

THE CORPORATE  
GOVERNANCE  
REVIEW

SEVENTH EDITION

**Editor**  
Willem J L Calkoen

THE LAWREVIEWS

# THE CORPORATE GOVERNANCE REVIEW

The Corporate Governance Review

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This article was first published in The Corporate Governance Review - Edition 7  
(published in March 2017 – editor Willem J L Calkoen)

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Published in the United Kingdom  
by Law Business Research Ltd, London  
87 Lancaster Road, London, W11 1QQ, UK  
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Enquiries concerning editorial content should be directed  
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ISBN 978-1-910813-51-5

Printed in Great Britain by  
Encompass Print Solutions, Derbyshire  
Tel: 0844 2480 112

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# ACKNOWLEDGEMENTS

The publisher acknowledges and thanks the following law firms for their learned assistance throughout the preparation of this book:

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A&L GOODBODY

BÄR & KARRER AG

BHARUCHA & PARTNERS

BREDIN PRAT

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# PREFACE

I am proud to present this new edition of *The Corporate Governance Review* to you.

In this seventh edition, we can see that corporate governance is becoming a more vital and all-encompassing topic with each year that passes. We all realise that the modern corporation is one of the most ingenious concepts ever devised. Our lives are dominated by corporations. We eat and breathe through them, we travel with them, we are entertained by them, most of us work for them. Most corporations aim to add value to society and they very often do. Some, however, are exploiting, polluting, poisoning and impoverishing us. A lot depends on the commitment, direction and aims of a corporation's founders, shareholders, boards and management and employees. Do they show commitment to all stakeholders and to long-term shareholders, or mainly to short-term shareholders? There are many variations on the structure of corporations and boards within each country and between countries. All will agree that much depends on the personalities and commitment of the persons of influence in the corporation.

We see that everyone wants to be involved in 'better corporate governance': parliaments, governments, the European Commission, the US Securities and Exchange Commission (SEC), the Organisation for Economic Co-operation and Development (OECD), the UN's Ruggie reports, the media, supervising national banks, more and more shareholder activists and other stakeholders. The business world is getting more complex and overregulated, and there are more black swans, while good strategies can quite quickly become outdated. Most directors are working diligently, many with even more diligence. Nevertheless, there have been failures in some sectors, so trust has to be regained. How can directors do all their increasingly complex work and communicate with all the parties mentioned above?

What should executive directors know? What should non-executive directors know? What systems should they set up for better enterprise risk management? How can chairs create a balance against imperial CEOs? Can lead or senior directors create sufficient balance? Should most non-executive directors understand the business? How much time should they spend on their function? How independent must they be? What about diversity? Should their pay be lower? What are the stewardship responsibilities of shareholders? What are the pros and cons of shareholder rights plans?

Governments, the European Commission and the SEC are all pressing for more formal inflexible legislative acts, especially in the area of remuneration. Acts set minimum standards, while codes of best practice set aspirational standards. We see a large influence on 'norms' by codes and influential investor groups.

More international investors, voting advisory associations and shareholder activists want to be involved in dialogue with boards about strategy, succession and income. Indeed, far-sighted boards have 'selected engagements' with stewardship shareholders to create trust.

What more can they do to show all stakeholders that they are improving their enterprises other than through setting a better ‘tone from the top’? Should they put big signs on their buildings emphasising integrity, stewardship and respect?

Interest in corporate governance has been increasing since 1992, when shareholder activists forced out the CEO at General Motors and the first corporate governance code – the Cadbury Code – was written. The OECD produced a model code and many countries produced national versions along the lines of the Cadbury ‘comply or explain’ model. This has generally led to more transparency, accountability, fairness and responsibility. However, there have been instances where CEOs gradually amassed too much power or companies have not developed new strategies and have produced bad results – and sometimes even failure. More are failing since the global financial crisis than previously, hence the increased outside interest in legislation, further supervision and new corporate governance codes for boards, and stewardship codes for shareholders and shareholder activists. The European Commission is developing a regulation for this area as well.

