 2008 (notes on file with author).

¹⁴¹ See *supra* note __.

¹⁴² See for example *Shanghai Tap Water Company, Shanghai Baiyulan International Travel Culture Research Institute v. Shanghai Huihuang Enterprise Company* (Shanghai No. 1 Intermediate People's Court, No. 3 Civil Division, 1999) (Beijing Higher People's Court 2007: 111-6) (two plaintiff shareholders can sue third defendant shareholder in limited liability company "in the name of" the limited liability company for non-perfected contribution of capital (land use rights) and misappropriation of corporate funds, even though defendant shareholder – through majority ownership, board chairmanship and appointment as company Legal Representative – seeks to block the limited liability company from acting as plaintiff against himself). This is a profound and interesting case, and would seem to indicate that the plaintiffs saw no remedy in suing on the "contract" which formed the limited liability company, because that would only provide a remedy for the non-perfected capital contribution claim, and not the corporate claim for misappropriation of corporate funds by the controlling shareholder defendant.

statute or by Supreme People's Court Regulation.¹⁴³ After adoption of the 2006 Company Law, the nationwide People's Courts continued to accept, or allowed the structuring of claims in accordance with, the classical derivative action – only then, as in the case of veil-piercing, with explicit statutory authorization but the continued lack of Supreme Court Regulations (or in the case of Shanghai, pursuant to the conditions and remedies elaborated in the local-level Shanghai Company Law Opinion).¹⁴⁴

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

Notwithstanding these real assertions of autonomy, the Shanghai People's Courts and the entire Chinese judiciary by their own judgment still have a long way to go in fully realizing the fruits of such tentative assertions of authority. The Shanghai Higher People's Court alludes to some of the other constraints at work in its evaluation of veil-piercing doctrine as applied in concrete adjudication tasks:

... China at the present time does not have specific or employable decision standards sufficient to [allow judges to] rule on disregard of the corporate form.... These standards must be based in a very high degree of freedom in adjudication given to judges in the course of their adjudication practice. What must be

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

¹⁴⁴ This is the same for derivative suits in the People's Court nationally (see for instance, ZHONGGUO ZUIJIN XIN GONGSIFA 307-11 & 329-33 [Beijing cases]; 333-39 [Yangzhou & Nanjing cases] (Huai Xiaofeng ed., 2007)).

¹⁴⁵ Before the PRC Company Law was amended to include specific provisions identifying such liability (2006 Company Law, Article 95). See *Shanghai Yongqi Beauty and Hairdressing Limited v. Shanghai New Concepts Beauty and Hairdressing Limited* (Shanghai Luwan District People's Court, 2003, appealed to Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 265-9) (personal contract signed by promoter of company must be performed by subsequently-formed company especially where assets purchased under the contract are contributed into company as capital investment by individual).

¹⁴⁶ See *Company A v. Company B* (Shanghai Huangpu District People's Court, upheld by Shanghai No. 1 Intermediate People's Court, 1997) (Ma Qijia 2006: 142-4) and *Huang Ziyu v. Guan Feng and Fu Ri Enterprise Company* (Shanghai Pudong New District People's Court, upheld on appeal by Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 310-318), discussed *infra*.

¹⁴⁷ Before a mechanism for the determination of direct stock ownership was defined (2006 Company Law, Article 33). See *X. Fang v. Y. Information Technology Co., Ltd.* (Shanghai Yangpu District People's Court, 2005) (Shanghai Higher People's Court 2007: 59-65) (ESOP provides employees only with dividends expectation, not “disposition” property rights with regard to the underlying stock).

¹⁴⁸ See *infra* notes ___ and accompanying text.

emphasized [here] is that -- looking at China's current environment -- the conditions needed for determination of these standards are not yet ripe.¹⁴⁹

A final barometer of this aspect of judicial autonomy – adjudication without Supreme People's Court authorization or in contravention of what Supreme People's Court Regulation permits – and specifically applicable to the period immediately after January 1, 2006, is the extent to which the Shanghai judiciary used the new Company Law and its expanded remedies on controversies where the underlying claims arose before the effective date of the new statute. This is relevant to consideration of the power of Supreme People's Court authorization because the 1st Supreme People's Court Regulations on the 2006 Company Law¹⁵⁰ were issued to direct the national People's Courts on the appropriate handling of these straddling claims. The issue cannot be an easy one for the People's Courts, as the 2006 Company Law contains not only substantive innovations (*e.g.*, fiduciary duty of care (*qinmian yiwu*)) but also procedural changes and associated remedies (*e.g.*, derivative actions). The Supreme People's Court's 1st Company Law Regulations addressing this question are somewhat opaque, and seem to leave the People's Courts with a good deal of room to handle pre-2006 claims under post-January 1, 2006 norms. Certainly there is evidence of the Shanghai People's Courts acting in accordance with a strict understanding of these bifurcated worlds. For instance, in 2006 the Shanghai Higher People's Court took a very firm line on this when it chastised the Shanghai No. 1 Intermediate People's Court for using 2006 Company Law provisions to adjudicate shareholders' rights of first refusal where the challenged transfer occurred before January 1, 2006.¹⁵¹ That scolding from the Higher People's Court may have caused the No. 1 Intermediate People's Court itself to invoke the Supreme People's Court's 1st Regulations in a 2006 proceeding, where the Intermediate People's Court instructs the District level People's Court that dissident shareholders' challenges to allegedly defective shareholders' resolutions adopted before 2006 may only be construed under the 1994 Company Law.¹⁵²

Notwithstanding these exhortations in individual cases, the Shanghai Higher People's Court's own data show something radically different, and in fact much more aggressive application of the 2006 Company Law to claims arising before January 1, 2006 and thus technically under the 1994 statute. In the Higher People's Court's consideration of Company

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

¹⁵⁰ SPC Company Law Regulations, *supra* note __, at 3.

¹⁵¹ *Shanghai Hupu Zheyeye Company v. Ling Shuzhao and Shen Zufang* (Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division), 2005, upheld by Shanghai Higher People's Court, 2006)(HSHFY, 2006 Hu Gao Min Er (Shang) Zhong Zi No. 76) (Huai Xiaofeng 2007: 216) (transfer of shares in limited liability company still valid, and must be fully performed, and is not invalidated because non-selling shareholder's did not exercise rights of first refusal, or because of a separate (Tianjin) People's Court judgment blocking sale).

¹⁵² *Xu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007:185).

Law adjudication in calendar year 2006,¹⁵³ the Court reports that for the 318 cases producing a judgment after a first hearing, 164 (51.57%) used the PRC Company Law in arriving at a judgment, and of the 164 cases invoking the Company Law, 102 (62.20%) issued a final judgment on the basis of the 2006 Company Law while only 62 cases (37.80%) issued judgments using the pre-amendment 1994 Company Law. This was true even though fully 88.46% of the Company Law litigation arose from events and establishments that occurred *prior to January 1, 2006*. This variance (only 21% of claims arose after 2006, yet 62% of the judgments use the post-2006 Company Law to arrive at a decision) provides a strong indication that the Shanghai People's Courts felt relatively unconstrained in aggressively implementing the new Company Law. This is an indication confirmed rhetorically in the same report by the Shanghai Higher People's Court, when the Court proudly alludes to one case where it applied the expanded legal rights bestowed in the 2006 Company Law, even though the subject claim arose before January 1, 2006 when only the much narrower rights granted in the 1994 law were available.¹⁵⁴

There is one blemish in the otherwise rosy picture of increased autonomy sketched out above, and it arises in the post-January 1, 2006 world of corporate law adjudication. That blemish is identifiable because of the relative lack of certain kinds of cases in the Shanghai Courts after 2006 discussed *infra*,¹⁵⁵ and noted in an unreleased report commissioned by the Supreme People's Court on implementation of the new Company Law. It appears that even with a proper legal basis for claims under the corporate law, the People's Courts are in some cases bending over backwards not to accept or adjudicate such claims -- even though they heard the same cases in prior years when there was no legal basis.¹⁵⁶ If this is true, and it is difficult to prove in the Shanghai survey with respect to case *acceptances* because it requires proof of a negative, then it appears that the expansion of legal bases for litigation in the 2006 Company Law may have created the possibly unintended consequence of further constraining People's

¹⁵³ Shanghai Company Law Report, *supra* note __, at 37-51.

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

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

¹⁵⁶ See public remarks of Professor Zhu Ciyun, Professor of Law, Tsinghua University Law School at East China University of Politics and Law "Corporate Law Forum 2008" -- "Disregard of the Corporation and Liability to Third Parties in China's Corporate Law from a Corporate Governance Perspective", Shanghai, Nov. 3, 2008, where Professor Zhu publicly cited an internal Supreme People's Court study contracted to law academics indicating that China's People's Courts have shied away from accepting veil-piercing and derivative lawsuits after those same mechanisms were formally established in the 2006 Company Law, at least in comparison to pre-Jan. 1, 2006 period where there was no "legal basis" for accepting such cases. (There is no written form of Professor Zhu's remarks, only the notes of the author, who acted as commentator on the presentation.) One possible example of this dynamic is a case straddling 2004-6, *Shanghai Bund City Real Estate Comprehensive Development Company v. Zhu Minmao, Shanghai Guangtao Decorative Company, Shanghai Xucheng Enterprise Development Company, and Fan Jianmin* (Shanghai Jiading District People's Court 2004, reheard by Shanghai Jiading District People's Court 2005, overturned by Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division) in 2006, sent back to Shanghai Jiading District People's Court 2006, and then appealed again to Shanghai No. 2 Intermediate People's Court for 2006) (HSHFY, 2006 Hu Er Zhong Min San (Shang) Zhong Zi No. 461). In that case, an initial ruling by the Shanghai Hongkou District People's Court from March 2003 permitting corporate veil piercing (2002 Hong Zhi Zi No. 3301) is reversed by Intermediate People's Court after Jan. 1, 2006 because of highly-technical evidentiary questions about who is and is not a shareholder, and whether the defendant shareholders' held themselves out as actually capitalizing the company, etc.

Court action, but largely in the way of *self*-constraints (because no superior governmental body has issued instruction commanding non-acceptance of cases where there is now a legal basis).

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

A second demonstration of autonomy may be seen in the way Shanghai Courts act entirely on their own to develop law and procedure and create remedies in the interest of what they call "fairness," "rationality," "appropriateness," or to punish the breach of (commercial) "good faith." Thus, the Shanghai People's Courts act with creativity and power to create equitable procedures and legal claims to serve "justice," stretch the application of law (again to provide "justice"), dismiss form to privilege function, "make law" based upon their autonomous conception of who or what the statutory framework is designed to serve, devise non-statutory legal standards for application of corporate law doctrine, and create remedies out of whole cloth. When adjudicating in this way, the Shanghai People's Courts most often invoke the all-purpose (commercial) "good faith" provision in Article 4¹⁵⁷ of the 1986 General Principles of Civil Law (*minfa tongze*) ("GPCL")¹⁵⁸ as the broad basis for equitable resolution of corporate and property rights cases.¹⁵⁹ This posture is daring in the PRC, as Article 4 of the relatively outmoded GPCL is extremely commodious, and the GPCL is not the purpose-built statute anointed to govern corporate law matters.¹⁶⁰ Invocation of the GPCL and its Article 4 may be seen in two aggressive veil-piercing cases from 2000 and 2003. One has already been described above in the section on veil-piercing without statutory or Regulatory authorization, where liability is enforced not only against the ultimate shareholders at the time of suit, but also the original transferors to those defendants.¹⁶¹ As the written opinion by the lower-level Pudong New District People's

¹⁵⁷ This is the Roman Law concept of commercial "good faith" translated from reformed German Law of the late 19th century (the *Bürgerliches Gesetzbuch* ("BFB")), to Japanese law at the start of the 20th century (when Meiji Japan translated the *BGB* word for word and called it the Meiji commercial code, and then Chinese law in the 1930s during *Guomindang* rule.

¹⁵⁸ CLC, *supra* note __, at 1-111 – 1-123.

¹⁵⁹ For invocation of the broad civil law "good faith and fair dealing" basis in Article 4 of the General Principles of Civil Law by the Shanghai People's Courts in deciding corporate law cases in addition to the cases noted immediately below, see *Shanghai Jingan Food and Beverage Service Company Jingan District Service Company Successor Entity, et al. v. Shanghai Foreign Economic Service Company* (Shanghai Jingan District People's Court 1999, reversed on appeal by Shanghai No. 2 Intermediate People's Court 2000) (Ma Qijia 2006: 86-93) (court of first instance only, broad General Principles of Civil Law view cut back completely on appeal by Shanghai No. 2 Intermediate People's Court); *Shanghai Guanghua Copper Materials Company v. Shanghai Boer General Company and Shanghai Boer Foodstuff Company* (Shanghai Yangpu District People's Court, reversed by Shanghai No. 2 Intermediate People's Court 2000) (BJFI, 2000 He Er Zhong Jing Zhong Zi No. 1209) (corporate veil pierced to make liable non-contract party because of common Legal Representative, shared premises, etc. on basis of "good faith and fair dealing" (*chengshi xinyong*) and "principles of fairness and rationality" (*gongping heli de yuanze*)); and see the veil-piercing case which arises not in the Shanghai People's Courts, but involves a very important Shanghai plaintiff, *China Eastern Airlines Company Limited Xiamen Enterprise Department v. Xiamen Municipal Renshan Airlines Ticket Agency Company and Xu Yimin* (Xiamen People's Courts, 2002) (Wang Xiaochuan 2006: 65-8) (on the basis of "equality, good faith and fair dealing" described in Article 4 of the General Principles of the Civil Law, the defendant controlling shareholder must have liability to corporate creditors). Note this is a different basis for the provision in the GPCL used as the source for claims in tort -- "rights" or "property" infringement.

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

¹⁶¹ See *Xishan City Chemical Products Manufacturing Company v. Shanghai Aoshi Enterprise Company, Wan Yunhui, Tang Weijun, Shi Hong, Ni Shang and Shanghai Municipality Qingpu District Audit Bureau* (Shanghai District People's Court initially hearing case and Intermediate People's Court upholding not identified, 2000) (Wang

Court in the other, 2003, case makes clear, this far-reaching assignment of liability is justified because the transferring equity holders had depleted the capital of the direct guarantor, and had not in the first place made their full capital contributions to the guarantor but disposed of their equity interests to good faith purchasers under the false impression that the shares were fully-capitalized, and most critically:

..., from the standpoint of principles of fairness (*gongping yuanze*), even though there was an agreement that liabilities [of the guarantor] would be transferred along with transfer of equity [in the guarantor], as the original shareholders who had not fully contributed their [subscribed for] capital to the guarantor, those [original shareholders] cannot because of the transfer of the not fully paid (defective) capital be completely exempt from their responsibilities to [the guarantor entity]; thus, where the transferee shareholders cannot meet the obligations of the [guarantor] company, then these two [original] shareholders still have liability to make up the guaranty obligations.¹⁶²

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

Xiaochuan 2006: 293-9) (trade creditor pierces corporate veil of limited liability company to assess joint and several liability of several shareholders, including initial promoters who have fraudulently undercapitalized the company and their subsequent transferees, for trade payable of RMB 2.9 million yuan, but liability of defendant shareholders to third party creditor is on appeal limited to difference between actual capitalization and subscribed-for capitalization; in this case, even the state Audit Bureau which licenses the accounting firm that certified the original non-contributions has contribution liability); and *Shanghai Bonded Production Materials Market China Communications Products Exchange Center v. Shanghai Baoan Enterprise Company* (Shanghai Pudong New District Peoples Court, upheld on appeal at the Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 278-86).

¹⁶² *Shanghai Bonded Production Materials Market China Communications Products Exchange Center v. Shanghai Baoan Enterprise Company* (Shanghai Pudong New District Peoples Court, upheld on appeal at the Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 282).

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

¹⁶⁴ *Shanghai Jingfa Enterprise Development Company v. Shanghai Haining Petroleum Products Company* (Shanghai No. 2 People's Court, upheld on appeal at the Shanghai Higher People's Court, 2003) (Shanghai Higher People's Court 2005: 299-309) – where judicial buyout of complaining shareholders is the "only remedy" and an "appropriate request" (on the part of plaintiffs) in light of shareholder deadlock and the failure of private ordering (Shanghai Higher People's Court 2005: 303).

¹⁶⁵ *Id.*, at 304.

¹⁶⁶ Addressed below in the discussion of *lack of autonomy* (identified deference to national economic and social policy) : *Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd.* (Shanghai No.1 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008b: 138-44).

Intermediate People's Court wrote forthrightly that, in addition to what statute commands, it must also consider the "appropriateness" (*zhengdangxing*) and "rationality" (*helixing*) of a remedy as significant as dissolution.

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

¹⁶⁷ See *supra* notes ___ and accompanying text.

¹⁶⁸ See for example: *Shang A. v. Lu B.* (Shanghai Changning District People's Court, Intermediate People's Court dismissing appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 107-9) (plaintiff/original named capital provider in "equity cooperative" (*gufen hezuo*) entity who becomes hidden shareholder (*i.e.*, share interest held in defendant's name) in post-transformation limited liability company has right to be listed as a name shareholder on the shareholder register of the post-transformation company, and vote at shareholders' meetings, etc., because this is the "fairest" way to handle the problem); *Yu Xiaohui and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 178-87) (Court reads into Company Law a notice period which starts from "receipt" of notice by shareholders, and not "distribution" of notice by parties convening the meeting); *Shanghai Shenmao Dianci Factory v. Wang Longbao, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company* (Shanghai Nanhui District People's Court, 2004, upheld Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division), 2004, overturned by Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division) 2006 on re-hearing) (Shanghai Higher People's Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) (Intermediate People's Court *first* (before over-ruling itself) sees forced buy-out of stock in "non-profit" stock cooperative upon plaintiff's leaving employ a breach of good faith and fair dealing, even though consistent with regulation and the Articles of Association); and *Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd.* (Shanghai No.1 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008b: 138-44) (briefed in Case Reports Appendix, ruling against plaintiff because of something akin to "unclean hands").

¹⁶⁹ *Company A v. Company B* (Shanghai Huangpu District People's Court, upheld by Shanghai No. 1 Intermediate People's Court, 1997) (Ma Qijia 2006: 142-4) (25% shareholder sues company under control of another minority shareholder for distribution of dividends from distributable profits per company Articles of Association, but not distributed because control party wants to redirect earnings to cash-poor beer plant asset). But note *contra* and more conservative approach in *Guo Shaoqu v. Shanghai Saiyang Textile Science and Technology Company and Wu Yiming* (Shanghai Hongkou People's District Court, 1999, upheld by Shanghai No. 2 Intermediate People's Court, 2000) (Ma Qijia 2006: 260-5) (BFJI, 2000 Hu Er Zhong Jing Zhong Zi No. 280) (People's Courts refuse to order dividends distribution to 20% equity holder because, per the 1994 Company Law, this is a matter for a shareholders' meeting resolution (which 80% shareholder is assured of passing against dividend distribution) and such shareholders' resolutions can only be challenged in court where they are "in breach of law or administrative regulation, or infringe upon the lawful rights of shareholders").

¹⁷⁰ See *Huang Ziyu v. Guan Feng and Fu Ri Enterprise Company* (Shanghai Pudong New District People's Court, upheld on appeal by Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 310-318).

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

The Shanghai judiciary also uses equity court or even common law-like reasoning to "make law." One 2006 example¹⁷³ shows the Shanghai No. 1 Intermediate People's Court using a sophisticated rationale to determine the date upon which a shareholder notice response period should start -- from "receipt" and not "distribution" of the notice. The Court reasons that because the point of notice is actual notification to shareholders so they can exercise their statutory rights, and the Court must take into consideration the differences in physical location of shareholders, the Company Law notice provision as written must be interpreted so as to advantage shareholders or at least not injure them.¹⁷⁴

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

¹⁷¹ A power explicitly gained in the 2006 Company Law, Article 75(1).

¹⁷² The Shanghai Higher People's Court, in its commentary on the case, distinguishes between the "abstract" right to dividend distributions, and the "specific" right to the same -- saying that the former triumphs over the latter in a situation where the corporate form itself acts to frustrate the ability to exercise the abstract right.

¹⁷³ See *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 187). Sadly, this judicial elaboration of the bald corporate law statute invalidates a special meeting and the entire lawsuit of a dissident shareholder group against a controlling shareholder/Legal Representative who has already been proven in breach of law and his corporate fiduciary duties.

¹⁷⁴ The Shanghai Court system has separately read into the Company Law a 30 day exercise (response) period for limited liability company shareholders' exercise of a right of first refusal on a notified and approved transfer, and a one year statute of limitations on un-notified transfers (from registration of the transfer). Nowhere do these provisions appear in the 2006 Company Law, but are instead entirely "judge-made" and apparently necessary because of the imperatives of "commercial transaction efficiency and the stability of legal relationships". See Shanghai Higher People's Court No. 2 Civil Division 2007, *supra* note __, at 42.

¹⁷⁵ Shanghai Higher People's Court No. 2 Civil Division 2007, *supra* note __, at 45.

¹⁷⁶ This is one area which received specific doctrinal elaboration subsequently in the 2nd Judicial Regulations on the new Company Law issued in May of 2008. See SPC Company Law Regulations, *supra* note __, at 7-11.