This all implies that executive and non-executive directors should work harder and more as a team on policy, strategy and entrepreneurship. More money is lost through lax or poor directorship than through mistakes. On the other hand, corporate risk management is an essential part of directors’ responsibilities, and sets the tone from the top. How can directors do their important work well without being petrified of attacks from shareholders’ regulations and the press?

Each country has its own measures; however, the chapters of this book also show a convergence. The concept underlying the book is of a one-volume text containing a series of reasonably short, but sufficiently detailed, jurisdictional overviews that permit convenient comparisons, where a quick ‘first look’ at key issues would be helpful to general counsel and their clients.

My aim as editor has been to achieve a high quality of content so that *The Corporate Governance Review* will be seen, in time, as an essential reference work in our field. To meet the all-important content quality objective, it was a condition *sine qua non* to attract as contributors colleagues who are among the recognised leaders in the field of corporate governance law from each jurisdiction.

I thank all the contributors who helped with this project. I hope that this book will give the reader food for thought; you always learn about your own law and best practice by reading about the laws and practices of others. Further editions of this work will obviously benefit from the thoughts and suggestions of our readers. We will be extremely grateful to receive comments and proposals on how we might improve the next edition.

**Willem J L Calkoen**

NautaDutilh  
Rotterdam  
March 2017

# CHINA

*Sherry Gong*<sup>1</sup>

## I OVERVIEW OF GOVERNANCE REGIME

In accordance with the People's Republic of China (PRC) Company Law (hereinafter Company Law), companies in China are classified as limited liability companies (which are analogous to LLCs under some common law jurisdictions) or stock limited companies (SLCs) (which are similar to incorporations under some common law jurisdictions). A listed company, pursuant to the Company Law, refers to an SLC whose stocks are listed and traded on a securities exchange. The State Administration for the Industry and Commerce (SAIC) in charge of company registration is the major government authority supervising the corporate governance of LLCs and unlisted SLCs by reviewing the non-listed companies' incorporation documents and mandatory filings for the change of registration in accordance with the Company Law and various regulations in relation to company registration. The China Securities Regulatory Commission (CSRC) is authorised to supervise the corporate governance of listed companies in accordance with the Company Law, the Securities Law of the People's Republic of China and various listing rules. Each of the Shanghai Securities Exchange and the Shenzhen Securities Exchange has also issued non-binding guidelines for the corporate governance of companies listed on the corresponding securities exchange. In general, listed companies are subject to more stringent corporate governance requirements than non-listed companies in China.

Companies in China can also, by reference to the place of incorporation of the shareholders, be divided into foreign-invested enterprises (where the shareholders include foreign economic entities or individuals) or domestic companies (where all shareholders are Chinese entities or individuals). Foreign-invested enterprises can be set up in the form of wholly foreign-owned enterprises (WFOEs), where all shareholders are foreign economic entities or individuals; Sino-foreign equity joint venture companies (EJVs), which must get a legal personality, or Sino-foreign cooperation joint venture companies (CJVs), which is more flexible with corporate structure. Though each of WFOE, EJV and CJV is actually an LLC, a special corporate governance regime has been set up for EJVs and CJVs respectively in accordance with the Sino-Foreign Equity Joint Venture Enterprise Law and the Sino-Foreign Cooperative Joint Venture Enterprise Law.

On 3 September 2016, the Standing Committee of the National People's Congress issued a new Decision on Revising the WFOE Law, EJV Law and CJV Law, effective as of 1 October 2016. Before this new Decision, the establishment of, and changes to, a foreign-invested enterprise were subject to examination and approval by the Ministry of

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<sup>1</sup> Sherry Gong is counsel at Hogan Lovells International LLP.

Commerce (MOFCOM) or its local branch. Following this new Decision, if a foreign-invested enterprise is not engaged in any area subject to special market access administration measures, its establishment and changes only need to do a record filing with the MOFCOM. In other words, the foreign-invested enterprises approval system was simplified into a record-filing procedure. In addition, previously, changes to a foreign-invested enterprise, such as equity transfer and amendment to the articles of association, took effect upon the approval of the MOFCOM. Now, these changes will take effect upon the decision of the company's highest authority. There is a trend to harmonise the special corporate governance regime for foreign-invested enterprises with the general regime for all LLCs.

There are very strict listing rules in China and SLCs are normally transferred from the LLCs with the aim to get listed soon and thus majority companies in China, especially foreign-invested companies, are LLCs. Therefore in this chapter, we focus mainly on the corporate governance of LLCs with reference to non-listed SLCs where necessary.

## **II CORPORATE LEADERSHIP**

### **i Board structure and practices**

For LLCs and SLCs, the shareholders' meeting is the highest business-decision-making body of the company and the board of directors is the enforcement organisation of the shareholders' meetings. As for LLCs with relatively few shareholders or of a relatively small size may have one executive director as an alternative of the board of directors. The executive director may concurrently hold the post of the manager of the company. A special rule for EJVs and CJVs is that they are not required to hold shareholders' meetings, in which case, the board of directors is the highest authority in lieu of shareholders' meetings.

#### ***Composition, appointment and dismissal***

##### *Number of board members*

LLCs shall have a board of directors that is to be composed of three to 13 members unless the executive director structure is adopted in lieu of a board of directors. SLCs shall have a board of directors that is to be composed of five to 19 members. EJVs and CJVs typically have boards of directors consisting of no less than three directors.

##### ***Elections***

Directors who are not the representatives of the staff members are elected and appointed by the shareholders by a simple majority unless the articles of association provide otherwise. For EJVs and CJVs, the shareholders will agree on the number of directors appointed by each shareholder in the joint venture contract and the directors will be appointed by a shareholder without going through the election process.

##### ***Representatives of the staff members***

The Company Law has special requirements for appointing the representatives of the staff members as directors. In the case of an LLC established with investment from two or more state-owned enterprises or two or more other types of state-owned investing parties, the members of its board of directors must include the representatives of the staff members of the company; in the case of any other LLC and SLC, the members of its board of directors may include representatives of the staff members of the company. The representatives of the

staff members in the board of directors shall be elected democratically through a general meeting of the representatives of the staff members, general meeting of staff members, or in other forms.

### ***Chairman***

The board of directors must have a chairman. For LLCs, the methods for election of chairman shall be specified in the articles of association. For SLCs, the chairman shall be elected by more than half of all the directors. Chinese laws do not make a distinction between executive directors and non-executive directors. The chairman has no additional cast voting at board meetings unless the articles of association provides otherwise.

### ***Legal responsibilities***

#### ***Statutory powers***

The Company Law grants certain statutory powers to the board of directors or executive director (the statutory powers) in both LLCs and SLCs as below, to:

- a* be responsible for convening shareholders' meetings and presenting reports to the shareholders' meeting;
- b* implement resolutions adopted by the shareholders' meeting;
- c* determine the company's business plans and investment plans;
- d* prepare annual financial budget plans and final accounting plans in relation to the company;
- e* prepare profit distribution plans for the company and plans for making up any losses suffered by the company;
- f* prepare plans for increasing or reducing the company's registered capital and for issuance of corporate bonds;
- g* formulate plans for mergers, divisions, changes of corporate form or the dissolution of the company;
- h* determine the company's internal management structure;
- i* determine the appointment or removal of the company's manager and determining matters relating to his remuneration, appointment or removal, and upon the manager's recommendation, the appointment or removal of deputy managers of the company, the officer in charge of finance, and matters relating to determining their remuneration; and
- j* formulate the basic management system for the company.

The board of directors can be granted such other powers as are prescribed in the company's articles of association. There is no rule prohibiting any restriction of non-statutory powers.

The resolutions of the board of directors can be overridden by a resolution of a shareholders' meeting, in which case, the matter will be returned to the board of directors for reconsideration.