Law allows – for instance in examining a challenged shareholders’ resolution not only against Article 111 of the 1994 Company Law¹⁷⁷ but in light of whether the suspect resolution might implicate the more generalized “deprivation of [shareholders’] rights.”¹⁷⁸

The Shanghai Courts also fashion non-statutory remedies. For example, although Articles 200 and 201 of the 2006 Company Law provide a legal basis for the levy of fines on investors who do not capitalize a limited liability company or fully pay-up their shares, the 2006 Company Law does not provide a civil remedy for such breaches (particularly for third parties dealing with the investee company at arms-length). Accordingly, in 2006 the Shanghai People’s Courts allowed such a breach of funding obligations to support a third party creditor’s claim to pierce the corporate veil, and assessed joint and several responsibility for the liabilities of the company against the defaulting investor-shareholders. Similarly, Article 31 of the 2006 Company Law addresses only the joint and several liability of other shareholders to replenish in the event that a single shareholder’s *in-kind* contributions are deficient or initially overvalued. Noting that the same problem can occur when a *cash*-contributing investor does not make its contributions in a timely way, the Shanghai People’s Courts extended the joint and several liability of the other shareholders to replenish. The People’s Courts of Shanghai also fashioned their own tough remedies for successful derivative actions, proclaiming the power to void challenged transactions or assess damages for the company against persons adjudicated to have acted improperly (the directors and officers pleaded as defendants in the derivative action) and even other persons involved in the same transactions.¹⁷⁹

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

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

¹⁷⁷ Under the statute, only invalid if against Law, administrative regulation or the Articles of Association.

¹⁷⁸ *Guo Shaoqu v. Shanghai Saiyang Textile Science and Technology Company and Wu Yiming* (Shanghai Hongkou People’s District Court, 1999, upheld by Shanghai No. 2 Intermediate People’s Court, 2000) (Ma Qijia 2006: 260-5) (BFJI, 2000 Hu Er Zhong Jing Zhong Zi No. 280) (People’s Courts refuse to order dividends distribution to 20% equity holder because, per the 1994 Company Law, this is a matter for a shareholders’ meeting resolution (which 80% shareholder is assured of passing against dividend distribution) and such shareholders’ resolutions can only be challenged in court where they are “in breach of law or administrative regulation, or infringe upon the lawful rights of shareholders” yet then applies a standard which goes to “deprivation of shareholders’ rights).

¹⁷⁹ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 45.

¹⁸⁰ See *Yang Lizhi et al. v. Cao Zhengjie et al.* (Xuhui District People’s Court, 2006) (Shanghai Higher People’s Court 2008b: 208) (Huai Xiaofeng 2007: 359), where “compensation rights” (*peichangquan*) can be taken to refer to remedies for breach of corporate fiduciary duties.

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

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

A large amount of investment and commercial activity undertaken even in Reform-era China is through arrangements and vehicles that are neither corporate nor have anything much to do with the PRC Company Law, of whatever vintage.¹⁸² Although purely domestic investment and capital aggregation has exploded in China over the past 15 years, much of that is based in contract (and often not even contract *law*), such as “agreements” (*xieyi*), “joint operation” (*lianying*), “cooperative (*hezuo*)” or non-legal person “partnership” (*hehuo*)” arrangements. Even when something resembling a business organization is established, and even if formal “enterprise legal person” status is conferred on the entity by registration with the appropriate bureau of the State Administration of Industry and Commerce, the resulting firm often has no legal basis in the PRC Company Law, the various foreign-invested enterprise (“FIE”) statutes and implementing regulations promulgated since the late 1970s, or the “Regulations of the PRC on Administration of Company Registration.”¹⁸³ Indeed, the enterprise legal person landscape in China today is populated by an unusual collection of business forms. Sometimes these entities have a prior legal basis, as is the case with “collectively-owned enterprises.” Sometimes they have a precarious legal basis, such as the entities based on local government-promulgated “limited partnership” statutes pre-dating and/or at variance with the PRC Partnership Enterprise

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

¹⁸² See Donald C. Clarke, *How Do We Know When an Enterprise Exists? Unanswerable Questions and Legal Polycentricity in China*, 19 COLUM. J. ASIAN. L. 53 (2005-6).

¹⁸³ Promulgated by the PRC State Council on June 24, 1994, and amended by the State Council on December 18, 2005. These are not just enterprises formed under the 1986 “Law of the PRC on Industrial Enterprises Owned by All of the People” (widely known as the PRC’s “State-owned Enterprise Law,” adopted by the 1st Session of the Seventh National People's Congress on April 13, 1988, and effective as of Aug. 1, 1988), the 2000 “Law of the PRC on Individual Proprietorships” (adopted at the 11th Meeting of the Standing Committee of the Ninth National People's Congress on Aug. 30, 1999 and effective as of Jan. 1, 2000), or the 1997 “Law of the PRC on Township Enterprises” (meant to replace a separate Law and a good deal of regulation on so-called “collectively-owned enterprises” (*jiti suoyouzhiquye*), adopted at the 22nd Meeting of the Standing Committee of the Eighth National People's Congress on October 29, 1996 and effective as of January 1, 1997). For the presence of a collective in the sample, see *Shanghai Jinzhu Agricultural Trade and Commerce Company v. Shanghai Weisirui Company* (Shanghai Jinshan District People's Court, 1999, overturned by Shanghai No. 1 Intermediate People's Court, 2000) (Beijing Higher People's Court 2007: 279-82) (dispute over purported equity transfer agreement with respect to interests in a “factory” converted into a collectively-owned enterprise).

Law. And often they have no legal basis whatsoever, as in the case for the “stock cooperative” (*gufen hezuo*) form,¹⁸⁴ “domestic equity limited liability joint venture companies” (*guonei hezi youxian zeren gongsi*),¹⁸⁵ the “private single shareholder enterprise” (*siying duzi qiye*),¹⁸⁶ or the “enterprise groups” (*jitian*) which may or may not have independent legal personality or ownership of formal equity in their so-called “subsidiaries.” China has the additional problem of a very large number of corporate forms set up not by commercial actors, investors, or shareholders, but directly by government departments – not just the “wholly state owned company” *genus* of the limited liability company permitted under the 1994 and 2006 Company Laws,¹⁸⁷ but also direct establishments by very local-level governments.¹⁸⁸ Chinese opinion-writing judges and PRC scholars refer to all of these business association forms, both those formed by informal contract and those holdovers from the completely state-owned and controlled economy, as “issues left [to us] from history.” However, they are not merely of historical import; they are encountered constantly in modern-day corporate law and commercial disputes, and very often where informal or state-tied investment arrangements have ripened into a corporate or enterprise legal person establishments and been registered as such.

Accordingly, any analysis of the application of the (formal) Company Law in the People’s Courts cannot be limited to how the People’s Courts handle issues which are neatly identified by some authoritative actor, or even the disputants themselves, as within the purview

¹⁸⁴ Alluded to by the Shanghai Higher People’s Court in its Company Law Opinion, Shanghai Higher People’s Court 2006, *supra* note __, at 231-6, and discussed in several cases in the sample. For a post-2006 example, see *Shanghai Shenmao Dianci Factory v. Wang Longbao*, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company (Shanghai Nanhui District People’s Court, 2004, upheld Shanghai No. 1 Intermediate People’s Court (No. 3 Civil Division), 2004, overturned by Shanghai No. 1 Intermediate People’s Court (No. 3 Civil Division) 2006 on re-hearing) (Shanghai Higher People’s Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) (forced buy-out of stock in “non-profit” stock cooperative upon Vice Chairman’s leaving employ pursuant to board regulations, shareholders’ resolution and Articles of Association not a violation of shareholders’ rights), where the Court cites not the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry-level Commission on the Restructuring of the Economic System and Shanghai “Provisional Measures” on stock cooperatives and collectives.

¹⁸⁵ Alluded to in one Shanghai opinion reviewed by the Supreme People’s Court (RENMIN FAYUAN ANLIXUAN 235 (Supreme People’s Court China Practical Jurisprudence Research Institute ed., 2006)) and another by the Shanghai Higher People’s Court (GONGSI HUAINAN ANLI PANJIE 149 (Beijing Higher People’s Court ed., 2007)), and a 2008 case *Ding Guangjiang v. Yan Haibo* (Shanghai No. 1 Intermediate People’s Court (No. 1 Civil Division), 2007, upheld by Shanghai Higher People’s Court (No. 1 Civil Division), 2008) (HSHFY, 2008 Hu Gao Min Yi (Min) Zhong Zi No. 49). The reference is usually to a limited liability company with only PRC investors, and thus not a limited liability company with foreign investment (which would make the entity subject to the PRC’s FIE laws), but how one wishes the Courts would simply refer to “Chinese capital limited liability companies” (*zhongzi youxian zeren gongsi*) without introducing the FIE joint venture term of art “joint venture” (*hezi*).

¹⁸⁶ Referred to, and deemed subject to registration, by the Shanghai Higher People’s Court in *Shanghai Huayuan Real Estate Development Company v. Shanghai Shenji Food and Beverage Enterprise Management Company* (Shanghai Higher People’s Court, No. 2 Civil Division, 2002) (Beijing Higher People’s Court 2007: 152).

¹⁸⁷ See 1994 Company Law, Article 64-72 and 2006 Company Law, Articles 65-71.

¹⁸⁸ See *Shanghai Kangpais Enterprise General Company v. Shanghai Municipal Administration of Industry and Commerce Huangpu District Branch*, *Shanghai Pushun Shunzhe Development Company* and *Shanghai Huangpu Market Development General Company* (Shanghai No. 2 Intermediate People’s Court, 2001, upheld by Shanghai Higher People’s Court, 2003) (Shanghai Higher People’s Court 2005: 349-56) (defendant and contract party that is sued for performance of a condemnation and relocation agreement is the Huangpu District Office of the Shanghai Municipal Administration of Industry and Commerce).

of the Company Law or corporate norms. Instead, analysis of contemporary China must focus on how informal (and often illegal) economic organizations, all very significant drivers of China's recent growth and global expansion, are shaped and affected by the formal legal system and institutions, even when a seemingly obvious mismatch between indigenous forms and "modern" legal structures exists.¹⁸⁹ In fact, the subjects of much interaction between the judicial system and the Company Law are entities which are not corporation but corporate-style partnerships, closed corporations, or something akin to the Limited Liability Company or "LLC" form known in the United States.¹⁹⁰

¹⁸⁹ A good, and very specific, example of this mismatch is the linguistic oddity often seen when Chinese companies refer to their board of directors. Instead of using the statutory term "board of directors' meeting" (*dongshi hui*) (akin to the UK term for shareholders that is "the general shareholders' meeting"), many companies – even in public documents – call that central organ the "board of directors bureau" (*dongshi ju*). See for example the public notice issued by the board of directors of the electronics concern "Gome" in November 2008 when the company chairman was detained on suspicion of stock manipulation, where the board refers to itself as the "*dongshi jüjü*", at DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Nov. 24, 2008, at B-9. This may seem obscure to non-Chinese speakers, or even Chinese speakers who have so internalized the truth of Chinese corporate governance they do not see the difference, but the use of the character "jü" (bureau) instead of "hui" (meeting) gives the organ the taste of a central policy directing body (perhaps acting on behalf of a controlling shareholder), not a body meant to represent the entire shareholders' meeting. Thus, the linguistic oddity might inform not only different assumptions, but different applications of legal doctrine.

¹⁹⁰ See for example *Shanghai 100 Group Real Estate Company v. Shanghai Aofeng Trade Development Group* (Shanghai No. 1 Intermediate People's Court, 1997) (Beijing Higher People's Court 2007: 191-3) (parties establish a limited liability company which is really a loose general partnership focusing on a real estate project, revealed when one of the parties tries to transfer not an equity interest in the limited liability company, but a square-meter portion of the real estate assets theoretically "under" (owned by) the partnership); *Chen Zhijin v. Shanghai Kaikai Enterprise Company, Limited* (Shanghai Jingan District People's Court, 1998, partially upheld by Shanghai No. 2 Intermediate People's Court, 1998) (BJFI, 1998 Hu Er Zhong Jing Zhong Zi No. 729) (plaintiff's "internal" (employee's) shares in company limited by shares properly subject to mandatory buy-back upon plaintiff's leaving employ of company because the entity is really a close partnership); *China Textile Machinery Company Limited and 7 Other Shareholders v. Shanghai Machinery Import Export (Group) Company* (Shanghai District People's Court initialing hearing case and Intermediate People's Court dismissing appeal not identified, 2001) (Wang Xiaochuan 2006: 239-43) (entity established before 1994 Company Law on the basis of a "joint investment agreement", eventually with separate Articles of Association and "enterprise legal person" registration); *Shi Jianjia v. Shanghai Fuxing Mingfang Accountancy Firm Company* (Shanghai Luwan District People's Court, 2002, upheld by Shanghai No. 1 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2005: 319-22) (limited liability company accountancy is in effect a corporate partnership based on Articles of Association, with shareholders meeting as highest authority, and when leaving employ of accountancy and thus disassociating himself, plaintiff must sell his interest to other continuing partners); *Zhang Qingzhao and Wang Zhaoming v. Zhang Wenhui, Shanghai Baoxing Machinery Maintenance and Manufacturing Company Limited* (Shanghai Baoshan District People's Court, 2002, and Shanghai No. 2 Intermediate People's Court, 2004) (Supreme People's Court China Practical Jurisprudence Research Institute 2006: 234-241) (Court looks through apparent corporate establishment to impose general partnership rules); *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 178-187) (subject firm is established as a "limited liability company" under the 1994 Company Law but – pursuant to company Articles of Association – has all the attributes of a limited liability partnership: *i.e.*, the entity has a board of directors, but the highest organ of authority in the entity is the shareholders' meeting (which the board or a certain percentage of investors calls into session); voting rights are accorded by individual identity, not amount of equity contribution; shareholders' have a non-compete obligation and thus a duty of loyalty to the entity and the other members; upon death, retirement or transfer to another job, members' interests are redeemed (or "sold to the company" on a mandatory basis) for a return of capital which is an individual's participation in net partnership assets; some shareholders' have agency power for the entity, etc.).

This is not the place to describe the reasons for the hardy persistence of the small-bore partnership form in the PRC business landscape, except to note that the phenomenon strongly recalls the persistence of the same forms in late imperial and pre-1949 China,¹⁹¹ and is closely tied to post-1978 economic reforms which saw initial privatization of smaller-scale SOEs and “collectively-owned enterprises”¹⁹² into various forms of non-state and non-collective ownership, especially “stock cooperatives” (*gufen hezuo*) or “stock cooperative companies” (*gufen hezuo gongsi*)¹⁹³ with no legal basis whatsoever.¹⁹⁴ Nor is this the place for a long exegesis on the fundamental differences between partnerships and corporate establishments, or the necessarily separate norms which govern them in a coherent manner.¹⁹⁵ Those differences

¹⁹¹ It is a strong echo of the persistence of private, customary, and traditional partnership (*hehuo*) formations in China through the end of Qing rule, the Beiyang Government, and Nationalist Party rule, notwithstanding four separate company statutes and company registration procedures (1904, 1914, 1929 and 1946), the lack of a statute actually authorizing partnerships, and the conferral of shareholder limited liability only for registered “companies”! See History of Chinese Corporate Thought, *supra* note __, at 36-7; MADELINE ZELIN, THE MERCHANTS OF ZIGONG: INDUSTRIAL ENTREPRENEURSHIP IN EARLY MODERN CHINA 51-8 & 84-94 (2005); and Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN.L. REV. 1599 (2000).

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

¹⁹³ NICHOLAS LARDY, CHINA’S UNFINISHED ECONOMIC REVOLUTION 21-4 (1998).

¹⁹⁴ With respect to explicitly-named “collectives”, see: *Shang A. v. Lu B.* (Shanghai Changning District People’s Court, Intermediate People’s Court dismissing appeal not identified, 2006) (Shanghai Higher People’s Court 2008a: 107-9) (plaintiff/original named capital provider in “equity cooperative” (*gufen hezuo*) entity who becomes hidden shareholder (i.e., share interest held in defendant’s name) in post-transformation limited liability company); and *Shanghai Shenmao Dianci Factory v. Wang Longbao, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company* (Shanghai Nanhui District People’s Court, 2004, upheld Shanghai No. 1 Intermediate People’s Court (No. 3 Civil Division), 2004, overturned Shanghai No. 1 Intermediate People’s Court (No. 3 Civil Division) 2006, on re-hearing) (Shanghai Higher People’s Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) (forced buy-out of stock in “non-profit” stock cooperative upon Vice Chairman’s leaving employ pursuant to board regulations, shareholders’ resolution and Articles of Association not a violation of shareholders’ rights, where the Court cites not the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry level CRES and Shanghai “Provisional Measures” on stock cooperatives and collectives). For entities that “grow out” of collectives, see *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People’s Court and Shanghai No. 1 Intermediate People’s Court, 2006) (Huai Xiaofeng 2007: 178-87) (limited liability company is transformed collectively-owned enterprise, with uncertain application of internal governance mechanisms arising from corporate law over former collective participants). One authoritative Shanghai judge, the President of the Changning District People’s Court, offered a somewhat circular explanation for the abundance of partnerships established as limited liability companies which invokes such “stock cooperatives” (*gufen hezuo*). He stated in December 2008 that because such “stock cooperatives” continue to exist in such numbers in China, it is natural that a good number of disputes concerning their operation and internal governance enter the People’s Courts. Remarks of President Zou Bihua, Dec. 5, 2008 (on file with the author). This is only a partial explanation, because as this writing makes clear so much of the energy behind the application of partnership law principles in China is directed at closed corporation-type business organizations formed long after the implementation of the 1994 Company Law, where there was no question of rogue “stock cooperative” establishments or transformation of collectives or small SOEs into anything other than companies.

¹⁹⁵ Partnerships are the expression of an intimate, non-owner-alienated, business association, where the relatively few partners will participate in the running of the business and have confidence in the trustworthiness and technical competence of their co-venturers – a confidence based on knowledge about the other partners, their past performance in business, their skill-sets, etc. That intimate association is recognized in the default partnership norms which distribute ownership and management authority equally to all of the partners, give full agency powers in regards to the partnership to each partner, and dictate that the partners share profits, and bear the burden of losses, equally. Contrast with the partnership or sole proprietorship the orthodox corporate form where powers attendant to

touch on every major area of enterprise law, including fiduciary duties (both for orthodox corporate fiduciaries and shareholder-investors), the ease and justification of asserting liability against promoter-shareholders (veil-piercing), the relationship between management/employee (contract) status and ownership (property) rights, and the adaptability of the enterprise upon the defection of any owner-operator. The very obvious problem with the PRC Company Law and China's relatively new company system is that the formal "Company" Law makes little of these fine distinctions, potentially leaving the deeply-disadvantaged People's Courts in a position where they cannot apply, or must mis-apply, "corporate" law doctrine to what are in fact limited liability "partnerships".¹⁹⁶ As the Shanghai Higher People's Court noted in 2003 when faced with this mismatch between legal form and enterprise reality,¹⁹⁷ in corporate law matters the courts simply have to be expert in construing the rights and obligations relevant to the many business forms in play, whether or not the Courts have a legal or doctrinal basis.

Thus, it is a significant demonstration not just of judicial autonomy but of real competence to see the Shanghai People's Courts refuse to apply formal corporate law to so-called "corporate" establishments and instead apply decision principles that conform to the reality underlying Chinese business organization and participant expectations. In one well-handled 2004 case the Shanghai Baoshan District People's Court (upheld by the Shanghai No. 2 Intermediate People's Court) looked through a *de jure* "corporate" establishment to understand a *de facto* "partnership" and ruled on the parties' rights accordingly. It did so not in conformity with the flawed PRC Partnership Enterprise Law but instead universal partnership principles.¹⁹⁸

the ownership right are parceled out amongst directors (centralized management), officers (day-to-day operations and management) and the mere capital providers (and residual interest rights holders) the share-"owners" -- which shareholders are alienated from management authority, have no agency powers with respect to the corporation, and have a right to distributed profits only in accordance with the equity investment represented by their share capital, all in exchange for limited liability protection. Yet one difference arising from the distinction is with respect to the costs of partnering (as contrasted with a corporate establishment): the peculiar *lack* of adaptability seen in the partnership establishment, where *per* the default rule all partners have to agree on significant matters and disassociation (often resulting from inability to agree) by one partner leads to the dissolution of the association, and pay-out to the partners (redemption via liquidation). Contrast the pure corporate form, where centralized management by the board of directors (requiring only a majority vote of the directors, and not unanimity) and their appointed management, and continuity of life of the entity, are undisturbed by the disagreement of even a significant proportion of shareholders or the departure of any mere "owner" via transfer of its share interest or -- if permitted -- by stock redemption.

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

¹⁹⁷ Alluding to the difficulties encountered in dealing with "stock cooperative" (*gufen hezuo*) entities under the Company Law. See Shanghai Higher People's Court 2006, *supra* note __, at __.