### ***Right to sue***

As in the case of derivative actions by shareholders, where supervisors acting in breach of their duties cause losses to the company, the board of directors or the executive director may file an action with court upon the written request of the aforesaid shareholders.



### ***Power of convening interim shareholders' meetings***

For LLCs, an interim shareholders' meeting must be held if so proposed by the shareholders representing more than one-tenth of the voting rights, or more than one-third of the directors or board of supervisors or supervisors in lieu of the board of supervisors. For SLCs, an extraordinary general meeting shall be held within two months where the board of directors deems it necessary to hold the extraordinary general meeting.

### ***Special committees***

The board of directors of a listed company shall, according to the relevant resolution of the general meeting of shareholders, establish special committees for strategies, auditing, nomination, remuneration and assessment, etc. Members of the special committees shall be composed of directors. Each special committee shall be responsible to the board of directors, and the proposals of each special committee shall be submitted to the board of directors for examination and decision. Chinese financial regulators require certain financial institutions to have special committees in the board of directors.

### ***Board meetings***

The meetings of the board of directors shall be convened and presided over by the chairman of the board of directors. One person shall be entitled to only one vote in voting on a resolution of the board of directors.

For LLCs, the rules of procedure and voting procedures of the board of directors shall be set forth in the company's articles of association. For SLCs, the board of directors shall convene at least two meetings annually. Shareholders representing more than one-tenth of the voting rights, more than one-third of all directors, or the board of supervisors may propose to convene an interim meeting of the board of directors. A meeting may be held only when more than half of all the directors are present. A resolution of the board of directors shall be passed by more than half of all the directors.

## **ii Directors**

### ***Term, qualification and remuneration***

For LLCs and SLCs, the term of office of a director of a company shall be specified in the company's articles of association, subject to a maximum of three years. The term of office of a director may be renewed upon expiry thereof in the case of successful re-election.

Under the Company Law, the following circumstances will disqualify a candidate (disqualified person) from serving as a director of a company:

- a* the person does not have legal capacity;
- b* the person was criminally penalised for economic offences in the past five years;
- c* the person was a director or the person in charge of an enterprise that was declared bankrupt in the past three years and that person was responsible for the bankruptcy;
- d* the person was the legal representative of an enterprise, with respect to which the competent authority revoked its business licence or issued a closure order against that company in the past three years; or
- e* the person is in significant indebtedness that has become overdue.

The appointment of a disqualified person to serve as the director is void. A director who has become a disqualified person during the term of his or her appointment must be removed from the office.

For LLCs and SLCs, the shareholders' meeting has the right to decide the remunerations of the directors and supervisors. SLCs shall regularly disclose to its shareholders information on the remunerations received by the directors, supervisors and senior management personnel from the company.

### ***Liability***

#### ***Fiduciary duty and duty of care***

A director owes a fiduciary duty to the company and is prohibited from engaging in the following activities under the Company Law:

- a* misusing company funds;
- b* depositing funds owned by the company in an account in his or her own name or in another person's name;
- c* lending company funds to others, or using company funds to provide security to others in breach of the provisions of the company's articles of association, and without the consent of the shareholders' general meeting, the shareholders' meeting or the board of directors;
- d* entering into a contract with the company, or entering into a transaction in breach of the provisions of the company's articles of association, or without obtaining the consent of the shareholders' general meeting or the shareholders' meeting;
- e* taking advantage of his position to appropriate for himself or herself or a third party a commercial opportunity that should belong to the company, or himself or herself or for the benefit of third party operating a similar business as that of the company in which he holds office, without obtaining shareholders' general meeting or shareholders' meeting consent;
- f* appropriating the commission for a third party's transaction with the company for himself or herself; or
- g* revealing company secrets without authorisation.

Gains made in breach of the aforementioned fiduciary duties can be claimed by the company.

A director owes a duty of care to the company under the Company Law and the General Provisions of the Chinese Civil Code. A director must exercise due care in the course of exercising his or her statutory powers as well as other powers provided in the articles of association. The director also has a duty to comply with the requirements stipulated in the relevant laws, regulations, and the articles of association of the company.