¹⁹⁸ *Zhang Qingzhao and Wang Zhaoming v. Zhang Wenhui, Shanghai Baoxing Machinery Maintenance and Manufacturing Company Limited* (Shanghai Baoshan District People's Court, 2002, Shanghai No. 2 Intermediate People's Court, 2004) (Supreme People's Court China Practical Jurisprudence Research Institute 2006: 234-241)

In this very impressive work, the District-level People's Court boldly disregarded the form of corporate establishment (including a "Shareholders Agreement" between the investors) to rule that the entity is in fact a kind of general partnership and order equal *partner* distributions of the residual assets (rather than different proportions of the residual assets determined by the investors' notional "equity" investment).

The same smart application of law can be identified after January 1, 2006. For instance, for calendar year 2006 the Shanghai Higher People's Court reported a large number of cases in which company Articles of Association provide for expulsion of shareholders by the shareholders' meeting upon the occurrence of certain events, including infringement upon the rights of other shareholders, failure to fully pay-in capital, withdrawal or termination of human capital contributions, and the like. The 2006 Company Law countenances no such possibility, as is correct under corporate law doctrine. The Higher People's Court reported much litigation arising from this contradiction, where the expelled shareholder says he or she simply cannot have his or her status as a shareholder extinguished (absent redemption of his or her share interest at the initiative of the shareholder). The respondent company commonly answers by portraying the Articles of Association as the shareholders' agreement and the full contractual expression of almost sacred "private ordering," so that when one contract party fails to abide by its obligations the other contract parties can exercise the remedies set forth in the contract (expulsion from the company). The Higher People's Court supported the latter jurisprudence in explicit terms because the result protects the power of "private ordering"¹⁹⁹ and "freedom of contract" in China's new semi-marketized economy.²⁰⁰ Yet, what the Shanghai Higher People's Court was actually doing is something far more profound than a hymn to self-ordering: it was exercising a high degree of autonomy (and not a little "legal realism") in supporting application of company law in conformity with the underlying identity of China's firms, or "partnerships." This may be a bit of a travesty in corporate law terms, but shows a technical skill and autonomy not generally associated with the Chinese People's Courts in their history.

A related instance of autonomous and commendable misapplication of the law is one case from the middle 1990s in which the Shanghai Higher People's Court – in an initial hearing and then re-hearing -- bent over backwards *not* to invalidate a share transfer agreement between the shareholders of a two-shareholder entity which would have resulted in a single-shareholder limited liability company, something not permitted under the 1994 Company Law.²⁰¹ In a

(formal corporate establishment to be disregarded, and investors to be seen as general partners, with liquidation and distribution rights determined accordingly). The Shanghai No. 2 Intermediate People's Court opinion is summarized at length in the attached Case Reports Appendix.

¹⁹⁹ See *infra* notes __ and accompanying text.

²⁰⁰ And under the condition that the expulsion mechanism does not contravene any mandatory rule of law, or harm the interests of creditors, see Shanghai Higher People's Court No. 2 Civil Division 2007, *supra* note __, at 46-7. See how the Shanghai Courts achieve the same emphasis in *Shanghai Yingdafang Service Company v. Shanghai Yingdafang Zhangjiang Service Company, et al.*, Shanghai (Pudong New District People's Court and Shanghai No.1 Intermediate People's Court, 2005) (Shanghai Higher People's Court 2008b: 190-195), summarized in the Case Reports Appendix; and *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 178-87) (a limited liability company which has all the properties of a partnership).

²⁰¹ *Shanghai Huayuan Real Estate Development Company v. Shanghai Shenji Food and Beverage Enterprise Management Company* (Shanghai Higher People's Court, No. 2 Civil Division, 2002) (Beijing Higher People's

remarkable opinion, the Higher People’s Court offered various remedies to the technical problem at issue – the legal impossibility of a single shareholder company – with helpful suggestions, one of which is plainly illegal. The Court blithely suggested that the resulting sole shareholder can (i) actively find another shareholder, (ii) change the company into an unlimited liability entity, (iii) liquidate the company, or (iv) continue to operate the company as a single shareholder company. As the Shanghai Higher People’s Court, the apex of the Shanghai judicial system, writes with some degree of understatement, “the three first ideas are legal, and the fourth idea *has some degree of illegality*.”²⁰² The Shanghai Court then went even further afield with the assurance that external creditors of a single person company will be protected because they can “avail themselves of the [protective] remedy that is disregard of the corporate form.” This is equally odd jurisprudence because, at the time, corporate veil-piercing had no formal legal basis (statutory or Regulatory). The Court then performed a final, dizzying, turn, by arguing in favor of spontaneously-formed single shareholder companies²⁰³ as a necessary legal-structural remedy for shareholder-deadlocked companies because the other remedy in corporate law – a shareholder’s suit to ask for judicial dissolution of the entity – “*has no legal basis under the Company Law*.” In the space of a few lines in one opinion, the Higher People’s Court has counseled “some degree of illegality,” provided assurances to creditors based on a mechanism which the Courts are not authorized to apply, and then argued again in favor of the admitted illegality because the only other legal claim is unauthorized. Yet, this exercise of extreme autonomy has a praiseworthy aspect when compared with the many post-2006 cases demonstrating hostility to judicially-directed deadlock resolution.²⁰⁴ The remedy suggested in this decision, which slides up against (and over?) the line of illegality and doctrinal incoherence, is a rational technique allowing two warring shareholders to re-deploy their capital investment to better productive uses and escape the straightjacket of a badly-drafted 1994 Company Law.

d. Protecting Firm Autonomy and Private Ordering

Fourth, the Shanghai Courts express their autonomy by acting as the guardian of corporate and commercial autonomy itself. In recent years each of the State Council, the National People’s Congress²⁰⁵ and the Shanghai Higher People’s Court²⁰⁶ has pointed to the enabling of this function as a key policy aim behind the 2006 Company Law amendments. Thus, China’s law drafters apparently hoped that the new Company Law would articulate and protect the autonomy of corporate legal persons and the parties who form and operate them, a position in direct contrast to the legal positivist “business regulation” philosophy underpinning both the 1994 Company Law and much of China’s substantive law and regulation produced from the start of the Reform era. This idea is most often exemplified in opinion rhetoric and case outcomes

Court 2007: 148-152) (shareholders’ agreement which will result in a single shareholder limited liability company in legal and binding, and local bureau of industry and commerce should register resulting entity).

²⁰² *Id.*, at 151 (emphasis added).

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

²⁰⁴ And the overwhelming concern with what the Shanghai People’s Courts call “market stability” and entity preservation at all costs. See *infra* notes ___ and accompanying text.

²⁰⁵ LAO Company Law Explanation, *supra* note ___.

²⁰⁶ Shanghai Higher People’s Court 2006, *supra* note ___, at 5.

which uphold the idea of “market autonomy” against state power/regulation, and the equally sustained support for “private ordering” and “self-regulation” versus mandatory business regulation.

This orientation apparently was the case even before the 2005 amendments.²⁰⁷ A 2004 case presenting a situation all too common in Chinese corporate dealings – the frustration of corporate decision-making by failure of a board chairman (and Legal Representative (*fading daibiaoren*)) to convene a shareholders’ or board meeting – is lost by plaintiffs because the Shanghai Luwan District People’s Court privileged the entity’s Articles of Association²⁰⁸ (which give the board chairman in question the exclusive authority to “convene” such meetings), despite clear evidence that the same chairman was protecting the shareholding group he represented against the other shareholders in the company and in clear breach of his/their corporate fiduciary duties to the company.²⁰⁹ The Court issued a mini-sermon on the virtues of strict deference to private arrangements such as Articles of Association over “public authority” (*i.e.*, bedrock corporate law principles applied by judicial institutions):

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

²⁰⁷ But not uniformly. See for instance the 1997 case: *Company A v. Company B* (Shanghai Huangpu District People’s Court, upheld by Shanghai No. 1 Intermediate People’s Court, 1997) (Ma Qijia 2006: 142-4) (25% shareholder sues company under control of another minority shareholder for distribution of dividends from profits per company articles of association, but not distributed because control party wants to redirect earnings to cash-poor beer plant asset). In that case, on appeal the defendant argued that the plaintiff shareholder should not be able to sue the company for failure to distribute dividends because the problem should have been resolved at the shareholders’ meeting or board meeting level, and only if the resulting resolutions in some way infringed upon the lawful rights of the plaintiff shareholder could the plaintiff sue under Article 111 of the 1994 Company Law. The Shanghai No. 1 Intermediate People’s Court rejected this solid statutory argument, and ordered the distribution of dividends with interest in line with the plaintiff’s inherent right (also described in the Articles of Association) to 25% of after tax profits.

²⁰⁸ Based, however, in the formal articles of the 1994 Company Law which direct the same.

²⁰⁹ See the same result in *X. Fang v. Y. Information Technology Co., Ltd.* (Shanghai Yangpu District People’s Court, 2005) (Shanghai Higher People’s Court 2007: 59-65).

²¹⁰ See *X. Jiyin Chip Company et al. v. Y. Group Co., Ltd.* (Shanghai Luwan District People’s Court, 2001) (Shanghai Higher People’s Court 2007: 75). This rhetorical position is countered by the result from the Shanghai

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

The orientation of the Shanghai courts as guardian of corporate autonomy is stronger after 2006. In its 2007 analysis of more than 750 Company Law-related opinions rendered in 2006, the Shanghai Higher People’s Court confirms one side of the achieved result, asserting the “exhaustion of internal remedies” as one of the principles perceived at work in post-January 1, 2006 corporate law jurisprudence.²¹² This assertion means that parties involved in corporate disputes were encouraged and permitted to take full advantage first of internal (*i.e.*, intra-shareholder) remedies before having recourse to procedures and mechanisms directed by public institutions, such as derivative actions, or lawsuits seeking judicially-ordered equity transfers, or dividend distribution.²¹³ Confirmation of this new dogma appears in the Shanghai No. 1 Intermediate People’s Court 2007 commentary on a pre-2006 Company Law case,²¹⁴ in which the adjudicating Court is deemed to have chosen “incorrectly” between protection of the existing shareholders’ right of first refusal on transfer, on one side, and the rights of a good faith third party stock transferee under a fraudulently “shareholder-approved” transfer agreement, on the other. The People’s Court’s post-January 1, 2006 commentary on the case makes clear to what extent judges working in the Shanghai system are to prioritize private ordering over the statutory framework:

No. 1 Intermediate People’s Court in the *A. Investment Development Company v. Wang and Other Shareholders* case alluded to below, *infra* note __, where the Court has to choose between a fraudulent, albeit privately-ordered, stock transfer contract (and the interests of a good faith purchaser), on one side, and the preemptive rights bestowed on existing shareholders in the Company Law, on the other – coming down firmly on the side of the Company Law, probably because of the presence of fraud in the underlying transfer contract.

²¹¹ *Shanghai Yingdangfang Service Company v. Shanghai Yingdangfang Zhangjiang Service Company, et al.*, Shanghai (Pudong New District People’s Court and Shanghai No.1 Intermediate People’s Court, 2005) (Shanghai Higher People’s Court 2008b: 190-195). And see *Guo Shaoqu v. Shanghai Saiyang Textile Science and Technology Company and Wu Yiming* (Shanghai Hongkou People’s District Court, 1999, upheld by Shanghai No. 2 Intermediate People’s Court, 2000) (Ma Qijia 2006: 260-5) (BFJII, 2000 Hu Er Zhong Jing Zhong Zi No. 280) (People’s Courts refuse to order dividends distribution to 20% equity holder because, per the 1994 Company Law, this is a matter for a shareholders’ meeting resolution (which 80% shareholder is assured of passing against dividend distribution) and such shareholders’ resolutions can only be challenged in court where they are “in breach of law or administrative regulation, or infringe upon the lawful rights of shareholders”).

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

²¹³ For a post-2006 expression of what the Shanghai Higher People’s Court deems a new line, see *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People’s Court and Shanghai No. 1 Intermediate People’s Court, 2006) (Huai Xiaofeng 2007: 185) (contested shareholder resolutions passed at dissident special shareholders’ struck down because they were defective under a strict reading of the company’s Articles of Association, which are given priority over the corporate law).

²¹⁴ See *A. Investment Development Company v. Wang and Other Shareholders* (Shanghai No. 1 Intermediate People’s Court, on appeal, 2003) (Shanghai Higher People’s Court 2007: 106-9) (shareholder resolution approving transfer of 83% of company stock by one shareholder without exercise of preemptive rights by other shareholders pursuant to Article 35 of the 1994 Company Law is forged for beneficiary of rights by application of forged seal for the beneficiary; the higher Court then invalidates the original transfer contract to a third party, giving the Company Law preemptive right precedence over the falsely-approved contract) .

First and foremost, the thing we must clarify is this: the jurisprudential logic underlying the giving of priority to the shareholders' preemptive rights of purchase over the [good faith] purchase rights of the transferee is absolutely not because the former right is in statute, and the latter is merely a contract right. This is because statutory rights are not always superior to contract rights – in fact, it is just the opposite. Approaching it systemically, and adhering to the orientation which protects private ordering, regulation of the market requires that the formulation of law fully respects the freedom to contract, so as to encourage successful transactions. ... The amendments resulting in the 2006 Company Law with respect to the issues on transfer of shares in limited liability companies especially emphasize: “Where the Articles of Association make other stipulations on share transfers, those other stipulations shall govern.” There is significant meaning in this.²¹⁵

This is a remarkable view of state-issued norms in the context of recent Chinese history, and certainly a departure from the view of Chinese law even through the 1990s. The same orientation is seen in other post-January 1, 2006 Shanghai Company Law cases. A case decided on appeal in 2006 shows heavy privileging of apparent self-ordering via Articles of Association and entity “regulations” approved by the board, where the result is to disenfranchise someone clearly a shareholder.²¹⁶ A late 2006 case arising in Shanghai's Changning District shows the extraordinary weight placed on a company's partnership agreement-like Articles of Association, as an expression of “private ordering”, which triumphs absolutely over the larger default provisions or corporate law doctrines of the Company Law such as fiduciary duties. In that case, even with public identification of (and administrative punishment for) breach of corporate fiduciary duties and fraud by a controlling shareholder/Legal Representative, resolutions passed by a dissident shareholders special meeting were ruled invalid because the dissident meeting was not convened, and the voting at the meeting was not effected, in technical conformity with the agreed Articles of Association.²¹⁷ Finally, a 2007 Intermediate People's Court²¹⁸ went so far rhetorically as to see off its own role -- *judicial* intervention -- with the ringing admonition “the

²¹⁵ *Id.*, at 111.

²¹⁶ *Shanghai Shenmao Dianci Factory v. Wang Longbao, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company* (Shanghai Nanhui District People's Court, 2004, upheld Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division), 2004, overturned Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division) 2006, on re-hearing) (Shanghai Higher People's Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) (forced buy-out of stock in “non-profit” stock cooperative upon Vice Chairman's leaving employ pursuant to board regulations, shareholders' resolution and Articles of Association not a violation of shareholders' rights). In this case, the defendant entity actually pleads that assertion of “law” over the agreements in the board “regulations” and the Articles of Association amounts to “state interference”.

²¹⁷ The defects are very, very, arcane, and related to meeting notice, and the status of individuals who have died, redeemed their equity, or transferred their equity to third parties. See *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 187).

²¹⁸ In *Sun X. v. Li Y. and Shi Z.* (Initial People's Court hearing case and Intermediate People's Court hearing appeal not identified, but latter probably Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division)), 2007 or 2008) (Yu Wei 2008: 28-9). This is the same case invoked as a demonstration of judicial “conservatism” *infra*, see notes __ *infra* and accompanying text.

People's Courts should not use the coercive power of the state to interfere with matters within the scope of a company's self-governance."²¹⁹

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

But, the People's Court has also noticed that the three defendants, as directors of the company, have not really made the transition from their former role as leaders (*lingdao jiaosi*) of a collectively-owned enterprise to that of shareholders in a limited liability company. For instance, in calling shareholders' meetings they have not conformed to their notification obligations, have failed in bringing about discussion of corporate operating policies, and ignored the other related rights of the seven plaintiffs. In addition, in managing corporate finances, there seems to be in evidence action which includes the transfer of corporate funds into personal accounts and the holding out of corporate vehicles as personal assets. And, the expenditures by the company have not been handled transparently, etc. The above-described actions by the defendants have certainly brought about the lack of trust by the plaintiffs, which has resulted in the disagreement [between shareholders].²²⁰

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

Conversely, if the Shanghai Courts are in the business of protecting firm autonomy, and urging former political actors to participate in the new system as commercial actors (under law), they also act to disallow political actors the use of corporatization and the law as a shield. In a 2007 case, the lower-level People's Court and the Shanghai Higher People's Court dismissed two defenses: one that sought to distinguish SOE-subsidary "enterprise department" action from the interests of the SOE itself, and another that sought to protect a corrupt cadre from

²¹⁹ The case is *Sun X. v. Li Y. and Shi Z.* (Initial People's Court hearing case and Intermediate People's Court hearing appeal not identified, but latter probably Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division)), 2007 or 2008) (Yu Wei 2008: 28-9). The statement quoted is at 28.

²²⁰ *Yang Lizhi et al. v. Cao Zhengjie et al.* (Xuhui District People's Court, 2006) (Shanghai Higher People's Court 2008b: 208) (Huai Xiaofeng 2007: 359).

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

prosecution because he had diverted funds to a “commercial” limited liability company he promoted and controls absolutely.²²² A similar case, also from 2007, summarily dismissed a criminal defendant’s assertions that his corporate misfeasance (false accounts to boost manager bonuses, etc.) and breach of corporate law and regulation were unrelated to the crime of “private misappropriation of public assets” because they were the internal affairs of a corporate entity (albeit a registered SOE).²²³ The Court had none of this theory, and sentences the defendants to several years in prison and return of diverted income.²²⁴

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

e. Exercise of Judicial Power

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

- liberally declared void *ab initio* share transfer agreements (and associated purchase obligations) which had not seen waiver of non-selling shareholders rights of first refusal;²²⁶

²²² See *PRC v. Xue Henghe* (Shanghai Rail Transport Intermediate People’s Court, upheld by Shanghai Higher People’s Court, 2007)(Shanghai Higher People’s Court 2008b: 447-52) (the SOE subsidiary “enterprise department” is – under the principle “he who invests has property ownership rights” (*shei touzi shei yongyou chanquan*) – “owned” (and governs assets belonging to) the SOE, even when administered independently; the corporation set up to receive diversion of assets from the same “enterprise department” is pierced because the corporation is entirely controlled by, and gives benefits to, the criminal defendant).

²²³ *PRC v. Wang Haiqing et al.* (Shanghai Hongkou District People’s Court, 2007) (Shanghai Higher People’s Court 2008b: 437-442).

²²⁴ This is consistent with the same sensitivity and approach taken in a 2001 criminal case, where the establishment of a new, private, enterprise (by an SOE manager) designed to skim transfer value from the SOE’s sourcing transactions is a violation of the Criminal Law’s prohibition against “illegally engaging in the same business” (as an SOE where the criminal defendant is posted); see *PRC v. Shen XY* (Shanghai Higher People’s Court, 2001) (Shanghai Higher People’s Court 2007: 260-4).

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

²²⁶ See *Zhu Liqun v. Hong Bangyao and Wu Lieming* (Shanghai Changning District People’s Court, 2000, Shanghai Intermediate People’s Court upholding not identified, 2000) (share transfer agreement involving equity in limited liability company void because approval of transfer not obtained from “all” shareholders) (Beijing Higher People’s Court 2007: 194-7) and *Wu Yazhong (Michael Woo) v. Shanghai Bin Clothes Manufacturing Company* (Shanghai Fengxian District People’s Court, 2000, Shanghai Intermediate People’s Court upholding not identified, 2000) (Beijing Higher People’s Court 2007: 203-5) (share transfer agreement involving registered capital interests in Chinese-foreign equity joint venture void because approval for proposed transfer not sought from other participants (or their board appointees) pursuant to statute, the joint venture contract and articles of association, and the examination and approval authority governing such foreign invested enterprises).

- ordered, with great assurance, the buy-out of unhappy shareholders where there was strong evidence of opportunistic or even fraudulent behavior by promoter shareholders;²²⁷
- ordered corporate actors to conform to their legal obligations in certain circumstances -- in one case so as to protect and elaborate the full range of property rights (transferability, right to profits, and voting rights) where a capital provider's contribution had not been recognized by the investee company and the People's Courts ordered the defendant corporations to undertake their registration obligations;²²⁸
- adjudicated legal person entities as tortfeasors for the actions of their officers and employees;²²⁹ and
- assessed criminal liability against control parties and key employees.²³⁰

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

²²⁷ *Shanghai Jingfa Enterprise Development Company v. Shanghai Haining Petroleum Products Company* (Shanghai No. 2 People's Court, upheld on appeal at the Shanghai Higher People's Court, 2003) (Shanghai Higher People's Court 2005: 299-309): where judicial buyout of complaining shareholders is the "only remedy" and an "appropriate request" (on the part of plaintiffs) in light of shareholder deadlock and the failure of private ordering, *Id.*, at 303.

²²⁸ *Shang A. v. Lu B.* (Shanghai Changning District People's Court, Intermediate People's Court dismissing appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 107-9) (plaintiff/originally-named capital provider in "equity cooperative" (*gufen hezuo*) entity who becomes hidden shareholder (i.e., share interest held in defendant's name) in post-transformation limited liability company has right to be listed as a name shareholder on the shareholder register of the post-transformation company, and vote at shareholders' meetings, etc., unless such recognition violates a mandatory rule).

²²⁹ *Wang A. v. Shanghai B. Public Transportation Company* (Shanghai Luwan District People's Court, Intermediate People's Court upholding and rejecting appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 7-10).

²³⁰ *See PRC v. Yang Demao and Chen Yihua* (Shanghai Luwan District People's Court, upheld by Shanghai No. 1 Intermediate People's Court, 2003) (preferential transfers by controlling shareholders out of company approaching liquidation either to loot company in breach of duties, or remove assets from creditors' claims, judged basis for the crime of "harmfully impeding liquidation") (Wang Xiaochuan 2006: 460-5); *PRC v. A. Internet Company, Li B., Li C., Liang D., Lu E., and Sun F.* (Shanghai Pudong District People's Court, Intermediate People's Court upholding and rejecting appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 305-9) (corporate legal person criminally liable under PRC Criminal Law Article 366 crime of "unit (legal person) distribution of pornography for profit", and same for those corporate officers and employees "having direct management responsibility" or are "directly responsible"); *PRC v. Shanghai X. Real Estate Jingji Limited and Liu A.* (Shanghai Xuhui District People's Court, Intermediate People's Court upholding and rejecting appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 334-7) (limited liability company which has engaged in fraudulent real estate contracting and transactions assessed criminal liability); *PRC v. X. Securities Limited, Peng A., Lou B., Chen C. and Li D.* (Shanghai District People's Court first hearing the case not identified, appeal rejected by Shanghai No. 2 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008a: 340-5).

²³¹ *PRC v. X. Securities Limited, Peng A., Lou B., Chen C. and Li D.* (Shanghai District People's Court first hearing the case not identified, appeal rejected by Shanghai No. 2 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008a: 340-5) (securities company building government-approved financial advisory and asset management business collects investment funds from a very broad public against promises of high "interest" return, and thus is engaged in illegal public offering of securities, commercial banking, etc., both company and executives and employees directly responsible have criminal liability).

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

III. AUTONOMY CONSTRAINTS

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

a. Application of the Law to Support Public Policy in Contravention of Law

In 2007 the Shanghai Higher People's Court praised newly-inserted clauses of the Company Law designed to unblock deadlocked companies,²³³ in particular a new Article 183 which allows shareholders to petition for firm dissolution. In its focus on new Article 183 however, the Higher People's Court raised a concern which exemplifies a first constraint working on the autonomy of the Shanghai Courts: explicitly alluding to the importance of continued firm existence and operation for growth, employment, and social welfare, the Higher People's Court worried that new Article 183 would force it to order firm dissolution in the event of deadlock, and lamented the apparent inability to instruct other less socially-costly remedies.²³⁴ The concern of the Higher People's Court in this regard is echoed in the values *cum* doctrinal choice by a Shanghai Intermediate People's Court in the 2006 *Tang Chunshao* judicial dissolution case²³⁵ briefed in the Case Reports Appendix -- one which shows PRC People's Courts consciously deferring to national social and economic policy rather than implementing formal corporate law or doctrine.²³⁶ It is the same values choice confirmed directly by the Chief

²³² *PRC v. Fang Kun, Ni Chunhua, Zhang Minxia* (Shanghai Pudong New District People's Court, upheld by Shanghai No. 1 Intermediate People's Court, 2007) (Shanghai Higher People's Court 2008b: 419-26) (trading in unlisted securities, including acting as agent-underwriter in public offerings, without CSRC approval and registration to engage in the securities business, constitutes the crime of "illegal business operations").

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

²³⁴ Such as ordered settlement negotiations, settlement after trusteeship, auction and buy-out by existing shareholders, or judicially-ordered acquisition. See Shanghai Higher People's Court 2006, *supra* note __, at 11-12.

²³⁵ *Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd.* (Shanghai No.1 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008b: 138-44), a case decided before the 2nd Judicial Regulations on the 2006 Company Law applicable to shareholders' suits for dissolution were issued.

²³⁶ It is the same doctrinal approach adopted two years later in the 2nd Supreme People's Court Judicial Regulations on Application of the 2006 Company Law, see *Zuigao Renmin Fayuan Guanyu Shiyong "Zhonghua Renmin Gongheguo Gongsifa" Ruogan Wenti de Guiding (Er)* (Supreme People's Court Regulations (2nd) on Several Issues Related to Application of the "Company Law of the PRC"), 2008 *fashi* No. 6, issued May 12, 2008, SPC Company Law Regulations, *supra* note __, Article 5, which for petitions under Article 183 directs the People's Courts first to "emphasize" (*zhuzhong*) mediation, and then pushes the People's Courts to support an agreed buyout among the shareholders, reduction of capital and exit of one or more partners, or *any* method which is not in

Judge of the Shanghai Higher People's Court No. 2 Civil Division in December 2008 when discussing the Shanghai Courts' hesitancy in accepting and allowing dissolution-liquidation pleadings.²³⁷ In the *Tang Chunshao* case, the Shanghai No. 1 Intermediate People's Court rejected the plaintiff's suit for judicial dissolution of a thoroughly deadlocked company, even though the underlying real estate project had been shuttered for more than a year because of the inability of the two shareholders to agree. The expanded reasoning behind the simple judgment is most important to note here, as the Court is loathe to order the dissolution of a corporate legal person because it would "necessarily impact in different degrees [on] market order and stability".²³⁸ Another 2006 judgment, in which shareholders of a limited liability company (converted from a collectively-owned enterprise) also sought judicial dissolution, evidences a similar approach by the Shanghai Xuhui District People's Court.²³⁹ In that case, a petition seeking judicial dissolution was also refused because it was explicitly deemed a market-disrupting remedy, and it would have altered arrangements for continued payment of salary to laid-off workers. The Shanghai Higher People's Court in its commentary on this case again lauds the result because of the negative impacts on "market stability" arising from firm dissolution and the attendant judicial and social costs.²⁴⁰

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

contravention of mandatory law or administrative regulation, all in order to serve the priority of keeping the company in existence. As such, the *Tang Chunshao* case may show an example where lower-level People's Court adjudication shaped Supreme People's Court Regulation, and not the other way around.

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

²³⁸ *Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd.* (Shanghai No.1 Intermediate People's Court, 2006) (Shanghai Higher People's Court 2008b: 138-44), at 143.

²³⁹ See *Yang Lizhi, et al. v. Cao Zhengjie et al.* (Xuhui District People's Court, 2006) (Shanghai Higher People's Court 2008b: 205-10) (Huai Xiaofeng 2007: 356-9) (plaintiffs' application does not meet the high standard set forth in 2006 Company Law, Article 183; in addition, plaintiff shareholders are encouraged to plead again on breach of defendant directors' apparent breaches of corporate fiduciary duties).

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

²⁴¹ See *supra* notes ___ and accompanying text.

²⁴² Accelerated Hearings, *supra* note ___.

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

b. "Conservative Adjudication"

The Shanghai People's Courts are conservative, and the degree of conservatism appears to increase after 2006 and promulgation of the new Company Law. This so-called conservative orientation for the Shanghai judiciary consists of action, or inaction, which indicates a turn against the full exercise of autonomy granted in law or implied by the Courts' institutional position. Importantly, this action or inaction is not necessarily the result of political pressure, or resource or competence constraints,²⁴⁶ but is very often an expression of studied Court avoidance of granted institutional powers.

A recent case reported by a sitting judge of the No. 2 Intermediate People's Court No. 3 Civil Division demonstrates the conservative adjudicatory style.²⁴⁷ Plaintiff Sun and Defendants Li and Shi acted as promoters in the formation of a limited liability company, the Shixin Company. Defendant Li was originally named Legal Representative of the company. In October 2006, the company convened a shareholders' meeting at which each of the three shareholders of the company signed the meeting registry. The shareholders at the meeting considered and voted on a resolution addressing (i) the removal of Defendant Li from all positions at the company, (ii) the validity of an agreement executed in September of 2006 with

²⁴³ See *infra* notes ___ and accompanying text.

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

²⁴⁵ There is no reason to think that the Shanghai People's Courts *cannot* act in the fully autonomous way posited above. Contrast the two 2006 outcomes described here with the result in a pre-2006 Company Law case (under the 1994 Company Law which had no provision allowing shareholder suits for judicial dissolution): *Shanghai Jingfa Enterprise Development Company v. Shanghai Haining Petroleum Products Company* (Shanghai No. 2 People's Court, upheld on appeal at the Shanghai Higher People's Court, 2003) (Shanghai Higher People's Court 2005: 299-309). In that case the Shanghai No. 2 Intermediate People's Court orders the "put" of equity interests owned by complaining shareholders to the other (breaching) shareholders so the company may "continue normal operations" and continue to "maintain utilization of the company's accumulated value" (*Id.*, at 304) but *also* implicitly to allow redeployment of capital by the complaining shareholders to continuing and better productive uses. The judicial rhetoric about "market stability" and "continued use of productive assets" in this case is roughly the same, but the 2001 Court feels emboldened to fashion continued firm existence via its own, implicitly far more efficient, remedy – a remedy which speaks to the significant power and autonomy of the Court itself.

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

²⁴⁷ The case is *Sun X. v. Li Y. and Shi Z.* (initial People's Court hearing case and Intermediate People's Court hearing appeal not identified, but latter probably Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division), 2007 or 2008) (Yu Wei 2008: 28-9).

Plaintiff Sun, and (iii) the withdrawal of the company's suit against Plaintiff Sun, with all litigation costs to be borne by Defendant Li.²⁴⁸ Both Plaintiff Sun and Defendant Shi signed the shareholders' resolution, but Defendant Li refused. Defendant Li rejected the validity of the shareholders' resolution, but did not bring suit as permitted under the 2006 Company Law seeking to invalidate or declare the resolution *ineffective*. Plaintiff Sun, however, did bring suit before the Shanghai People's Courts asking that the resolution be declared *effective*. The trial court, probably a District-level Shanghai People's Court, rejected Sun's lawsuit that sought a declaration of effectiveness for two reasons. First, it was rejected for what the Court called a "procedural" defect: the 2006 Company Law and the company's Articles of Association mandate that shareholders' meetings should be reduced to meeting minutes. Because the disputed resolution was not reduced to any form in the shareholders' meeting minutes, it was defective. Second, the lower-level Court identified an evidentiary problem: in a situation where one shareholder does not recognize a resolution and the only evidence offered to the Court is the actual resolution signed by just two of three shareholders, it is difficult, the Court said, to determine whether the shareholders' meeting actually passed the resolution.²⁴⁹ Therefore, said the Court, pursuant to Article 11 of the 2006 Company Law (which speaks to the binding effect of company Articles of Association) the plaintiff's suit should be rejected. Plaintiff Sun appealed to an unnamed Intermediate People's Court, likely the Shanghai No. 2 Intermediate People's Court where the judge reporting the case sits. The appeals-level Intermediate People's Court also rejected the plaintiff's suit for a declaration of effectiveness, but on radically different grounds, declaring irrelevant the bases invoked by the District-level People's Court. The Intermediate People's Court focused on Article 22 of the 2006 Company Law, that provision of the new statute which allows shareholders' suits to challenge the validity of shareholders' meeting resolutions because the resolution substantively violates law, regulation or the company Articles of Association, or the convening of the meeting or voting procedures violate law, regulation or the company's Articles of Association. As the Court noted, Article 22 of the new Company Law bestows upon shareholders injured by a defective or illegal resolution the right to sue for a specific remedy to protect their rights. However, the Court continued, if the injured shareholder does not bring suit under the 2006 Company Law to have the allegedly defective resolution declared ineffective, "the People's Courts should not use the coercive power of the state to interfere with matter within the scope of a company's self-governance."²⁵⁰ In the instant case, concluded the Intermediate People's Court, the subject resolution is obviously harmful to the ousted shareholder, Defendant Li, yet he is not the person who has brought suit regarding the resolution. Instead, the suit seeking an affirmative declaration of *effectiveness* (not a negative declaration of *ineffectiveness*) had been brought by Plaintiff Sun, one of the beneficiaries of the contested resolution. Accordingly, the Court stated, Plaintiff Sun's lawsuit "by nature does not

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

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

²⁵⁰ *Sun X. v. Li Y. and Shi Z.* (initial People's Court hearing case and Intermediate People's Court hearing appeal not identified, but latter probably Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division)), 2007 or 2008) (Yu Wei 2008: 28-9), at 28.

conform to the conditions set for the acceptance of civil lawsuits by the People's Courts, and in addition the suit lacks an appropriate [legal] basis (*xiangying de yijü*)".²⁵¹

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

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

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

i. Limitation on equity court-like decision making

In many cases the Shanghai People's Courts limit the ability of litigants to take advantage of equity court-like elaboration or exceptions to statutory rules which remedy illegality or opportunism. In so doing, they stand stubbornly behind the bargain that is a business association

²⁵¹ *Ibid.*

established as a “company” under the Company Law. One 2000 case²⁵² rejected a 20% shareholder’s suit for distribution of dividends from a two-person corporation when the 80% shareholder-dominated shareholders’ meeting had already resolved not to make any distributions. The reasoning was that the statutory standard for voiding a shareholders’ resolution under the 1994 Company Law is high, “breach of law or administrative regulation, or infringement upon the lawful rights of shareholders.” In the absence of any breach of positive law, or direct rights infringement, and with a properly-convened shareholders’ meeting resolving in the interest of the 80% majority shareholder, the plaintiff minority shareholder subject to oppression had no case. In this example, one of many, the Shanghai People’s Courts signaled to the participants in the corporate form that the judiciary will support inflexible aspects of the corporate law compact, and intervene only when a very high standard of breach/infringement is identified.

ii. *Enabling to mandatory*

A second and perhaps related expression of conservatism is the tremendous affection shown by the Shanghai People’s Courts for the rules set forth in the Company Law. Here the Courts effectively take such rules from the *enabling* column and invest them with the character of *mandatory* rules which may not be contravened by private ordering. For example, one 1995 Shanghai case²⁵³ reversed the appointment in a company limited by shares of three new directors to the board pursuant to a clause in the Articles of Association granting the board the power to do just that. Both the People’s Court of first instance and the Intermediate People’s Court on appeal held Articles of Association which purport to vest in the *board* the power to *appoint* directors were “illegal” (*weifa*) and invalid, because they were contrary to the 1994 Company Law provision vesting the power to *elect* directors solely in the *shareholders’ meeting*. The two Courts held to this judgment in the face of quite reasonable pleadings by the defendant company that the offending Articles of Association clause was passed by the shareholders’ general meeting, which the company asserted should be seen as a delegation of the shareholders’ statutory powers to elect directors to the board. A later 2001 case similarly cast very serious doubt on the validity of a stand-alone shareholders’ capitalization agreement which is different from the Articles of Association (also setting forth capitalization requirements), by ruling that the contractual capitalization plan would implicate one of the investors in a violation of the 1994 Company Law’s prohibition on passive investment of more than 50% of “net assets.”²⁵⁴ That single fact poisoned the enforceability of the private-ordering agreement.

²⁵² *Guo Shaoqu v. Shanghai Saiyang Textile Science and Technology Company and Wu Yiming* (Shanghai Hongkou People’s District Court, 1999, upheld by Shanghai No. 2 Intermediate People’s Court, 2000) (Ma Qijia 2006: 260-5) (BFJI, 2000 Hu Er Zhong Jing Zhong Zi No. 280).

²⁵³ *Zhang X. and Other Shareholders of Shanghai A Company Limited v. Shanghai A Company Limited* (Shanghai People’s Court of first instance and Intermediate People’s Court hearing appeal not identified, 1995) (Ma Qijia 2006: 229-31).

²⁵⁴ *Shanghai Minzu Music Instruments No. 2 Factory v. Shanghai Heli Trade Company and Shanghai Heyin Music Instruments Company* (initial Shanghai People’s Court not identified, case not appealed, 2001) (Wang Xiaochuan 2006: 45-9) (shareholders’ agreement is thus void *ab initio*, and even if not void, then without effect as against the company and the world at large (which the Articles of Association are).)

iii. *Strict formalism or non-application*

A third expression of conservatism, embodied in the *Sun X.* case detailed at the start of this section,²⁵⁵ is a strict formalism or case decisions determined by a Court's view that there exists no explicit "legal basis" for implied rights in *corporate* law. There are numerous examples of this kind of conservative adjudication. A 1998 opinion ruled that an agreement transferring beneficial ownership of 20% of a company's stock (and the expectation of annual dividends) is enforceable under *contract* law, notwithstanding the failure of the parties to make the transfer known or see to public registration of the share ownership change under *corporate* law.²⁵⁶ The defendant's argument that the shares (and dividend rights) were never really transferred in *corporate* law was deemed irrelevant in the face of a separate and entirely enforceable *contractual* promise by one party to pay over dividends to another. Here the Shanghai People's Court side-stepped a possibly messy corporate law/equity rights transfer question by focusing solely on the formalistic action (or inaction) of the parties and a purported contractual obligation. In a case from 1999-2000, the Shanghai No. 2 Intermediate People's Court overturned the expansive view of the Jingan District People's Court (and the latter's invocation of Article 4 of the General Principles of the Civil Law)²⁵⁷ in a corporate shareholders' suit, and pulled the parties back to a strictly formalistic approach to the corporate law and property rights.²⁵⁸ In that case, the court of first instance acted liberally in recognizing the plaintiff investor's direct equity interest in a project company even though the plaintiff was a so-called "hidden" (*yinming*) shareholder, *i.e.*, merely in contract with a name shareholder of the company and maintaining no legal privity whatsoever with the corporate vehicle. Aside from the broad invocation of Article 4 of the General Principles of the Civil Law, the lower court said the other declared shareholders in the company were estopped from denying the hidden shareholder's interest because they had knowledge of the plaintiff's investment participation in the company. The Shanghai No. 2 Intermediate People's Court, seeking to correct the errant lower Court, took a much more formalistic approach to the problem, dismissing the application of vague Article 4 of the General Principles of Civil Law and declaring with enviable certainty that the agreement between the hidden and name shareholders was effective only between those two parties, and had no legal meaning against third parties or the world at large, including other name shareholders or the company itself.²⁵⁹

²⁵⁵ *Sun X. v. Li Y. and Shi Z.* (initial People's Court hearing case and Intermediate People's Court hearing appeal not identified, but latter probably Shanghai No. 2 Intermediate People's Court (No. 3 Civil Division)), 2007 or 2008) (Yu Wei 2008: 28-9) described *supra* notes __ and accompanying text.

²⁵⁶ *Shanghai Xinlu Battery Company v. Shanghai Dongda Import Export Company* (initial Shanghai People's Court not identified, 2001) (Wang Xiaochuan 2006: 231-3) (defendant obligor's claim that stock transfer agreement to plaintiff transferee is not effective deemed irrelevant to enforceability of defendant to pay over 20% of dividends to same plaintiff transferee shareholder).

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

²⁵⁸ *Shanghai Jingan Food and Beverage Service Company Jingan District Service Company Successor Entity, et al. v. Shanghai Foreign Economic Service Company* (Shanghai Jingan District People's Court 1999, reversed on appeal by Shanghai No. 2 Intermediate People's Court 2000) (Ma Qijia 2006: 86-93).

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

In a 2001 opinion upheld by the Shanghai Higher People's Court, a District-level People's Court refused to award an ESOP-like participating former employee any *stock* interest in a newly-established corporate entity promoted partially on the basis of the ESOP's contributed shareholding interest in a predecessor company. Both Courts justified the refusal with the rationale that participants in the dissolved ESOP were not identified in the share register of the new company.²⁶⁰ In 2004, the Shanghai Higher People's Court struggled *not* to award the hidden investor in a Chinese-foreign joint venture an equity interest in a successor limited liability company, because the interest was booked to a different name and notwithstanding years of dividend distributions to the real investor and a written promise by the company acknowledging that the equity investment was put in the name of another only "temporarily" at the time of conversion of the legal entity into a limited liability company.²⁶¹ The Higher Court's opinion in the case was based on its view that recognition of the real investor's US\$ 2.17 million investment in the company was a matter to be sorted out between the name investors and the true parties in interest, which had a "direct legal relationship," not by the company which had no legal privity with the capital provider. This position is a stretch, as the company had issued a document acknowledging the real investor's contribution of US\$2.17 million to the company's capital account, and promising to transfer the resulting interest into the name of the rightful investor.²⁶² This example once again shows a Court in the Shanghai system striving not to use China's corporate law in a flexible way, but instead in an entirely undiscerning and mechanical manner to avoid the exercise, or appearance of the exercise, of significant judicial power. A similar 2006 case shows the Courts rejecting a dissident shareholders group request to order amended firm registration to *status quo ante*, even though the defendant's re-registration was proven in separate proceedings to have been fraudulent.²⁶³ In that same case, the Courts awkwardly invalidated the dissident (but majority) shareholders' meeting based upon a very minor defect in the notice given to the *same* dissident shareholders.²⁶⁴ It seems nonsensical for the Courts to invalidate a meeting organized by a group of shareholders because of a defect in notice *to those shareholders*, who never even pleaded the defect. Clearly the Courts in this case were reaching for whatever safe harbor they could find to avoid involvement in a shareholder

²⁶⁰ See *X. Jiyin Chip Company et al. v. Y. Group Co., Ltd.* (Shanghai Luwan District People's Court, 2001) (Shanghai Higher People's Court 2007: 71-7). This result no doubt is one of the reasons for new Article 33 of the 2006 Company Law, which stipulates that only those natural or legal persons identified in the share register of a limited liability company can "exercise the [full] rights of a shareholder".