#### ***Conflicts of interest***

As noted above, the director is prohibited from engaging in competing with the company for business without the consent of the shareholders or the board of directors.

#### ***Liability for compensation***

The director who makes use of his or her affiliation to prejudice the interests of the company shall be liable for compensation if he or she causes any loss to the company.

For SLCs, the directors shall be liable for the resolutions of the board of directors. If a resolution of the board of directors is in violation of laws, administrative regulations, the company's articles of association or a resolution of its general meeting, and causes heavy losses to the company, the directors who participated in adopting the resolution shall be liable for compensation, with the proviso that a director may be exempted from liabilities if it is proved that he or she expressed objections at the time of voting and the objections were recorded in the meeting minutes.

Where any director violates laws, administrative regulations or the company's articles of association during the performance of duties, he or she shall be liable for compensation if any loss is caused to the company.

For SLCs, directors are obliged by statute to establish a liquidation committee in the event of dissolution, as well as fulfil other obligations in relation to the preservation of assets of the companies. Failure to discharge these duties will make the directors jointly and severally liable to creditors to the extent of the losses so caused. These obligations are not applicable to directors of LLCs, with respect to which, these obligations are imposed upon shareholders.

### ***Other duties***

#### *Duties owed to the company*

The directors owe a fiduciary duty and a duty of care to the company. The company can sue the directors who have breached these duties. The board of supervisors is also entitled to sue the directors in the name of the company.

#### *Duties owed to shareholders*

The directors owe a duty of care to shareholders. The directors shall attend a shareholders' meeting or a general meeting and accept the inquiries from shareholders upon the requirement of the meeting. The directors who acted in breach of laws, regulations, or the articles of association of a company, thus causing losses to a shareholder, can be sued by the shareholder.

#### *Duties owed to creditors*

As noted above, in the case of liquidation, directors of SLCs can be sued by creditors when they fail to fulfil some certain obligations by statute.

The directors registered on the official registrar of the relevant company can be sued. The concept of shadow director or *de facto* director is not recognised under Chinese laws.

### ***Outside director***

In China, only listed companies and some state-owned companies are required to have outside directors who are normally professionals such as lawyers and accountants.

## **iii Special governing bodies in China**

### ***Supervisory board***

#### *Elections*

Supervisors who are not the representatives of the staff members are elected and appointed by the shareholders by a simple majority unless the articles of association provide otherwise. The directors or senior management personnel shall not concurrently hold the posts of supervisors.

### ***Number of members of the supervisory board***

LLCs and SLCs shall have a board of supervisors that is to be composed of at least three members. LLCs with relatively few shareholders or of a relatively small size may have one or two supervisors instead of a board of supervisors.

### ***Representatives of the staff members***

For LLCs and SLCs, the board of supervisors shall include representatives of the shareholders and an appropriate proportion of representatives of the staff members of the company. The specific proportion of the latter shall be specified in the company's articles of association, subject to a minimum of one-third. The election method of representatives of the staff members as supervisors is the same as that of the directors.

The term of office of a supervisor shall be three years. The term of office of a supervisor may be renewed upon expiry thereof in the case of successful re-election. The circumstances that will disqualify a candidate from serving as a supervisor are as same as those conditions specified above in the qualification of directors. The board of supervisors shall have one chairman. For LLCs and SLCs, the Chairman shall be elected by more than half of all the supervisors.

### ***Legal responsibilities***

#### *Statutory powers*

The board of supervisors or, in the absence thereof in a company, the supervisors shall exercise the following powers:

- a* conducting inspection of the financial issues of the company;
- b* supervising the performance of duties by the directors and senior management personnel, and submitting a proposal on the removal of any director or senior management person who violates laws or administrative regulations, the company's articles of association, or any resolution of the shareholders' meeting;
- c* requiring the directors or senior management personnel to correct their conducts that prejudice the interests of the company;
- d* proposing to convene interim shareholders' meetings, and convening and presiding over shareholders' meetings when the board of directors fails to perform the duties of convening and presiding over shareholders' meetings as specified in this Law;
- e* putting forward proposals to the shareholders' meeting; and
- f* filing actions against the directors or senior management personnel in accordance with the Company Law.