²⁶¹ See *Honghui International Company v. Shanghai Minfeng Investment Co., Ltd. Et al.* (Shanghai Higher People's Court, 2004) (Shanghai Higher People's Court 2005: 270-7) (equity interest by real investor in limited liability company not recognized over interest of name investor, because real investor must seek remedy not from issuing company but name investor).

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

²⁶³ *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 1-185).

²⁶⁴ *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 186-7).

squabble and adjudication of somewhat abstract misfeasance (oppressive and opportunistic behavior by the defendant shareholder).

Even in areas in which it is clear that litigation will arise, and even in the face of lower-level People's Courts consciously trying to act more autonomously, the Shanghai People's Courts often take the same conservative approach to issues where there is no clear legal or policy basis. A good example of this approach is the reaction of the Shanghai judiciary in 2006-7 to the problem of contributed services (as capital). Although Article 27 of the 2006 Company Law is silent on the permissibility of human capital contributions, the 2005 "Regulations of the PRC on Administration of Company Registration"²⁶⁵ specifically forbid the contribution of labor services (*laowu*).²⁶⁶ The Shanghai Higher People's Court reported in 2007 that the Pudong New District People's Court system had on its own already accepted a large number of cases concerning human capital or services contribution. The Higher People's Court duly noted that with no legal or regulatory basis for the definition of "human capital," and no local People's Government or "department-in-charge" policy guidance, the People's Courts had found it very difficult to define the concept in practice. This state of affairs was problematic for the Shanghai judiciary, said the Higher Court, because many company establishments in Shanghai are capitalized, whether in shareholders' agreement or the Articles of Association of the company, by the contribution of personal knowledge, technical skills and ability, and the like. Accordingly, in 2005 the Shanghai *Municipal* People's Government had been forced to issue the *District*-specific "Pudong New District Provisional Measures on Human Capital Contributions" setting forth two legally cognizable mechanisms for the valuation of such contributions.²⁶⁷ As noted further in the report, upon promotion and establishment of companies accepting personal services contributions as equity, lawsuits invariably arose, most often in the context of individuals trying to leave a company or transfer the equity interest gained in exchange for their personal intangible investment. At the same time, said the Court, very difficult questions concerning (potential) harm to third party creditors and undercapitalization of the firm partially capitalized with services were at issue. Recognizing all that, and understanding the requirement that human capital contributions to corporate business organizations be permitted, and notwithstanding its praise for the solution implicit in the rogue District-level norms, the Higher Court in 2007 nonetheless counseled the Shanghai People's Courts to take a very cautious approach to the question²⁶⁸ and warned against "blind support and pursuit of a policy with very obvious defects."²⁶⁹

²⁶⁵ Promulgated by the State Council on June 24, 1994, and amended by the State Council on December 18, 2005.

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

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

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

²⁶⁹ Shanghai Company Law Report, *supra* note __, at 46.

The Shanghai judiciary appears to defer when faced with the lack of an explicit legal basis in at least two other areas. The Shanghai Higher People's Court report on the 2006 application of the new Company Law states categorically that the Shanghai Courts are "temporarily" *not* to accept the invitation in Article 184 of the 2006 Company Law allowing them to direct the establishment of liquidation committees because "[the Shanghai People's Courts] lack liquidation rules, and the Courts affirmation of effective liquidation lacks a legal basis (*fali yiju*)."²⁷⁰ In the same vein, one senior judge at the Shanghai No. 2 Intermediate People's Court in 2008 called for an explicit legal basis to help in the handling of related party creditors in bankruptcy proceedings, or something similar to the doctrine of equitable subordination or the "Deep Rock Doctrine." That judge asserted that the PRC is a "civil law country" (*chengwenfa guojia*) and therefore any doctrine of equitable subordination, like any definition of related party creditors, can be introduced into judicial practice only via additional statute, or judicial Regulations. In doing so he rejected out of hand any idea that the Shanghai People's Courts might themselves develop such a doctrine for application in bankruptcy cases.²⁷¹ Yet another Shanghai judicial official, this time a Shanghai Higher People's Court judge, asked for the same kind of direction in 2008 with respect to an implantation of a *de facto* merger doctrine, again discounting any possible elaboration of this concept by the judiciary or outside of Supreme People's Court Regulations or legislative pronouncement.²⁷² One interesting aspect of this push-back justified on the lack of any "legal basis" is that explicit examples appear more often *post-2006* and thus after a legal basis had been provided in statute for an enforceable aspect of corporate law.²⁷³

The autonomy breakdown I note here is in many situations indicated by the explicit request for superior bureaucratic guidance in respect of difficult (and not so difficult) cases. For instance, in the report on Company Law implementation in 2006, the Shanghai Higher People's Court indicates with some apparent relief that in 2006 it never²⁷⁴ actually "pierced the corporate

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

²⁷¹ Fu Yang, *Pochanfa Miandui Guanlian Zhaiquan de Kunjing Yu Shenshi Yuanze de Yinrun* [Problems Facing Related Party Creditors Under the Bankruptcy Law and Use of the Deep Rock Doctrine] in GONGSI JIUFEN YU GONGSIFA JIUI 184-191 (Shanghai Higher People's Court No. 2 Civil Division & East China University of Politics and Law eds., 2008).

²⁷² Remarks of Judge Yang Yisheng of the Shanghai Higher People's Court, Dec. 5, 2008 (notes on file with author).

²⁷³ Prior to 2006, one of the only explicit examples of such rejection is the 2001 opinion which fails to award a former employee of a collective any *stock* interest in a newly-established corporate entity promoted partially on the basis of the ESOP's contributed shareholding interest in a predecessor company because the ESOP has no basis in PRC law. See *X. Jiyin Chip Company et al. v. Y. Group Co., Ltd.* (Shanghai Luwan District People's Court, 2001) (Shanghai Higher People's Court 2007: 71-7).

²⁷⁴ But see, after 2006, *Shanghai Huaxin Electric Wire and Cable Company v. China Tietong Group Company* (Shanghai No. 2 Intermediate People's Court (No. 4 Civil Division), 2007, upheld by the Shanghai Higher People's Court, 2007) (HSHFY, 2007 Hu Gao Min Er (Shang) Zhong Zi No. 145) (RMB 32 million yuan creditor pierces to the Beijing-based SOE parent of a Shanghai limited liability company debtor where the parent has undercapitalized the debtor by RMB 38 million yuan, as confirmed by separate Suzhou Municipality and Beijing Municipality People's Courts judgments, specifically upholding the assertion of parent liability "by litigation" and invoking "misuse of the corporate form" under Article 20 of the 2006 Company Law). The idea that the Shanghai People's Courts are not handling piercing cases post-2006 and into the end of 2008 was *vigorously* disputed in December 2008 by the President of the Shanghai Changning District People's Court Zou Bihua and a judge from the Shanghai

veil,” because all such cases were settled,²⁷⁵ withdrawn, or dismissed. The Shanghai judiciary evidences some happiness at this result and openly wonders how, if piercing had happened, its subordinate Courts might have performed in specific aspects such as assessing liability for all shareholders (*i.e.*, not just the controlling shareholder) of the discarded corporate form, the extent to which the Courts can keep on piercing (up through successive layers of limited liability), and how to define “misuse” of the corporate form.²⁷⁶ These aspects, and above all the factors determinative in disregarding the corporate form, remain mysterious to the Shanghai Courts, and the Shanghai Higher People’s Court requested that the Supreme People’s Court or the legislature provide guidance.²⁷⁷ The Shanghai Higher People’s Court explicitly sought the same kind of guidance on how to handle *creditors’* suits for liquidation²⁷⁸ and situations in which the shareholders of a company in liquidation do not want to implement liquidation for the benefit of creditors, who want liquidation.²⁷⁹ As noted above, in 2008 the Supreme People’s Court issued the 2nd Regulations on application of the 2006 Company Law in just this area. Still, the Chief Judge of the Shanghai Higher People’s Court No. 2 Civil Division declared in December 2008 that the Shanghai Courts still feel at a complete loss in shareholder-instigated dissolution-liquidation proceedings and are still hesitant about accepting them.²⁸⁰ In much the same way, the Shanghai Higher People’s Court noted difficulties in actual application of the 2006 Company Law’s new resolution-invalidation mechanism. Although the statute provides precise shareholder level and period requirements for derivative lawsuits, no similar statutory requirements apply to lawsuits seeking to invalidate shareholders’ and directors’ resolutions. While the Court acknowledged that it now must accept the latter kind of cases, even for publicly-listed companies, it also calls on its bureaucratic superior to set qualifications on the action, lest listed companies become subject to vexatious litigation or opportunistic strike suits by minority shareholders.²⁸¹

On occasion, the Courts ask not for instructions from their bureaucratic superior, but from the legislature. For instance, both the 1994 and 2006 Company Laws place an upper limit of 50 shareholders for the limited liability company form. This limitation fans the widespread problem of hidden shareholders in China, individuals with an economic interest in a company who must keep concealed their formal shareholders’ interest so as not to exceed the maximum

No. 2 Intermediate People’s Court, who stated that the veil-piercing case load has only increased with formal authorization in the 2006 Company Law (notes on file with author).

²⁷⁵ Seen for example before 2006 in *Xishan City Chemical Products Manufacturing Company v. Shanghai Aoshi Enterprise Company*, *Wan Yunhui*, *Tang Weijun*, *Shi Hong*, *Ni Shang* and *Shanghai Municipality Qingpu District Audit Bureau* (Shanghai District People’s Court initially hearing case and Intermediate People’s Court upholding not identified, 2000) (Wang Xiaochuan 2006: 293-9).

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

²⁷⁷ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 48.

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

²⁷⁹ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 49.

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

²⁸¹ Shanghai Higher People’s Court No. 2 Civil Division 2007, *supra* note __, at 48.

legal number of shareholders.²⁸² In its report on Company Law application in 2006, the Shanghai Higher People's Court urged PRC legislative institutions to create a legal basis for "trust" relationships, in which a single "trust" can be the name shareholder on behalf of a larger body of individuals with economic interests in the investee company. Although the solution is a creative one, and it is a positive development to see a PRC judicial institution openly asking for more, and better, substantive law from the legislature, the appeal symbolizes how the People's Courts have so far deferred from *on their own* creating such "trusts" for share ownership.²⁸³

iv. Avoiding application of fiduciary duties doctrine

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

The aversion to implementation of corporate fiduciary duties, admittedly a complex and difficult task, is a bit of a puzzle. The PRC People's Courts clearly applied corporate fiduciary duties doctrines even before authorization in the 2006 Company Law,²⁸⁴ there is some evidence showing use of the doctrines in Shanghai,²⁸⁵ and the Shanghai Courts seem content to advertize their ability to handle such cases.²⁸⁶ Notwithstanding these proclaimed powers, the 2003 Shanghai Company Law Opinion does not mention any such case in its review of a decade's worth of corporate law adjudication in the period between 1993-2003. The later 2007 report by the Higher People's Court on 2006 adjudication admits that the People's Courts under its jurisdiction took relatively few cases involving "corporate management rights and obligations" – breach of corporate fiduciary duties – in calendar year 2006.²⁸⁷ And although as noted above

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

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

²⁸⁴ See Doctrine That Dared Not, *supra* note __.

²⁸⁵ See *supra* notes __ and accompanying text. Note however that there are also pre-2006 examples of the Shanghai Courts strenuously avoiding corporate fiduciary duties: see *China Textile Machinery Company Limited and 7 Other Shareholders v. Shanghai Machinery Import Export (Group) Company* (District People's Court initially hearing case and Intermediate People's Court dismissing appeal not identified, 2001) (Wang Xiaochuan 2006: 239-43) (at entity established before 1994 Company Law on the basis of a "joint investment agreement", eventually with separate Articles of Association and "enterprise legal person" registration, one investor in not funding its full capital contribution and in transferring assets out of the arrangement without board or shareholder approval has breached its *contractual obligations* to the other investors, and *infringed upon the rights* of the other participants); likely decided in this corporate fiduciary duties-avoiding way because the subject entity is not, at inception, a formal corporation, but a legal enterprise person initially formed by contract and only registered later).

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

²⁸⁷ Because of the relative degree of difficulty of hearing such cases. See Shanghai Company Law Report, *supra* note __, at 38.

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

²⁸⁸ *Precious Metal Company A. v. China Industrial and Commercial Bank W. City X. Branch, Y. Gold Exchange Market, and Z. Science and Trade Company* (Shanghai Luwan District People's Court, Intermediate People's Court dismissing appeal not identified, 2006) (Shanghai Higher People's Court 2008a: 94-9) (District-level People's Court investigates allegation of failure by entrustee/agent to conform to its "duty of cautious [investigation]" (*jinshen zhuyi yiwu*) (plaintiff's claim) or "duty of care of a good manager" (*shan liang guanliren de zhuyi yiwu*) under Article 406(1) of the PRC Contract Law (Shanghai Higher People's Court commentary), and finds no breach). How much happier the PRC People's Courts would be in trying to apply a fiduciary duty of care if the National People's Congress had passed the version first submitted to it which, at Article 20, contained an expanded version of duty of care and a standard of application (taken from Taiwan's Company Law and Taiwan's Commercial Code, and already a part of CSRC-promulgated mandatory articles of association). See LAO Company Law Explanation, *supra* note __, at 530.

²⁸⁹ The reports are equally spare for other jurisdictions, *see for example Li Xiaozhong v. Jin Rongzhong, Xiao Wuyong, Zhang Dingzhong, Cheng Kang and Wang Tinggui* (Nanchuan Municipal People's Courts, 2006) (Huai Xiaofeng 2007: 312-7) (Nanchuan Municipality: directors, supervisory board members and senior management duty of loyalty) and *Wuxi Weiyuan Company v. Xu Naihong and Wuxi Delin Jingmi Moju Company* (Jiangsu Province Wuxi Municipal Binhu District People's Court, 2006) (Huai Xiaofeng 2007: 322-28) (Wuxi Municipality: senior management breach of duty of loyalty).

²⁹⁰ *See for example Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd.* (Shanghai No.1 Intermediate People's Court, 2005) (Shanghai Higher People's Court 2008b: 138-44) and *Yang Lizhi et al. v. Cao Zhengjie et al.* (Xuhui District People's Court, 2006) (Shanghai Higher People's Court 2008b: 205-10) (Huai Xiaofeng 2007: 356-9), both briefed in the Case Reports Appendix.

²⁹¹ Usually as listed on the CSRC website, or occasionally reported in the Chinese press when a director or officer allegedly in breach (and subject to a CSRC fine) contests the administrative penalty. *See Wang Dianxue, Shanghai Gongsi Dongshi Beifa Zhuanggao Zhengjianhui [Director of a Listed Company Sues the CSRC]*, XINJINGBAO [NEW CAPITAL NEWS], June 4, 2008, at A24 [hereinafter Listed Company Director Sues], detailing a common situation: Shenzhen Shenxin Taifeng Co., Ltd. was de-listed on March 25, 2008, when the board of directors issued a notice stating that the board chairman had been arrested for overstating the capital of an important subsidiary. In August of 2007 the CSRC had announced that in its 2003 periodic reporting the company had: falsely inflated its inventory by RMB 20 million and its receivables by RMB 65 million yuan, failed to report the misappropriation of RMB 26 million yuan of company funds, and failed to disclose in a timely manner five external guarantees (no doubt for related party beneficiaries) or 72 pending litigations relating to the company. The CSRC fined the chairman of the board, all of the directors, and the president of the company. Included among the punished directors was a Mr. Ding, who was fined RMB 30,000 yuan by the CSRC. Mr. Ding brought suit against the CSRC in the Beijing No. 1 Intermediate People's Court asking that the fine be overturned. Mr. Ding's lawyer pleaded for Ding's exculpation because Ding was "only a director appointed by a shareholder, and did not really participate in operation and management of the company" and so did not directly administer or operate the company, or directly manage or operate the company, "the only two kinds of people who can be fined under the PRC Securities Law". The CSRC answered sternly in its counter-argument, stating that Ding had failed to demonstrate he had met his corporate/securities law "duty of care" (*qinmian yiwu*) in reviewing and approving the disclosure documents, or by failing to raise his disagreement with the false information once disclosed and put into the market. As noted *infra* notes __ and accompanying text, this report also provides insight into how Chinese citizens (not just lazy directors and their lawyers) understand the (non-) application of the Company Law to publicly-listed companies, and may account for the relative paucity of public company cases in the Shanghai People's Courts. For an entirely similar argument on the responsibilities of a public company non-executive director, see the "Flower Vase" (Lu Jiahao) director case described at Doctrine That Dared Not, *supra* note __, at 226-8.

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

More compelling perhaps than lack of fiduciary duties cases is the affirmative evidence that Shanghai People's Courts' strive to avoid corporate fiduciary duties doctrine, or refuse to take judicial notice of clear corporate law aspects which are not specifically pleaded. The following six cases are exemplary. First, a 2003 case involved the transfer of RMB 6.1 million yuan out of a Chinese-foreign equity joint venture-owned RMB yuan account *by and to* the Chinese partner, without the joint venture legal person's or the other investors' approval. The District People's Court and then the Shanghai No. 2 Intermediate People's Court deemed the transaction "not inappropriate" and thus permissible because accounting regulations applicable to such foreign invested enterprises seem to confer power of disposition of such domestic funds on the Chinese partner.²⁹³ A less deferential judicial agency might have more sympathetic to the plaintiff's request for return of the funds, with interest, and then a reallocation of the same in accordance with the original partners' respective equity interests in the corporate joint venture. In certain contexts this kind of deference by judicial actors might be admirable. But in this context it eliminates the ability of those same judicial actors to intervene when participants in corporate legal persons opportunistically or oppressively use the corporate form to breach basic underlying corporate law obligations.²⁹⁴

²⁹² See *Lu Jianming v. Shanghai Light Industry Machinery Company, Limited*, (Shanghai Jingan District People's Court, Shanghai No. 2 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 189-194) (board resolution nominating director of listed company director not invalidated by board's failure to disclose – in the resolution -- that nominee formerly worked for listed company's controlling shareholder and is defendant company's Legal Representative's wife), a case which normally would have been subject to CSRC enforcement. The fact that the case made it into the People's Courts is rare.

²⁹³ See *A. Co., Ltd. v. Shanghai B. (Group) Company* (Shanghai No. 2 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2007: 83-6) (transfer of RMB yuan funds out of corporate account by and to Chinese investor permitted because of special nature of account use and accounting regulation giving Chinese partner disposition rights over the same; the accounts were established to fund social welfare obligations payable in RMB yuan to Chinese employees of the joint venture and were not included in the joint venture financial accounts). Yet see the *contra* result in *Shanghai X. Electronics Company v. Mr. A, et al.* (Shanghai No. 2 Intermediate People's Court, 2003) (Shanghai Higher People's Court 2007: 114-117) (Japanese director of Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC invested limited liability company because of Japanese partner's sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director's personal account without joint venture board approval or joint venture investor (shareholder) approval). The difference in the two cases lies perhaps in the nationality of the fiduciary absconding with funds from the corporate entity, but also because the funds in the latter case are indisputably those of the corporate entity, with no investor in the entity having any color of a disposition right, and because the funds are accounted for as cash assets on the books of the same legal person entity. These cases are also interesting because they show that the Shanghai People's Courts will accept cases regarding Chinese-foreign joint ventures and apply the PRC Company Law to them, except where there are specific laws or regulations governing such joint ventures differently. Some national People's Courts, and many business people and lawyers disagree with strict application of China's corporate law to such foreign invested enterprises.

²⁹⁴ See for example the much earlier case, *Chen Zhijin v. Shanghai Kaikai Enterprise Company, Limited* (Shanghai Jingan District People's Court, 1998, partially upheld by Shanghai No. 2 Intermediate People's Court, 1998) (BJFI, 1998 Hu Er Zhong Jing Zhong Zi No. 729) where the People's Court supports a mandatory buy-back of so-called "internal" (employee) shares, and at a very low price of RMB 1.00 per share against net per share asset

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

Third, a subsequent 2006 case in which shareholders had their application for judicial dissolution denied by the first level People's Court also refused to consider, in the same action, evidence of breach of corporate fiduciary duties by defendant directors (including transfer of corporate funds into personal accounts, diversion of assets sales proceeds into personal accounts, and some evidence of accounts manipulation). Instead, the Court held very closely to the Article 183 inquiry as pleaded.²⁹⁶

Fourth, in the complex dissident shareholder case invoked above²⁹⁷ the Shanghai People's Courts avoided discussing clear fraud (already identified and punished by other public institutions) and breach of corporate fiduciary duties by a controlling shareholder/Legal Representative, and ruled out of order and ineffective shareholder self-help (resolutions produced at a special shareholders' meeting) aimed at defeating the rogue partner. The decision was based on the most technical grounds pertaining to compliance with detailed procedures in the company's Articles of Association.

In a fifth case decided in 2006, Shanghai People's Courts refused to identify how the failure to disclose a public company nominee director's employment and personal relationships was a breach of the fiduciary duty²⁹⁸ to inform shareholders prior to the exercise of their voting rights.²⁹⁹

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

value at the time of buy-back of RMB 2.80 yuan, because the plaintiff has only challenged the buy-back and not "raised" the price issue.

²⁹⁵ See *Shanghai Yingdafang Service Company v. Shanghai Yingdafang Zhangjiang Service Company, et al., Shanghai* (Pudong New District People's Court and Shanghai No.1 Intermediate People's Court, 2005) (Shanghai Higher People's Court 2008b: 190-195), reported in detail in the Case Reports Appendix.

²⁹⁶ *Yang Lizhi et al. v. Cao Zhengjie et al.* (Xuhui District People's Court, 2006) (Shanghai Higher People's Court 2008b: 205-10) (Huai Xiaofeng 2007: 356-9).

²⁹⁷ *Yu Xiaoqi and 18 Shareholders v. Shanghai Changxin Accountancy Limited and Guo Hongtao* (Shanghai Changning District People's Court and Shanghai No. 1 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 178-87).

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

²⁹⁹ *Lu Jianming v. Shanghai Light Industry Machinery Company, Limited*, (Shanghai Jingan District People's Court, Shanghai No. 2 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 189-194) (board resolution nominating director of listed company director not invalidated by board's failure to disclose – in the resolution or the accompanying notice -- that nominee formerly worked for listed company's controlling shareholder and is the wife of the defendant company's Legal Representative). Here the Courts rule very narrowly on the specific question of whether the board resolution is "in violation of law or regulation" (no), or whether the content of the resolution violates the company's Articles of Association as in effect at the time of the meeting (again, no).

the first-level People's Court and the appeals-level Court (in the first hearing and opinion) identified the forced put as an opportunistic use of the shareholders' general meeting highly indicative of breach of fiduciary duties and fair dealing in the close corporation context.³⁰⁰

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

In its 2007 report on the first year of application of the 2006 Company Law, the Shanghai People's Court describes a basic adjudication principle which casts some light on why there is a paucity of corporate fiduciary duties cases (outside of those implicated in the almost blanket refusal to accept public company limited by shares cases discussed *infra*) and evidence of studied avoidance of such claims. That basic principle is the priority given to commercial law (*shangfa*) over civil law (*minfa*) in corporate law cases. The principle is a profound one in the workings of the Chinese legal system and Civil Law-family jurisdictions.³⁰¹ In the Chinese case it holds that the People's Courts should apply appointed commercial law (*e.g.*, the Company Law, the Securities Law, or the Contract Law) first, and only then having recourse to more generalized "civil" law if the "commercial" law does not address the problem. This principle is part of a conservative vision which seeks to dampen the People's Courts' enthusiasm for application of broad civil liabilities and remedies (such as the catch-all breach of (civil law-system) "good faith" (*chengshi xinyong*) or "infringement of rights" (*qinquan*) under the General Principles of the Civil Law) in favor of close adherence to what the Chinese legislature has offered in statute as legal causes of action and remedies.³⁰² As an illustrative example, in a pre-2006 breach of

³⁰⁰ *Shanghai Shenmao Dianci Factory v. Wang Longbao, Shanghai Shengmao Xiancai Company, Shanghai Guanlong Electrical Machinery Assembly Company and Taicang Municipal Guanlong Dianci Company* (Shanghai Nanhui District People's Court, 2004, upheld Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division), 2004, overturned Shanghai No. 1 Intermediate People's Court (No. 3 Civil Division) 2006, on re-hearing) (Shanghai Higher People's Court 2005: 324-7) (HSHFY, 2006 Hu Yi Zhong Min San (Shang) Zai Zhong Zi No.1) (forced buy-out of stock in "non-profit" stock cooperative upon Vice Chairman's leaving employ pursuant to board regulations, shareholders' resolution and Articles of Association not a violation of shareholders' rights, where the Court cites *not* the PRC Company Law but instead a set of 1997 guidelines issued by the now-extinct Ministry level Commission on the Restructuring of the Economic System ("CRES") and Shanghai "Provisional Measures" on stock cooperatives and collectives).

³⁰¹ Which is not to say that the PRC's legal system should be construed as part of the civil law family of legal systems.

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

fiduciary duty of loyalty context this guiding principle would counsel that judges identify a specific breach of bright-line loyalty provisions over invocation of a breach of abstract corporate fiduciary duties (cast as lack of “good faith” or “rights infringement” under the General Principles of the Civil Law). The orientation perhaps illuminates the relative lack of fiduciary duties cases pre-2006. For the post-2006 period, the similar lack of application indicates persistent adherence to the same underlying principle, regardless of new statutory authorization in the supposedly prioritized “commercial” law, and explains why some Shanghai judges are openly calling for a collapse of the unwieldy separation.³⁰³

Whatever the complex of reasons for this non-utilization of a key corporate law doctrine, it was obvious before 2006 that the implementation of such doctrines would be aided greatly by a broadly drawn and flexibly applied notion of corporate fiduciary duties in the Company Law itself. Without doubt, this is one of the reasons the drafters of the new Company Law and the academics who advised them pushed so hard for new Article 148 and a newly-actionable Article 149 in the 2006 statute.³⁰⁴ The hunger on the part of the judiciary for the ability to apply such broader corporate law principles is embodied in a 2003 opinion. In that case, the Shanghai No. 2 People’s Court had to struggle with the overly bright-line articles of the 1994 Company Law prohibiting fiduciaries’ looting to support the plaintiff’s claim that it is wrong for a director to take RMB 324,000 yuan (and interest) out of the company and pay it into his personal account without shareholder or board approval.³⁰⁵ Without a broad fiduciary duty principle to apply, and the very narrow focus of the bright line prohibitions of Article 50 of the 1994 Company Law, the first-level People’s Court had no choice but to rely on the company’s Articles of Association and their requirement that certain “major matters” be approved by all shareholders. This approach elevated the diversion of a relatively small *quantum* of funds to the director (who pleaded the transaction as merely the disbursement of his salary) into a qualitatively significant breach of the Articles of Association. The Court, seemingly with a sigh of relief, was able to equate this transgression of the Articles of Association to a full-fledged “breach of the director’s duty of loyalty and obligation to protect the company’s interest.”³⁰⁶ It is easy to perceive the same ambition – and relief at the inclusion of new Articles 148 and 149 in the 2006 Company Law -- in the Shanghai Higher People’s Court post-January 1, 2006 commentary on the same case, celebrating how the new Company Law (and broader principles of corporate fiduciary duties) ensures that such diversions of funds by fiduciaries, whether as “salary” or something else, are a new kind of “internal” or “private” corporate governance matter which can be attacked *ex post* through “public authority” judicial proceedings.³⁰⁷

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

³⁰⁴ See Doctrine That Dared Not, *supra* note ____.

³⁰⁵ *Shanghai X. Electronics Company v. Mr. A, et al.* (Shanghai No. 2 Intermediate People’s Court, 2003) (Shanghai Higher People’s Court 2007: 114-117) (Japanese director of Chinese-foreign equity joint venture which at time of suit is converted into a wholly PRC invested limited liability company because of Japanese partner’s sale of equity is liable for return of RMB 324,000 yuan (and interest) taken from the joint venture and transferred to another Japanese party-controlled company and then the director’s personal account without joint venture board approval or joint venture investor (shareholder) approval).

³⁰⁶ *Id.*, at 116, which judgment is upheld on appeal by the Shanghai No. 2 Intermediate People’s Court.

³⁰⁷ *Id.*, at 117. In the alternative, the Chinese judiciary (and People’s Procurate) might have taken up a harder instrument in attacking such transactions, by criminalizing breaches of fiduciary duty. See for example *PRC v. Yang Demao and Chen Yihua* (Shanghai Luwan District People’s Court, upheld by Shanghai No. 1 Intermediate People’s

c. Absence of Public Company Cases

In all of my reviews of Shanghai Higher People's Court reports, discussions of corporate law adjudication with Shanghai or Supreme People's Court judicial officials, PRC academics and lawyers, or readings of published case collections and case opinions posted online by the Shanghai Higher People's Court, I found very little evidence of (i) companies limited by shares, or (ii) such companies which have any part of their capital listed on stock exchanges, PRC or foreign.³⁰⁸ Indeed, in the many civil case judgments I reviewed for this study, only a few touched on disputes or shareholder actions arising in companies limited by shares.³⁰⁹ The absence of such entities does not mean that companies limited by shares and their shareholders are not getting into trouble, or are being operated without discord and in perfect conformity with the highest standards of value generation, transparency, and good corporate governance. In fact, malfeasance and worse can be divined by the literally daily reports of corporate governance failure, oppression, misappropriation, and sins too manifold to mention in China's sophisticated and independent financial press. Instead, these cases are absent from the Shanghai People's Courts, which is after all the *situs* of the Shanghai Stock Exchange or China's "Big Board", for two primary clusters of reasons. First, the People's Courts simply do not accept such cases, either voluntarily, or because of bureaucratic instruction. A good deal of this refusal posture is based in Party, state and Court fears about large plaintiff group actions and their potential impact on the third rail of Chinese governance culture, "social instability". Second, shareholders and other affected parties do not bring such cases to the formal judicial system, but instead to the CSRC securities regulatory authority, or even the Exchanges. This is partly rooted in the way

Court, 2003) (Wang Xiaochuan 2006: 460-5) (preferential transfers by controlling shareholders out of a company entering liquidation either to loot company in breach of duties, or remove assets from creditors' claims, is judged the basis for guilt in the crime of "harmfully impeding liquidation"). See also the prosecution of Guan Guoliang for continuing use of the criminal law to punish breaches of corporate fiduciary duties. Luo Changping, Yu Ning & Luo Jieqi, *Yi Shen Guan Guoliang [First Hearing for Guan Guoliang]*, CAIJING, Dec. 8, at 140-2 [hereinafter Guo Guanliang Criminal Prosecution].

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

³⁰⁹ Two cases in the very thin pre-2006 and post-2006 sample are: *Zhang X. and Other Shareholders of Shanghai A Company Limited v. Shanghai A Company Limited* (People's Court of first instance and Intermediate People's Court hearing appeal not identified, 1995) (Ma Qijia 2006: 229-31) (delegation by shareholders' meeting of statutory power to elect directors to board contained in Articles of Association is ruled invalid, as are related director "appointments" made by the board of directors) and *Lu Jianming v. Shanghai Light Industry Machinery Company, Limited*, (Shanghai Jingan District People's Court, Shanghai No. 2 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 189-194) (board resolution nominating director of listed company director not invalidated by board's failure to disclose – in the resolution and meeting notifications materials -- that nominee formerly worked for listed company's controlling shareholder and is the wife of defendant company's Legal Representative).

Chinese public shareholders think about the property and legal rights represented by their stock interests in public companies, as well as the existence of a substitute regulatory regime perceived to reside in the CSRC as the PRC's anointed securities regulatory authority.

i. People's Court refusals – voluntary and instructed

The awkward interactions between the Shanghai People's Courts and public companies have a long history, and date from the early corporatization effort, the creation of tradable quasi-stock instruments, the later establishment of Exchanges and over-the-counter ("OTC") markets,³¹⁰ and what appears to be the proximate trigger, the promulgation of the form of China's first Securities Law. The Shanghai Courts' rejectionist stance was embodied in the very first public shareholders' suit brought against a capital markets issuer (and its board, officers and accountants) for false and misleading disclosure and the posture famously taken by the Pudong New District People's Court in response:³¹¹ *Jiang Shuzhen v. Hongguang Industry Co., Ltd. Directors et al.* In May 1997, a Sichuan Provincial government-promoted SOE previously transformed into a company limited by shares and named "Hongguang Industry Co., Ltd." (here, "Hongguang") went public on the Shanghai Stock Exchange and raised RMB 400 million yuan with an "A" share IPO.³¹² Six months after the IPO, a CSRC investigation confirmed that the Hongguang IPO was based on wholesale fraud and misrepresentation.³¹³ In June of 1997, long before completion of the CSRC investigation and public announcement of CSRC sanctions against Hongguang, investor Jiang Shuzhen purchased 1,800 shares of Hongguang on the Shanghai Stock Exchange for almost RMB 16,000 yuan. When the CSRC announced the investigation and penalties for Hongguang in late 1997 and details of the fraud and misrepresentation in the Hongguang offering were revealed in the financial press, the firm's share price dropped sharply. Shareholder Jiang sold just after the CSRC announcement, suffering a loss of RMB 3,136.30 on the Hongguang shares held between June and December 1997. On December 14, 1998, or within the one-year statute of limitations period for general infringement of rights under Articles 106(2) and (3) of the General Principles of Civil Law, Jiang brought suit in the Pudong New District People's Court against Hongguang's directors, officers, and outside accountants.³¹⁴ In addition to the General Principles of Civil Law, the lawsuit was

³¹⁰ For a pithy narrative of these developments, see China's Stock Markets, *supra* note __, 9-31.

³¹¹ The case and consistent details are described in countless PRC texts and articles. See Collected Securities Cases, *supra* note __, at 58-64.

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

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

³¹⁴ Although the issuer (Hongguang) was domiciled in Sichuan, the Shanghai Stock Exchange had already moved from Shanghai's old Astor Hotel over the Suzhou Creek and across the Bund on the Puxi side to the Pudong New District of Shanghai.

loosely grounded in the 1994 Company Law.³¹⁵ Although China's first Securities Law had not yet come into effect, it had already been adopted by the legislature and its form published and heavily propagandized.

More than two months later, in March 1999,³¹⁶ the Pudong New District People's Court finally refused outright to accept the case, saying: "The plaintiff's case regarding behavior in violation of laws and regulations in the stock market should be handled by the CSRC. The plaintiff's suit regarding a securities dispute does not come within the jurisdiction of this People's Court."³¹⁷ Regardless of the formal justification offered by the Pudong Court in 1999,³¹⁸ the Court's rejection of the Jiang Shuzhen lawsuit is emblematic of how the entire Chinese court system initially handled, or refused to handle, what all aspects of the PRC government feared would quickly become a flood of shareholders' lawsuits brought throughout the nation, at all levels of the court system.³¹⁹

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

³¹⁶ Notified only on April 2, 1999, after the lapse of the stipulated period for appeal, thus neatly blocking Jiang Shuzhen's ability to appeal the Pudong New District People's Court's refusal to accept the case.

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

³¹⁸ The formal justification of the Pudong New District People's Court in 1999 seems to be the following: "Laws may not be applied and interpreted by judicial courts because such laws (and the underlying claims) pertain to the stock market regulated (even if not *exclusively*) by the CSRC." While outside observers might think such a rationale unsustainable or plain silly, it is very close to the defense of the non-dutiful director noted *supra*, who tells a Beijing People's Court that he cannot be in breach of his *Company Law* fiduciary duty of care at a public company because that alleged failure is governed by the *Securities Law* which imposes such a duty only on people who directly operate or manage the firm. See Listed Company Director Sues, *supra* note __. Later, and in the context of the January 2002 Supreme People's Court ban on private shareholders' suits which preceded the January 2003 Supreme People's Court Regulations allowing such suits, more credible justifications were offered: no legal basis for a private right of action; questionable technical competence of judges hearing corporate and securities law cases; or simply the overwhelming complexities of the new Socialist Market economy. Even after lifting of the ban in January 2003, and allowance of shareholders' suits for damages (only) in false or misleading disclosure cases, the securities regulatory authority (and the state, through the People's Procurate) still monopolizes regulation of every other aspect of public company and securities regulation and enforcement aside from false or misleading disclosure – such as stock manipulation or insider trading. And even there the fines have been low, with the CSRC deprived of the ability to bring civil suits against market actors. Only in the Fall of 2008 did the CSRC first levy a fine exceeding US\$1.5 million for stock manipulation (coupled with confiscation of US\$2 million in illegal profits, and reference for criminal prosecution) in the Shoufang Financial Advisory-Wang Jianzhong "pump and dump" case. See Manipulator Punished, *supra* note __. This fine and reference for criminal prosecution was the high point in a six month period which saw very vigorous enforcement by the CSRC against market manipulators, corrupt funds trading, false disclosure, insider trading, etc., including the public investigation of the trading activities of one of China's commercial superstars, the Chairman of the Guo Mei ("Gomei") electronics concern. See DONGFANG ZAOBAO [ORIENTAL MORNING NEWS], Nov. 24, 2008, at B-9 (detailing enforcement actions and fines levied between April 8 and November 21, 2008).

³¹⁹ That flood duly materialized, forcing the Supreme People's Court to issue the ban on shareholders' rights cases in January 2002, which was only lifted in January 2003 with the Supreme People's Court Regulations permitting a narrow range of false and misleading disclosure cases into the Courts, but only after something like a determination of fact by the CSRC (or the Procurate for criminal faults), only with respect to evaluation of damages, and forbidding absolutely anything like class action suits (with lawyers' contingency fee arrangements forbidden in

In considering the critical question of the Shanghai Court system's blanket refusal to accept a whole *genus* of cases, it is important to note that the Shanghai Courts both constrain themselves voluntarily and are limited by bureaucratic instruction. It is well known that the Chinese People's Courts act *voluntarily* to reject or cease hearing cases from the recent example of a nation-wide voluntary halt on hearing cases seeking enforcement of transferred non-performing loans.³²⁰ That judicial strike commenced with a report by the President of a Provincial Higher People's Court delivered to the central government in late 2005, and to date no central authority, even the Supreme People's Court working in tandem with the State Council, has been able to prod the People's Courts back into action. With respect to formally instructed refusal, as noted above I was able to find several explicit instructions *before* January 1, 2006 calling on the Shanghai People's Courts not to accept certain types of public company cases.³²¹ But I found no evidence of written instructions, Regulations, Opinions or Approving Responses commanding the same *after* the 2006 Company Law became effective. However, the President of one of Shanghai's busiest and most expert District People's Court systems did refer to some kind of internal instruction from the Supreme People's Court (note, not the CSRC) forbidding acceptance of public company cases.³²²

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

regulations applicable to PRC lawyers). See the ban of January 2002: *Zuigao Renmin Fayuan Guanyu Shouli Zhengquan Shichang Yinxujiachenshu Yinfa de Minshi Qinquan Anjian Youguan Wenti de Tongzhi* [Supreme Peoples Court Notice Regarding the Issues Related to Acceptance of Civil Rights Infringement Cases Arising from False Disclosure in the Securities Markets], Jan. 15, 2002, at CLC, *supra* note __, at 5-29 – 5-30; and the January 2003 limited permission: *Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang Yinxujiachenshu Yinfa de Minshi Peichang Anjian de Ruogan Guiding* [Supreme Peoples Court Several Regulations Regarding Civil Compensation Cases Arising from False Disclosure in the Securities Markets], Jan. 9, 2003, at CLC, *supra* note __, at 5-25 – 5-29.

³²⁰ See *supra* notes __ and accompanying text.

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

³²² Remarks of Shanghai Changning District People's Court President Zou Bihua, December 5, 2008, notes on file with author.

³²³ The Shanghai Courts have no particular problem dealing with the one limited liability company form which actually pre-dated the Company Law and China's entire corporate law system, the *foreign-invested enterprise* forms comprising Chinese-foreign equity and cooperative joint ventures, wholly foreign owned enterprises, and foreign invested companies limited by shares, each of which have their own specific statute and/or regulations governing aspects of their legal identity, operations, and shareholder relations. One of the reasons more FIE-related cases are

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

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

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

The same facial rationale was offered by the District People's Court President cited immediately above who referred to an internal Supreme People's Court instruction warning subordinate Courts off of public company cases. He said the instruction was based largely on the desire to discourage vexatious shareholder litigation nationally.³²⁵ Certainly the Supreme People's Court and the Shanghai Higher People's Court express legitimate concerns in pointing to the battle against "vexatious shareholder litigation," but the concern seems over-estimated in the Chinese context, where there are no class actions suits, no lawyers' contingency fees, and various judicial bureaus and only semi-autonomous lawyers' associations have issued notices requiring caution in accepting large plaintiff group cases.³²⁶ The more authentic concern here is the problem of mass litigation or large plaintiff group lawsuits and their purported impact upon social and political stability, freely discussed in popular PRC journalism.³²⁷

not seen in the Shanghai People's Courts is that foreign investors and their PRC co-investors almost uniformly choose arbitration as the exclusive means of dispute resolution, thus depriving the Courts of any opportunity to hear such claims.

³²⁴ Shanghai Higher People's Court No. 2 Civil Division 2007, *supra* note __, at 44.

³²⁵ Remarks of Shanghai Changning District People's Court President Zou Bihua, Dec. 5, 2008, notes on file with author.

³²⁶ See Xin Tang, *Protecting Minority Shareholders in China*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 153-8 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008).