For most LLCs, the board of supervisors or the supervisors usually take passive roles in practice without much involvement in the operation of the company.

#### *Power of questioning*

The supervisors may attend the meetings of the board of directors as non-voting participants, and may raise questions or suggestions on the matters decided by the board of directors. The board of supervisors or, in the absence thereof in a company, the supervisors may conduct investigation when discovering any abnormality in the operating conditions of the company.

*Right to sue*

As in the case of derivative actions by shareholders, where a director or senior management person acting in breach of their duties causes losses to the company, the board of supervisors may file an action with court upon the written request of the aforesaid shareholders.

***Liability***

*Fiduciary duty and duty of care*

A supervisor shall abide by laws, administrative regulations and the company's articles of association. They shall be faithful and diligent to the company. No supervisor may, by abusing their powers, take any bribe or other illegal gains, or encroach on the property of the company.

*Liability for compensation*

The supervisor who makes use of their affiliation to prejudice the interests of the company shall be liable for compensation if he or she causes any loss to the company.

Where any supervisor violates laws, administrative regulations or the company's articles of association during the performance of duties, he or she shall be liable for compensation if any loss is caused to the company.

***Other duty***

Where a supervisor is required to attend a shareholders' meeting or a general meeting as a non-voting participant, the supervisor shall do so and accept the inquiries from shareholders.

***Legal representative***

In China the legal representative has a statutory power and apparent attorney to represent the company in commercial transactions and before the government authorities, arbitration tribunals or a court. The legal representative may only be served by the chairman and the general manager of the company. The legal representative can be held responsible for the harmful acts or omissions of the company even where he or she has no actual knowledge of the actions or omissions, such as when the company causes environmental damage or there is non-compliance with health and safety standards of the company.

Because of the significance of the position, the legal representative is also normally the chairman of the board of a purely domestic company, or sometimes a general manager or a factory head for state-owned enterprises. He or she has the authority to represent the company to enter into commercial transactions, to conduct litigation in the name of the company, and to transact business with the government authorities in relation to administrative matters.

The company may restrict the authority of the legal representative in the articles of association or shareholders' agreement. In the event that the legal representative acts outside his or her scope of authority, the company will be entitled to claim damages suffered as a result of the *ultra vires* of the legal representative. However, this restriction will not be binding on any relevant third party unless the third party is acting in bad faith in the sense that it has actual or attributed knowledge on the restricted authority of the legal representative.

### III DISCLOSURE

As mentioned above, the focus of this chapter is LLCs instead of listed companies. For private companies, disclosure is more of an issue for protecting the interests of minority shareholders. In accordance with the Company Law, shareholders of an LLC are entitled to inspect and take copies of the articles of association, the minutes of shareholder meetings, the minutes of board meetings, the minutes of supervisory board meetings, and financial accounting reports relating to the company.

Shareholders of an LLC are also entitled to inspect the accounting books of the company. To inspect the accounting books, a shareholder must submit a written application to the company stating the purpose of the inspection. In the event that the company has reasonable grounds for thinking that the purpose of the shareholder in inspecting the accounting books is inappropriate, and is likely to prejudice the legitimate rights and interests of the company, the company may refuse to allow inspection, and shall, within 15 days of the date on which the shareholder submits its written application, give a written reply to the shareholder stating the reasons for refusal to grant access. In the event that the company refuses to allow inspection, the shareholder may apply to the People's Court to compel the company to allow inspection.

### IV CORPORATE RESPONSIBILITY

There are no specific legal requirements in China regulating corporate social responsibility of non-listed or listed companies. However, more and more major companies are aware of the issues and are taking corporate social responsibilities in certain forms, such as establishing charity funds and breaking the glass ceiling for women.