³²⁷ See Mass Compensation, *supra* note __. Ben Liebman has also noted a related point, that refusal by the People's Courts of certain kinds of cases, even merely "warm" politically, is an entirely rational response by institutions which feel that any kind of decision will only bring trouble or in most cases remain unenforceable (thus diluting their own power and legitimacy). See Restricted Reform, *supra* note __.

ii. Availability and understanding of substitute enforcement

Another set of explanations for the absence of public company cases focuses not on the People's Court bureaucracy, but the potential plaintiffs in such missing actions. First, such cases may not make it into the formal Court system because of the existence of a working substitute enforcement architecture for listed companies cases: the public prosecutor (the People's Procurate)³²⁸ and the CSRC (as prodded by the very effective and muckraking financial media in China). That simple proposition, however, is not the same as saying that the substitute is adequate, that the substitute is not resource-constrained, or its coverage is unlimited. The truth is that neither the public prosecutor nor the CSRC has the resources or the competence (for instance, in regards to *ex post* veil-piercing, derivative actions, or fiduciary duties litigation) to be a fully adequate substitute for the judiciary in bringing the Company Law to act on China's companies limited by shares, public or not.³²⁹

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

³²⁸ For recent examples of the public prosecutor using the Criminal Law to punish corporate law violations (such as breaches of duty of loyalty) see the December 2008 hearing on the prosecution of New China (Xinhua) Life Insurance's former chairman Guan Guoliang for competing investments of over US\$30 million in the Beijing No. 2 Intermediate People's Court, which includes "financial advisory fees" paid to a financial consultancy established in Shanghai and controlled by Guan. Guo Guanliang Criminal Prosecution, *supra* note __.

³²⁹ See the rare CSRC-diminishing and judicial system-activist posture taken by the Shanghai No. 2 Intermediate People's Court in the case fully briefed in the Case Reports Appendix: *Lu Jianming v. Shanghai Light Industry Machinery Company, Limited*, (Shanghai Jingan District People's Court, Shanghai No. 2 Intermediate People's Court, 2006) (Huai Xiaofeng 2007: 189-194) (board resolution nominating director of listed company director not invalidated by board's failure to disclose – in the resolution -- that nominee formerly worked for listed company's controlling shareholder and is defendant company's Legal Representative's wife).

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

³³¹ See Listed Company Director Sues, *supra* note __.

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

iii. Negative implications of the public companies refusal

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

Whatever the causes of the relative paucity of public company cases in the Shanghai Courts, it does not excuse the same phenomenon. That lack of application constitutes a real tragedy for Chinese corporate governance reform, precisely because it was the dire state of corporate governance at public companies in China which occasioned the 2006 Company Law amendments and the statute's new "justiciability" outlined here,³³² and it has long been recognized that there is no more efficient or effective way to implement corporate governance in China. Because companies limited by shares or publicly-listed companies and their shareholders are simply not present in the Shanghai Courts, the following claims go unimplemented in the Shanghai judiciary: promoters' agreements, either among promoters,³³³ or against promoters;³³⁴ shareholders' meeting resolutions offered by shareholders (3% shareholding);³³⁵ rights and privileges of different share "classes";³³⁶ convening of board meetings by shareholders (10%), directors other than the board Chairman (one third), or the supervisory board;³³⁷ prohibition on company loans to directors, supervisory board members or senior managers;³³⁸ shareholders' approval of proposed transfer of "major" (*zhongda*) assets;³³⁹ supermajority approval by shareholders (two thirds) of sale of "major" (*zhongda*) assets or guarantee of value exceeding 30% of corporate assets;³⁴⁰ recusal by conflicted directors on board resolutions considering

³³² See China Corporate Governance Report, *supra* note ____.

³³³ 2006 Company Law, Articles 80(2), 84(2) & 94(2).

³³⁴ 2006 Company Law, Article 95.

³³⁵ 2006 Company Law, Article 103(2).

³³⁶ Permitted at 2006 Company Law, Article 132.

³³⁷ 2006 Company Law, Article 111(2).

³³⁸ 2006 Company Law, Article 116.

³³⁹ 2006 Company Law, Article 105.

³⁴⁰ 2006 Company Law, Article 122.

related party transactions;³⁴¹ shareholders' power to convene a shareholders' meeting (10% shareholder);³⁴² promoters' and directors, officers and supervisory board members' one year transfer restrictions;³⁴³ merger-objecting shareholders' appraisal rights;³⁴⁴ listed company mandatory disclosure obligations (as in the claim addressed in the immediately following paragraph, another badly-drafted incursion of the Company Law into the province of PRC securities regulation);³⁴⁵ or shareholder (10%) petitions for company dissolution.³⁴⁶ (In only one rare case in the 1992-2008 sample do the Shanghai People's Courts intrude into the explicit province of the CSRC.³⁴⁷ This however is a criminal case, where the Courts acting at the direction of the People's Procurate and as an adjunct to the CSRC in its central regulatory mission, and the judgment is firmly based in a Company Law provision which over-broadly addresses securities trading (a provision which should be the province of the PRC Securities Law).)³⁴⁸

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

³⁴¹ 2006 Company Law, Article 125.

³⁴² 2006 Company Law, Article 101(3).

³⁴³ 2006 Company Law, Article 142.

³⁴⁴ 2006 Company Law, Article 143(4).

³⁴⁵ 2006 Company Law, Article 146.

³⁴⁶ 2006 Company Law, Article 183.

³⁴⁷ The case relates to securities, and the trading of securities outside of a CSRC-approved Exchange and implementation of 2006 Company Law Article 139. *See PRC v. Fang Kun, Ni Chunhua, Zhang Minxia* (Shanghai Pudong New District People's Court, upheld by Shanghai No. 1 Intermediate People's Court, 2007) (Shanghai Higher People's Court 2008b: 419-26) (trading in unlisted securities, including acting as agent-underwriter in public offerings, without CSRC approval and registration to engage in the securities business, constitutes the crime of "illegal business operations").

³⁴⁸ For both companies limited by shares (listed or not) and limited liability companies (even the close corporation/corporate partnership form so prevalent in China's enterprise reality), a wide range of the tools offered in the 2006 Company Law are not used by the Courts either, including: shareholders' civil suits against other shareholders for oppression; claims against control or "actual control" parties for harm to the company; specifically-pleaded (Article 148 & 149) breaches of "duty of care" or "duty of loyalty" (including funds misappropriation, illegal lending or guarantees, self-dealing, corporate opportunity, corporate secrets confidentiality); specifically-pleaded claims against directors, officers or supervisory board members for compensation arising from law-breaching behavior; specifically-pleaded derivative actions under Article 152; adjudication of "actual control person" status; failure to make financial reports to shareholders; company dividend distributions; or breach of duties for a People's Court-confirmed liquidation group. Even in the apparently more accessible context of interaction with the limited liability form, there are few lawsuits involving new or previously existing claims permitted under the 2006 Company Law, such as contract claims by shareholders against other shareholders for failure to pay in subscribed-for capital, preemptive rights on new issuance of capital, or mandatory buy-back/appraisal rights. As demonstrated in this article, limited liability companies do see claims related to a narrow band of new rights offered in the new Company Law or pre-existing rights, including: shareholders information rights; 50% shareholder consent, and right of first refusal, on equity transfers; and shareholder (10%) petitions for company dissolution. *See* 2006 Company Law Articles 20(2), 21, 172(2), 150, 217(3), 166, 35, 167(4) & (5), 190, 28(2), 35, 75(3), 34, 72 and 183.

³⁴⁹ Measuring Harmony, *supra* note __.

the past few years: from 27 group cases suing on the same cause of action and 1047 claimants in 2006, to 50 cases (1671 claimants) in 2007, and 62 cases (1449 claimants) to October 1, 2008.³⁵⁰ That is a doubling in case acceptances over 24 months, and the referenced report does not indicate how many such cases were refused. The majority of these cases pertain to labor disputes, residential housing management, administrative condemnation of land and buildings, and rural contracting disputes,³⁵¹ and other data indicates that continued assays directed at the People's Courts nationally come in respect of labor rights,³⁵² environmental torts, official misfeasance,³⁵³ food contamination,³⁵⁴ securities lawsuits, and so on. One Intermediate People's Court in the Shanghai system, recognizing the unstoppable force of such group actions, has issued special procedures to handle such cases, procedures which may act to provide early warning to the entire Court system of the approach of such lawsuits.³⁵⁵ The more direct way of handling the phenomenon is of course simple refusal to accept cases potentially giving rise to large – and angry -- plaintiff groups. That is apparently the response of the Shanghai judiciary (and by extension the national People's Courts) in respect of companies limited by shares that have listed shares in the hands of hundreds and thousands of Chinese citizen shareholders.³⁵⁶

IV. CONCLUSIONS

In this study I have shown two aspects of company law adjudication in the Shanghai People's Courts between 1992 and 2008: bold autonomy,³⁵⁷ and continuing constraints on that autonomy. Two aspects of the constraints identified are worrying. First is the perverse authorization-constraint dynamic seen in the increasingly conservative application or non-application of corporate law doctrines like veil piercing, the derivative lawsuit or corporate fiduciary duties after the basis for those doctrines has at last been provided in statute. Second, and perhaps of greater concern, is the evident “red line” drawn around companies limited by shares (with many shareholders) and in particular companies limited by shares with publicly-listings (even more shareholders), where the Shanghai People's Courts simply do not accept or adjudicate cases involving corporations with a large number of shareholders. As noted in the body of this article, this is exemplified by the Courts' rejection of shareholders' suits generally,

³⁵⁰ Pan Gaofeng, *Shanghai Shi Di Yi Zhongyuan Tansuo Shenpan Xin Ju Cuo* [Shanghai No. 1 Intermediate People's Court Explores New Adjudication Measures], XINMIN WANBAO [NEW PEOPLE'S EVENING NEWS], Nov. 4, 2008, at A3 [hereinafter New Shanghai Adjudication Measures].

³⁵¹ *Ibid.*

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

³⁵³ Edward Wong, *Parents of Schoolchildren Killed in Quake Confirm Lawsuit*, N.Y. TIMES, Dec. 23, 2008, at A10.

³⁵⁴ Andrew Jacobs, *Chinese Parents Reject Milk Settlement, Seeking Care for Victims*, N.Y. TIMES, Jan. 14, 2009, at A_; Edward Wong, *Milk Scandal in China Yields Cash for Parents*, N.Y. TIMES, Jan. 17, 2009, at A6.

³⁵⁵ New Shanghai Adjudication Measures, *supra* note ____.

³⁵⁶ Most Chinese analysts understand that a rejectionist response is not sustainable over the long term, even if that refusal is animated by the sheer inability to process the huge number of cases flooding into the courts. See *Assuaging Popular Anger*, *supra* note ___, and *Mass Compensation*, *supra* note ____.

³⁵⁷ As noted *supra*, increased autonomy may not be an undiluted “good” as it may permit judicial institutions to act autonomously but illegally or corruptly.

and shareholders' actions to overturn board or shareholders' resolutions, force dividend distributions, cause judicially-mandated sale of equity, or spur dissolution, in each case specifically at companies limited by shares or such companies with listings. Recall how the No. 2 Civil Division of the Shanghai Higher People's Court explicitly addressed the situation in its grudging reversal of the pre-2006 policy ordering rejection of public company shareholders' petitions for invalidation of corporate resolutions:

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

The same concern can also be perceived, albeit more subtly, in the Shanghai judicial system's unremitting bias in favor of "stability" (including business entity preservation at all costs) over other corporate law values, such as transactional efficiency, adaptability and the easy redeployment of capital, or the rights explicitly granted in statute to firm participants. The evidence presented in this article shows that the shyness about accepting claims associated with multiple shareholders was largely ordered inside the Court bureaucracy. Under the 1994 Company Law, the Supreme People's Court, Shanghai People's Courts and other People's Courts systems assuredly issued "Opinions" and "Notices" explicitly forbidding the acceptance and adjudication of public company cases and directing those cases to the securities regulator (the CSRC). In the post-2006 scenario however, many of those explicit prohibitions have been removed³⁵⁹ or made moot by clear authorizing provisions in the 2006 Company Law, and yet the evidence presented here indicates that cases concerning such corporate entities and their many shareholders are not making it into the People's Courts. The problem then is the very strong concern in the People's Courts for political or social order even in the mundane world of corporate law adjudication, in which Law, regulation, coherence, and "fairness" (often invoked by the Shanghai People's Courts in corporate law cases) should be dispositive, and outside of the more sensitive social control context. This concern causes the judiciary to disregard the power it is clearly authorized to wield under the 2006 Company Law, or causes the political and administrative masters of the Court system to limit jurisdiction in bald contradiction with the scope of their power now outlined in statute.

With respect to the authorization-constraint dynamic, the development path presented here may appear counter-intuitive. It seems rare indeed to witness a state or governmental organ acting with less autonomy upon the grant of wider power. As with the rejection of public company cases, the Courts' refusal to hear cases they are now authorized doctrinally to adjudicate is the result of both specific instruction inside the bureaucracy and voluntary deference by the People's Courts. These refusals are both political and bureaucratic in origin. Doubtless, because of the keen political sensitivities sometimes in play, superior departments of the state or Party warn the Courts off certain kinds of cases. There is also ample evidence that the People's Courts voluntarily reject cases when they perceive a political problem. The latter

³⁵⁸ Shanghai Higher People's Court No. 2 Civil Division 2007, *supra* note __, at 44.

³⁵⁹ Although, as noted *supra*, at least one senior Shanghai People's Court judge alluded to some kind of broad non-public direction from the Supreme People's Court asking the lower level court systems *not* to take public company cases. See notes __ *supra* and accompanying text.

phenomenon is exemplified by the People's Courts' nationwide refusal starting in 2005 to adjudicate creditor claims on non-performing loans transferred to China's asset management companies and then resold to third party purchasers. This coordinated refusal was sourced in Court fears that such cases might implicate one of transitional China's hot-button issues: the theft of state assets.³⁶⁰ Most importantly, this national refusal came bottom-up, and has persisted even in the face of repeated public urgings from numerous central government authorities to re-start case acceptance and adjudication. The bureaucratically-based refusals are by and large voluntary and not ordered by superior departments. Revived voluntary constraints on autonomy, now in the more complex and less apparently political areas of fiduciary duties, veil-piercing, and judicial dissolution exemplify the underlying bureaucratic nature and status of the People's Courts in China. Without any mention of certain doctrines in statute before 2006, the People's Courts apparently felt free to range about and implement common sense or "justice" / "fairness"-oriented solutions, such as invocation of corporate fiduciary duties against obviously opportunistic or inattentive directors, or *ad hoc* derivative lawsuits, even if not pleaded.³⁶¹ However, with some of these doctrines now included in formal "Law", even if very much in principle, the People's Courts as embedded bureaucratic actors subject to Party direction now wait to see how the apex of their bureaucracy, the Supreme People's Court in Beijing, will instruct implementation of these newly-authorized doctrines. This view, however, cannot be wholly explanatory as even the Shanghai People's Courts did continue to act freely in some specific areas after January 1, 2006 without Supreme People's Court Regulations or any kind of superior direction.

The effects of the autonomy dialectic revealed here may be profoundly injurious for the Chinese legal reform project. As noted above, two of the functions asserted for judicial institutions in non-democratic, non-rule of law states like the PRC are to bolster a regime's claim to "legality" and to facilitate investment (and growth).³⁶² With respect to legality and legitimacy, in the counter-intuitive developments identified in this article, we may be seeing unfortunate effects akin to what Xu Xiaoqun, a historian of an earlier period of Chinese judicial reform, has called the "paradox of modernity."³⁶³ Professor Xu describes the efforts toward judicial reform in China's late Qing and Republican eras (1900-37), and the relatively consistent motivations and goals of the central state/Party in promoting that reform. He questions whether expansion of the formal state and judicial system actually resulted in real "development", by which he means the increased effectiveness, efficiency and legitimacy of those same state institutions (including the courts). Xu focuses on the defeated expectations of the consumers/subjects of the judicial power, who were made abundant promises by the "modernizing" state, but upon which the judiciary cannot deliver, thereby injuring the efficacy and legitimacy of the judiciary itself.³⁶⁴

³⁶⁰ This worry first articulated in a report issued in late 2004 by the Hebei Provincial Higher People's Court President Li Ruichan. See Two Regulation Difficulties, *supra* note __, at 60.

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

³⁶² Authoritarian Rule of Law, *supra* note __, at 4.

³⁶³ XU XIAOQUN, TRAIL OF MODERNITY: JUDICIAL REFORM IN EARLY TWENTIETH-CENTURY CHINA, 1901-1937 (2008) [hereinafter 20th Century Judicial Reform].

³⁶⁴ 20th Century Judicial Reform, *supra* note __, at 20-2.

Xu's insights about early 20th century China shed important light on the expansions of, and constraints on, judicial autonomy described in this article. As in the late Qing and early Republican periods, the expansion of and constraints on judicial autonomy in the years 1992-2008 with respect to corporate law adjudication exemplify not only the failure to deliver resolution, justice and some kind of predictability, but also serve to diminish the legitimacy of the "state" and its institutions, the People's Courts in particular. Contemporary China is witnessing the same paradox in the hesitancy of the Shanghai People's Courts and by implication the national People's Courts to hear cases which they used to accept and adjudicate without any legal basis in statute, and after a firm legal basis has been provided in the Company Law and the Law has – nominally -- increased its "justiciability." The same phenomenon can be perceived in the Courts' rejection of mass plaintiff, public company, cases. Of course, this paradox is most searing, disheartening, and de-legitimizing – and most readily noted by PRC and foreign legal analysts -- in other areas of PRC judicial activity, such as the application of criminal law or in the more direct social/political control context.³⁶⁵ Yet this negative phenomenon is equally important in the corporate and commercial sphere. It is important not just because of the harmful effects visited on economic development in an increasingly marketized and corporatized China. It is also of critical significance because formal institutional development and increased notional access to the People's Courts in the Company Law sphere specifically have spurred societal demand for competent institutions able to apply the Company Law fairly, which in turn only doubles the disappointment upon subsequent institutional failure or rejection of claims.

There is no question that China's 1994 Company Law and its 2006 re-formulation, and the existence of corporate business organization in Reform-era China, have changed the nature of law and legal institutions in China, the expectations of the consumer/subjects of the law in China, the idea of "rights" (including property rights but also brushing up against civil and political rights), and the relationship between the state (and Party) and the governed as mediated through the legal and political system. In Weberian-North terms³⁶⁶ China is still very far from the complete rule of law state with seamless protection of property rights and property expectations. Notwithstanding, my exhaustive analysis of corporate law cases and opinions rendered in Shanghai between 1992 and 2008 shows that the corporatization/partial privatization program and the implementation of a justiciable corporate law calling for *ex post* application of judicial standards by a stand-alone judiciary have spurred the nation's formal legal institutions to

³⁶⁵ The hardy appetite for rights protection and recourse to law in the company law sphere is echoed in all other sectors of Chinese civil society, including peasant society living under the fist of oppressive, corrupt and ill-educated local tyrants, laid off workers in Northeast China, and sweat shop workers in Southern China. See CHEN GUIDI & WU CHUNTAO, *ZHONGGUO NONGMIN DIAOCHA BAOGAO* (2005); *Against the Law*, *supra* note __; and China's Busiest Court, *supra* note __. This article does not focus on the "demand" side of corporate and commercial litigation, but the expertise and autonomy of China's judicial institutions when they are confronted with corporate law cases. There continues to be a very healthy debate on just how litigation-adverse modern PRC urban and rural citizens are. See *Measuring Harmony*, *supra* note __, citing a 2001 urban study performed by Ethan Michelson with Ford Foundation support for the Beijing Municipality and seven Beijing Districts, and a February 2002 study by the Sociology Department of China People's University in six rural Counties and 30 Villages.

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

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

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³⁶⁷ The cases listed here are arranged first by date of final hearing/opinion rendered, and then alphabetically by the first party listed. The notation describing the source of each case is cross-referenced to the "Key to Case Sources References" immediately following the Table of Cases.

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³⁶⁸ This is probably the case because the author of the paper reporting the case, Judge Yu Wei, is a sitting judge at the No. 2 Intermediate People's Court (No. 3 Civil Division).

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CASE REPORTS APPENDIX

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

Zhang Qingzhao and Wang Zhaoming v. Zhang Wenhui, Shanghai Baoxing Machinery Maintenance and Manufacturing Company Limited, Shanghai Baoshan District People’s Court, 2002, and Shanghai No. 2 Intermediate People’s Court, 2004 (Supreme People’s Court China Practical Jurisprudence Research Institute 2006: 234-241).