### V SHAREHOLDERS AND SHAREHOLDERS' MEETING

Companies are established based on the capital contribution of shareholders. In accordance with the Company Law, a LLC shall have no more than 50 shareholders while an SLC shall not exceed 200, and by deciding clause of articles of association and choosing directors and managers, shareholders control the company.

#### **i Shareholders' rights and liabilities**

After registering in the shareholder register book, shareholders can start to enjoy their various rights:

- a* right to know (inspect the accounting books; inspect and duplicate the company's articles of association, the minutes of the shareholders' meetings, the resolutions of the board of directors, the resolutions of the board of supervisors, and the financial and accounting reports of the company);
- b* rights to vote (in proportion to their respective capital contributions with each share having equal voting power);<sup>2</sup>
- c* rights to receive dividends (in proportion to the actual capital contributions paid up by them);

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<sup>2</sup> China does not recognise different classes of shares in general.

- d* rights to get remaining property after liquidation of the company; and
- e* right to sue (for damaging interests or unlawful procedure of meetings; directly or indirectly).

As for liabilities, any shareholder of a company that has caused any loss to the company or to other shareholders by abusing shareholder's rights shall be liable for compensation in accordance with the Company Law. If any shareholder of a company evades debts by abusing the independent legal person status of the company or by abusing the shareholder's limited liabilities, thereby gravely prejudicing the interests of the creditors of the company, the shareholder shall be jointly and severally liable for the debts of the company.

## **ii Dissenting shareholders' rights**

Although a general redemption right is not available to shareholders in China, under any of the following stipulated circumstances, a shareholder of a company who votes against a resolution of the shareholders' meeting may request the company to redeem their equity in the company at a reasonable price:

- a* where the company fails to distribute any profit to its shareholders for five consecutive years, while being profitable during those five consecutive years and satisfying the conditions on profit distribution specified in this Law;
- b* where the company is merged or divided, or it transfers its primary property; or
- c* where upon the expiration of the term of operation specified in the company's articles of association or the occurrence of any other cause of dissolution specified therein, a resolution is adopted at a shareholders' meeting to modify the articles of association to the effect that the company continues to exist.

If the shareholder fails to reach an agreement with the company on equity redemption within 60 days after the resolution of the shareholders' meeting is adopted, the shareholder may file an action with a competent people's court within 90 days after the resolution of the shareholders' meeting is adopted.

And where a company faces difficulty in operations and management such that the interests of its shareholders will suffer heavy losses if the company continues to exist, and there is no other way to resolve the problem, the shareholders representing more than 10 per cent of the voting rights of all the shareholders of the company may file a request with the competent people's court to dissolve the company.

According to a judicial interpretation of Supreme People's Court, difficulty in operation and management refers to situations as:

- a* the company fails to hold a shareholders' meeting or a general meeting of shareholders for at least two consecutive years, and the operation and management of the company encounters severe difficulties;
- b* the proportion required for adopting a resolution during a vote does not reach the statutory proportion or the proportion specified by the articles of association of the company, and no valid resolution of the shareholders' meetings or the general meetings of shareholders have been reached for at least two consecutive years, and the operation and management of the company encounters severe difficulties;
- c* conflict exists among the directors of the company for a long time, which cannot be settled through the shareholders' meetings or the general meetings of shareholders, and the operation and management of the company encounters severe difficulties; or

- d* other circumstances where the operation and management of the company encounters other severe difficulties and the continuance of the company's existence may cause major losses to the interests of the shareholders.

### **iii Derivative action**

Derivative Action also applies under the Company Law. Where a director, supervisor or senior management person violates laws, administrative regulations or the company's articles of association during the performance of duties, the shareholders of an LLC, or one shareholder of an SLC who holds, or several shareholders thereof who jointly hold, at least 1 per cent stake in the company for at least 180 consecutive days, may submit a written request to the board of supervisors (if to sue a director or senior management person) or board of directors (if to sue a supervisor) to file an action with the competent people's court. Where the board of supervisors or board of directors refuse to or fail to file an action within 30 days or where the failure to immediately file an action in an emergency case will cause irreparable damage to the interests of the company, the shareholders specified in the preceding paragraph may, in their own name, directly file an action to the competent people's court for the interest of the company.