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

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

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

to Baoxing Company for 24.83% of Baoxing Company's received capital; Plaintiff Wang contributed RMB 200,000 yuan (made up, in part, by conversion of RMB 44,024 of receivables due from Baoxing Company) for 47.15% of Baoxing Company's received capital; and Defendant Zhang contributed RMB 145,020 yuan for 28.02% of Baoxing Company's received capital. In the period to August 2002, Plaintiff Zhang had received from Baoxing Company RMB 66,410 yuan, Plaintiff Wang had received from Baoxing Company RMB 190,000 yuan and an additional RMB 30,000 yuan in employee compensation, and Defendant Zhang had taken out of Baoxing Company RMB 335,000 yuan; (iii) to August 2002, Baoxing Company's cash on hand and undistributed profits amounted to RMB 706,728 yuan, which, with the deduction of depreciation and rent payables, left undistributed cash of RMB 643,248 yuan – it being noted by the accounting firm that prior to the submission of capital by the Plaintiffs, the Baoxing Company had shown no records of profit or loss; and (iv) no evidence that vehicles or any materials used by Defendant Zhang had ever been included on the Baoxing Company accounts as company assets. The firm concluded its report by giving the accounts a fairly clean opinion, unable to identify any great variance or failure to record assets and liabilities. Finally, as the court proceedings started, Defendant's Brother asserted that he was merely a low-level person at Baoxing Company without any management involvement whatsoever, and in fact only knew about the "Shareholders' Agreement" between his brother Defendant Zhang and the two Plaintiffs once the litigation was filed.

Plaintiffs' Allegations at Time of Suit: The two Plaintiff's argue that when they signed the "Shareholders' Agreement" with Defendant Zhang in April of 1999 it was an agreement to jointly capitalize and establish the Baoxing Company. Under the Agreement, the three signatories were to have equal shares, and share the risk of profits and liabilities equally. After the Agreement took effect, the three parties invested RMB 519,059.41, comprising Plaintiff Zhang's RMB 130,000 yuan, Plaintiff Wang's RMB 244,024 yuan, and Defendant Zhang's RMB 145,034 yuan. Baoxing Company was established on March 25, 1999. Through the efforts of the three parties they exceeded initial expectations and did rather well, accumulating profits of RMB 706,728 yuan by August of 2002. In addition, in the period between March 2000 and the end of August 2002, Baoxing Company returned (*fanhuan*)³⁶⁹ RMB 665,000 yuan to the investors, with RMB 130,000 to Plaintiff Zhang, RMB 190,000 to Plaintiff Wang, and RMB 335,000 to Defendant Zhang. At the present time, the three parties have encountered disagreements about management of the Baoxing Company and Defendant Zhang has frozen the two Plaintiffs out of any management role in the company. In light of this, the two Plaintiffs ask the People's Court to issue an order confirming their rights as shareholders of Baoxing Company between April 1999 and August 2002; Plaintiff Wang sues for an order by the Court causing Defendant Zhang and Baoxing Company to return RMB 54,024.94 yuan of his investment; the two Plaintiffs ask for an order causing Defendant Zhang and Baoxing Company to distribute undistributed profits of RMB 471,152 yuan, and a separate order causing Defendant Zhang to return to Baoxing Company the RMB 335,000 yuan he improperly looted from the Company.

Defendants' Allegations at Time of Suit: Defendant Zhang and the Baoxing Company assert that the three-party "Shareholders' Agreement" never took effect and was never implemented. The two Plaintiffs never contributed capital, and never participated in management of the company,

³⁶⁹ The use of this term in Chinese shows the Plaintiffs think this is a "return of capital", not a distribution of profits, or salary and wages, etc. Obviously, this characterization needs to be settled by the People's Courts.

and thus cannot be considered “shareholders” of Baoxing Company or be seen to have any right to the company’s profits or request dividend distributions. Because the two Plaintiffs were never shareholders of Baoxing Company, there is no issue of share transfer. The relationship between the two Plaintiffs and Defendant Zhang is one of creditor-debtor, and Defendant Zhang has already returned to the two Plaintiffs all amounts borrowed from them. Defendant’s Brother’s pleading is similar: because Plaintiffs are not shareholders of Baoxing Company, there can be no talk of “dividends” or “stock redemption”.

Shanghai District Court’s Judgment: The No. 2 Civil Division of the Shanghai Baoshan District People’s Court ruled as follows on May 15, 2004: The true nature of the “Shareholders’ Agreement” signed between the two Plaintiffs and Defendant Zhang was that of a contractual agreement allowing the parties to “borrow” the existing name of the Baoxing Company to undertake business activities. Judging from the AIC’s records, and the results of the audit requested by the Plaintiffs and ordered by the People’s Court, the Baoxing Company was actually established before April 29, 1999 (in October 1998). Thus, the three parties could not have had an intention to “establish” the Baoxing Company or become the “new” company’s shareholders. Formally, Baoxing Company only had two shareholders, Defendant Zhang and Defendant’s Brother, neither of whom actually capitalized the Company. This corporate form was managed and operated by Defendant Zhang, and only used the name of Defendant’s Brother who did not contribute capital or participate in Company management. In fact, from the formal establishment of the Company to the date of signature of the “Shareholders’ Agreement”, or April 29, 1999, Baoxing Company had no real operations. Defendant Zhang, as one of the promoters – and publicly-identified (registered) shareholders -- of Baoxing Company, signed the “Shareholders’ Agreement” with the two Plaintiffs, which Agreement clearly stipulated that the three parties would jointly employ RMB 1,800,000 yuan to establish Baoxing Company, and that the enterprise would be managed by all three of the parties to the Agreement. However, even with the agreement of each of the parties to make their respective capital contributions and jointly run the enterprise, no change of the registered capital (RMB 500,000 yuan) or the list of shareholders was made at the relevant bureau of the SAIC and thereby not notified to the public at large. Therefore, and in accordance with the principle of public notice (*gongshi yuanze*) the Company itself enjoyed a reduced limitation on its liability (as against the world) of only RMB 500,000 yuan (*i.e.*, as against the RMB 1.8 million yuan of initial capitalization called for under the *post*-establishment “Shareholders’ Agreement”). Thus, the Court pronounces, the April 29, 1999 “Shareholders’ Agreement” in fact constitutes the borrowing of the name of the already-established Baoxing Company to undertake a “partnership” (*hehuo jingying*)-form business enterprise.³⁷⁰ Thus, the two Plaintiffs may not simply by virtue of partial capitalization of and management rights over the business be deemed shareholders of the Company. By the same token, Defendant’s Zhang’s claim that the relationship between the two Plaintiffs and Defendant Zhang is that of creditor-debtor cannot be sustained. That is because the “Shareholders’ Agreement” clearly stipulates that the three parties are cooperating partners, and the reality is that all three participated in active management and operation of the business. With respect to Plaintiff Wang’s claim against Defendant Zhang and Baoxing Company for return of RMB 54,024 yuan of his investment, the Court states as fact that Plaintiff Wang has already been given RMB 30,000 yuan as employment compensation, but that Plaintiff Wang has offered no

³⁷⁰ This idiom, *hehuo* is not used casually, and is the Chinese character set used for what we may think of as general partnerships and registered as such under the PRC Partnership Enterprise Law.

evidence to prove that this was Defendants' obligation to provide. Thus, the Court only supports a reasonable amount of "investment return" to Plaintiff Wang (after deduction for what he has already received from the business). With respect to the division and distribution of the profits earned by the Baoxing Company enterprise during the three-party cooperation period, when the partners can no longer work together then the commonly-derived profits should be subject to an accounting and distributed. Here, even though the "Shareholders' Agreement" calls for total investment in the business of RMB 1,821,693 yuan with each party contributing the same share, in fact not all of this investment was made, and not by each party equally. Because the parties did not contract to share profits and losses in accordance with their capital investment, and because it is difficult to sort out the real joint contributions to the business during the cooperation period, the Court rules that notwithstanding the actual proportions of capital contributions made by the three parties, profits and losses should be shared by the parties pursuant to the principle stipulated in the Agreement that "the three parties will together share the risk and the profits". Therefore, with confirmed retained profits of RMB 643,248 yuan, each is due a share of RMB 214,416 yuan. With respect to the obligor of these distributions, because the common investment was situated at Baoxing Company, then Baoxing Company has the obligation to make these distributions. Defendant Zhang has a double obligation here, as both a "partner" (*hehuoren*) and the Legal Representative of Baoxing Company – he has a duty to keep custody over and manage the "partnership's profits" (*hehuo lirun*) prior to their distribution to the investors. Therefore, if there is any shortfall in the distributions of profit made to the two Plaintiffs in accordance with the foregoing, Defendant Zhang has a duty to make up any shortfall. Finally, with respect to the Plaintiffs' claim that Defendant Zhang has illegally taken out RMB 335,000 yuan of cash from the enterprise, that claim is rejected. Defendant Zhang must be seen as one of the common operators (*gongtong jingying ren zhi yi*)³⁷¹ of the enterprise who has a right to share in the profits thrown off by the business. Thus, the amount taken out of the business by Defendant Zhang, although larger than his investment (and thus in excess of his return *of* investment) can also be seen to include his return *on* investment. Accordingly, the Court dismisses the Plaintiffs' claim that he has illegally looted the enterprise.

Shanghai Intermediate People's Court's Judgment: Neither Defendant Zhang nor Baoxing Company accepted the first judgment, and appealed.

In the appeal, the parties made additional or amended pleadings as follows. Baoxing Company: (i) the District People's Court made procedural mistakes in accepting the audit report asked for by the Plaintiffs in establishing evidence in the case, and the accounts have been completely under the control of Plaintiffs since the start of the litigation, and manipulated by them; (ii) the District People's Court's judgment to the effect that the tripartite agreement constitutes a "partnership" is wrong – Baoxing Company was established before signature of the "Shareholders' Agreement" and the Agreement was not actually implemented because the parties did not make their required capital contributions; therefore, from a funds flow and accounting payables point of view, the money actually contributed by the two Plaintiffs and Defendant Zhang is clearly part of a private lending arrangement between the cash providers and the Baoxing Company. In the alternative, even if the tripartite Agreement does create a partnership in law, the partnership has been dissolved in law by virtue of the parties' return of

³⁷¹ Note how the opinion, having the opportunity, does not now identify the individual as a "partner" (*hehuoren*) as previously.

investment ; the District People’s Court ignored the fact that the parties have effected a return of capital, and incorrectly confers on the Plaintiffs a right to share in the partnership’s post-dissolution residual profits. Defendant Zhang: Repeats the pleadings of Baoxing Company, and in addition asserts that he and the Company are independent civil legal subjects, and that as the Legal Representative of Baoxing Company he has no responsibility for the corporate liabilities of the company he acts as Legal Representative for (Baoxing). Plaintiffs: They assert that they have not manipulated the Company accounts offered as evidence, and that Defendant Zhang was allowed to review them prior to submission into evidence; in addition, the first Court’s view that the arrangement written up as equity investment in a limited liability company was actually an enforceable partnership arrangement is correct – the Agreement was only not implemented in part, not completely unimplemented; finally, because the Baoxing Company has been absolutely controlled by Defendant Zhang since inception, he should have personal responsibility to make up any shortfall in the Court-ordered distributions.

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

2006 Company Law, Article 22 – Shareholders’ Suit to Invalidate Board and Shareholders’ Resolutions

Shanghai Yingdafang Service Company v. Shanghai Yingdafang Zhangjiang Service Company, et al., Shanghai Pudong New District People’s Court, appealed to Shanghai No.1 Intermediate People’s Court, 2007 (Shanghai Higher People’s Court 2008b: 190-195).

Precis Summary of Case and Judgment: Plaintiff legal person shareholder seeks to annul board and shareholders’ resolution of investee company under the control of two other shareholders who have apparently breached pre-company formation agreement to direct all business to investee company, and established a competing company (without participation of Plaintiff shareholder) to which all corporate opportunities due to investee company will be directed. Both the Pudong District People’s Court and, on appeal, the Shanghai No. 1 Intermediate People’s Court agree that such resolutions should not be annulled because they are not contrary to law, and because they do not infringe upon the rights of the investee company or the Plaintiff shareholder.

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

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

Company came to term, Defendant Company B took the entirety of such work and assigned it to Competing Company Establishment.

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

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

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

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

there is no legal or factual basis for the Plaintiff's assertion of a continuing duty of the Defendant Companies A and B to direct business to the newly-established company. The Court then strays farther from reasonable doctrinal application and analysis by invoking Article 21 of the 2006 Company Law (prohibition against use of related party transactions to injure the interests of the company): admitting that Defendant Companies A and B have engaged in such a related party transaction in establishing the Defendant Companies' Holding Company and then using it to create the Competing Company Establishment, the Court then lets the Defendant Companies A and B completely off the hook by saying they are "operators" (presumably as well as shareholders) and the pre-Investee Company establishment had already expired, or "in the project preparation stage and before project commencement, electing to use another project services provider, that does not constitute using related party transactions to harm the interest of the Investee Company."³⁷² On the second sub-inquiry, item (b) above, the alleged defects in the calling of, or voting at, the board or shareholders' meeting, the court reviews the specific provisions of the Investee Company's Articles of Association (including convening and chairmanship authority, required notice period, form of notice, addressees of notice, etc.) and rules that all such provisions were complied with in the calling of the two meetings. The court further says that the Plaintiff's failure to participate in the meetings, directly as a shareholder and via its representative on the board in the board meeting, constitutes a "waiver of its rights". On voting procedures, the Court again studies the Investee Company's Articles of Association, and recites the facts that certain major decisions require the approval of all of the shareholders, with other matters requiring the approval only of shareholders holding more than 50% of the shares of the company. Likewise, all board decisions require the support of three or more directors to pass. The court rules that the subject of the shareholders resolution does *not* pertain to the "major matters" requiring unanimous shareholder approval. As the shareholders' meeting was attended by shareholders able to vote more than 50% of the shares, and as the directors' resolution gained the approval of three directors, both resolutions are produced in compliance with the Investee Company's Articles of Association and are not in contravention of law and thus should not be invalidated.³⁷³ Finally, on the second prong of the Plaintiff's attack, whether or not Defendant Companies A and B have "infringed upon the rights" of Plaintiff, the Pudong District People's Court piggybacks on its strangled view of the Defendant Companies A and B duties above, all in the context of board and shareholder resolutions which are procedurally and facially without defect, to rule that the redirection of business away from the Investee Company to another provider which does not include the Plaintiff as a shareholder is not an infringement of the Plaintiff's rights. Accordingly, the Plaintiff's claims are rejected, and the burden of costs assigned to the Plaintiff.

³⁷² Shanghai Higher People's Court 2008b: 192.

³⁷³ Note that the Pudong District People's Court does not seem to understand a separate *quorum* requirement, *i.e.*, the requirement that either meeting be attended by shareholders voting a minimum number of shares or a minimum number of directors, as the case may be, before the meeting is established in law. It is not clear from the opinions (i) what kind of company the Investee Company is (limited liability company or company limited by shares), or (ii) whether (a) the Articles of Association in this case had quorum requirements for the respective meetings and the meetings were established, or (b) the Articles of Association had no quorum requirements. It should be noted here that the 2006 Company Law – consistent with its proclaimed "private ordering" emphasis -- commands no quorum for limited liability company board or shareholder meetings, and no quorum for companies limited by shares shareholders' meetings, but a quorum for companies limited by shares' board meetings ("more than half of the directors") (see 2006 Company Law, Articles 37-51, 99-108, and 112).

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

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

Tang Chunshao v. Zhou Huizhong; 3rd Party Shanghai Fukang Century Real Estate Development Co. Ltd., Shanghai No.1 Intermediate People’s Court, 2006 (Shanghai Higher People’s Court 2008b: 138-44 (Case No. 23)).

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

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

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

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

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

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

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

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

Shanghai No. 1 Intermediate People's Court's Judgment: In its judgment the Court understands the case to be limited to the question of whether or not the application for judicial dissolution meets the standards for the same under the Company Law. While acknowledging that the Plaintiff has the requisite 10% minimum equity interest to plead dissolution, and that the Project Company has not been able to function (or produce a shareholders' resolution) for more than a year, the Court rules that – at the time of suit –the evidence offered by the Plaintiff (who the Court says has the burden of proof) is not sufficient to prove that if the Project Company continues it will result in significant injury to the shareholders, or that the difficulties experienced at the Company have reached such a point that only dissolution will solve the problem (hinting strongly that the parties should be able to negotiate a buy-out to bring about the exit of one of the two contesting shareholders). Accordingly, the case is dismissed, with costs (of RMB 60,010 yuan) to be borne by the Plaintiff.³⁷⁴

³⁷⁴ Interesting are the Court's rationales supporting its dismissal of the case, offered as a kind of *dicta*. First, the Court is loathe to order the dissolution of a corporate legal person because it would "necessarily impact in different degrees market order and stability." This legal policy aim may be contrasted with what might be termed an economist's focus on the situation, or the encouragement of re-deployment of capital when shareholder relations become so difficult as to stop a project before completion and revenue earning. Second, the Court understands that any dissolution uses up judicial resources (tantamount to a bankruptcy), and negatively impacts both shareholders and third parties (including creditors). Third, and as a kind of window into an equity approach to the problem, the Court says it must consider the "appropriateness" (*zhengdangxing*) and "rationality" (*helixing*) of such a significant step as judicial dissolution. This orientation allows the court to take judicial notice in effect of the Plaintiff's rather "unclean hands", and thus support its technical (lack of proof) dismissal of the case.

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

Lu Jianming v. Shanghai Light Industry Machinery Company, Limited, Shanghai Jingan District People's Court, Shanghai No. 2 Intermediate People's Court, 2006 (Huai Xiaofeng 2007: 189-194).

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

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

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

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

Facts Determined by The Court of First Instance: The Shanghai Jingan District People's Court determined the following: From February 16, 2005 to the time of suit in 2006, the Plaintiff owned 100 shares of the Defendant Company. On March 19, 2004, the *Shanghai Securities Daily* carried the Defendant Company's 2003 Annual Report summary. Under the heading "Changes in Shareholdings of Directors, Supervisory Board Members and Senior Management", it stated "Ms. Shi is a director of the [Defendant] Company from April 29, 2003 to April 28, 2006"; in a separate column describing the employment of board and supervisory board members, it stated "From October 2001 to the present, Ms. Shi has been employed at Shanghai Erdi Group Limited." On March 25, 2006, the *Shanghai Securities Daily* carried the Defendant Company's 2005 Annual Report summary, and board resolutions passed by the 13th meeting of the Defendant Company's 4th Board, and announcement for convening of the 15th General

Shareholders' Meeting. Resolution No. 9 contained in that announcement was simply that Ms. Shi be nominated as a director for the Defendant Company's 5th Board. The same announcement contained background information on the board nominees, and in the materials on Ms. Shi her employment at Shanghai Erdi Group Limited was not raised. Finally, in the Defendant Company's 2005 Annual Report publicly posted on the Shanghai Stock Exchange website in March 2006, it stated that between April 2003 and March 2004 Ms. Shi worked at Shanghai Erdi Group Limited and that from April 2004 to that date Ms. Shi had been the Defendant Company's Deputy General Manager (Vice President) and a board director.

Judgment of the Shanghai Jingan District People's Court: First, the Court holds that under the 2006 Company Law shareholders may bring an action in the People's Courts for invalidation of board resolutions in cases where a board meeting has been improperly convened, the method of voting violates law, administrative regulation or the company's Articles of Association, or the content of the challenged resolution violates the company's Articles. Thus, in trying to determine whether or not a board resolution is to be invalidated, the only standard that will be applied is whether or not the resolution violates law or administrative regulation. "The Guiding Articles of Association for Listed Companies"³⁷⁵ promulgated by the CSRC are departmental regulation (*bumen guizhang*) [*i.e.*, forms or regulations issued by Ministry-level state administrative organs] and thus do not come within the scope of "law" or "administrative regulation". Second, the Defendant Company's Articles of Association stipulate only that the board of directors should send information on a board nominee's career and basic situation to shareholders, with no clear stipulation requiring information on any relationship between an actual control party and the board nominee. Accordingly, the claim that, even though the Defendant Company made public notification of Ms. Shi's career history, because it did not allude to her service at the Controlling Shareholder the resolution passed by the 13th Meeting of the 4th Board of Directors is "in violation of the Articles of Association" goes too far. Third, listed companies are not limited to newspapers in making information disclosure. In "today's information society", shareholders can also go online to research information on a listed company. Even though the Defendant Company did not make complete disclosure of Ms. Shi's career background in its Annual Report carried in "Shanghai Securities Daily", and left out mention of her past service at the Controlling Shareholder, the same (full) Annual Report with complete disclosure about Ms. Shi's past was already filed with the Shanghai Stock Exchange, and could be easily accessed by any member of the public via the Internet. Finally, the claim by the Plaintiff that the Defendant Company purposefully and with bad intent concealed Ms. Shi's past service with the Controlling Shareholder is not supported by the facts and will not be entertained. Thus, the March 2006 board meeting was convened in accordance with valid procedure, the voting was in conformity with law and regulation, and the content of the resolutions did not conflict with the company's Articles of Association – and thus the claims of the Plaintiff cannot be supported.

³⁷⁵ Note: this is the form of "mandatory" Articles of Association required of all domestically-listing companies domiciled in China (there are separate Mandatory Articles of Association for Overseas-Listing Issuers). The Court's point here is that – as a form – the stipulations in these template Articles are not themselves law or regulation, they are merely a template of provisions which should be adopted by listing companies, which the CSRC enforces by forbidding listings if a company undertaking an IPO does not have conforming Articles. It would seem in this case that, at the time of the challenged board resolution, the Articles of Association had not been changed to conform with the updated (post-2006 Company Law) version of such Guiding Articles of Association.

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

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

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

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

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