Where any other person infringes upon the legitimate rights and interests of the company and causes losses thereto the shareholders specified in previous paragraph may also file an action with the competent people's court pursuant to the procedure above.

### **iv Shareholders' meeting**

The shareholders are the highest authority of a company and exercise their authority at shareholders' meetings, except that wholly state-owned companies, EJVs and CJVs are not required to hold shareholders' meetings, and in that case, the board of directors ascends.

As the company's governing body, the shareholders' meeting shall exercise the following powers:

- a* making decisions on the company's operation guidelines and investment plans;
- b* electing and replacing the directors and supervisors who are not the representatives of the staff members, and making decisions on the matters concerning the remunerations of the directors and supervisors;
- c* approving the reports of the board of directors through deliberation;
- d* approving the reports of the board of supervisors or those of the supervisors through deliberation;
- e* approving the annual financial budget plans and final accounts of the company through deliberation;
- f* approving the profit distribution plans and loss recovery plans of the company through deliberation;
- g* making resolutions on the increase or decrease of the company's registered capital;
- h* making resolutions on the issuance of corporate bonds;
- i* making resolutions on the merger, division, dissolution or liquidation of the company or on the conversion of the corporate form;
- j* modifying the company's articles of association; and
- k* exercising other powers specified in the articles of association.



## **VI OUTLOOK**

The Company Law was amended significantly for the purpose of improving the corporate governance in 2006 (2006 Company Law Amendments). These amendments reduced the power of the chairman of the board of directors, emphasised the role of the board of supervisors, and clarified the duties of the directors. They also provided protections to minority shareholders.

However, there are areas for further improvement in relation to corporate governance under the Company Law. It is often argued that some of those provisions in the Company Law are drafted in a manner that is too abstract and that has rendered their enforcement difficult. Sometimes, these have given the courts considerable discretion in the application of the relevant provisions in the Company Law, which has created some uncertainties in the enforcement and observation of good corporate governance practice.

As China continues with its rapid economic development, the National People's Congress and the State Council will address these areas for improvement. In addition, the Supreme People's Court has often taken the step of issuing interpretations of laws for application by first instance and intermediate people's courts to resolve unclear topics. Given the size of the national economy and the complexity of China's bureaucracy, these improvements are not likely to come about rapidly.

There is also a trend to harmonise the special corporate governance rules for foreign-invested companies with the general rules provided in the Company Law. For example, there is no clear stipulation on a WFOE's highest authority in law. Before the 2006 Company Law Amendments, the government approval and registration authorities in China were of the view that WFOEs should follow the rules for EJVs and CJVs and thus the articles of association of a WFOE are required to provide that its board of directors is the highest authority. After the 2006 Company Law Amendments, however, as a demonstration of the trend to harmonise the rules governing foreign investment companies and the general rules in the Company Law, the shareholders' meeting is required to be set out as the highest authority of the WFOE in its articles of association. This trend can be seen in the proliferation of legislation initiatives, such as the issuance of the draft Foreign Investment Law by the MOFCOM on 19 January 2015 (Draft Foreign Investment Law) with the purpose of reforming the whole foreign investment administration regime. According to the Draft Foreign Investment Law, there should be no exceptional rules for the corporate governance of foreign investment companies after it becomes effective. The Law is still in draft form at present. Another example is the Interim Administrative Measures for Record-Filing of Establishment and Alteration of Foreign-Invested Enterprises issued by the MOFCOM on 8 October 2016, which sets forth provisions regarding the applicability of record filing, record-filing procedures, supervision and inspection, legal liability, etc., to implement the new record-filing reform introduced in October 2016, as mentioned above.

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