THE CHINESE ‘OPPRESSION’ REMEDY:

CREATIVE INTERPRETATIONS OF COMPANY LAW BY CHINESE COURTS

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Abstract:

This is the first detailed study of the Chinese oppression remedy under the PRC *Company Law* (Article 20.1-2). Compared to UK, Canadian and Australian equivalents, the wording of the Chinese remedy is vague, and the Supreme People’s Court has not clarified its meaning. Yet Chinese courts have created a body of *de facto* case precedents and made the remedy into an effective tool for minority shareholders to gain redress for a broad range of wrongs committed by abusive shareholders. Such use of case precedents should be formalized in China to bring more predictability to statutory interpretation.

Keywords:

China – oppression remedy – company law – minority shareholders – case precedents

I. INTRODUCTION:

The statutory oppression remedy has long been a staple of corporate law in most common law jurisdictions. Designed to protect minority shareholders from unfair abuse by the majority controllers of the company, the statutory remedy was initially introduced in the 1948 UK *Companies Act*, but due to narrow wording and restrictive interpretation by the English courts, it was very difficult for applicants to obtain relief. They had to prove not only that the conduct of the defendants was 'burdensome, harsh and wrongful' but that they had been harmed in their role as shareholders rather than in any other role they played in the company, such as director, employee or creditor.[1]

To give just one example of the impact of these restrictions, relief was refused in a situation where the shareholders of the company were all directors being paid directors' fees rather than shareholder dividends, and the majority then excluded a minority shareholder from the board so that the shareholder was left without any income from the company. It was held that the harm occurred to the applicant in his role *as director* rather than shareholder, so the oppression remedy did not apply.[2]

A peculiar result of this narrow interpretation was that it was often easier to obtain the drastic remedy of a winding up order on just and equitable grounds than to successfully argue

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[1] For the origins and early development of the oppression remedy in the U.K., see Paul L Davies, *Gower and Davies: Principles of Modern Company Law* (8th ed., London: Thomson: Sweet and Maxwell, 2008), 690 [hereafter referred to as *Gower and Davies*]. The 'burdensome, harsh and wrongful' requirement was stated in *Scottish Co-operative Wholesale Ltd v Meyer* [1959] AC 324.

[2] *Lundie Bros, Re* [1965] 1 W.L.R. 1051, cited in *Gower and Davies* (n 1) 690.

oppression and seek a form of relief that would allow the company to continue operating, such as a share buyout of the applicant's shares.[3]

During the 1980s, the wording of the U.K. oppression remedy was broadened to encompass 'unfair prejudice,' which courts have interpreted to include behaviour that results in unfairness to shareholders even if not intentionally unfair; and U.K. courts have since removed most of the other restrictive interpretations that hobbled the remedy, including the idea that relief would only be granted for harm against the shareholder *qua* shareholder.[4] Other common law jurisdictions such as Canada and Australia adopted even broader statutory oppression remedies – indeed, the Canadian remedy has been described by one scholar as 'beyond question, the broadest, most comprehensive and most open-ended shareholder remedy in the common law world.'[5] Thus, despite its inauspicious beginnings, the statutory oppression remedy has now become 'one of the most widely used corporate law remedies available to shareholders,'[6] and actions for oppression, or more accurately, unfair prejudice, have become even more frequent than derivative actions due to the broad set of situations that the remedy covers, the wide range

[3] *Gower and Davies* (n 1) 705; Paul Redmond, AM, *Corporations and Financial Markets Law* (Sydney: Thomson Lawbook Co, 2013) 672. This is what actually occurred in the *Lundie Bros* case, cited *supra* n.2.

[4] *Gower and Davies* (n 1) 690-1.

[5] Stanley Beck, "Minority Shareholders Rights in the 1980s," in *Corporate Law in the 80s* (Toronto: Richard De Boo, 1982) 312, cited in Bruce Welling, *Corporate Law in Canada: The Governing Principles* (London, Ontario: Scribblers Publishing, 2006) 555, n.201.

[6] Redmond (n 2) 705, citing Ian M Ramsay, "An Empirical Study of the Use of the Oppression Remedy," 27 *Australian Business Law Review* (Feb. 1999), 23.

of relief available, and the relatively simple litigation procedure that, unlike derivative actions, does not require prior leave of the court for a shareholder to bring the action.[7]

A. *The Need for Minority Shareholder Protection in China*

In his 1999 study of Chinese corporate governance, On Kit Tam declared: 'The notion of corporate governance is a new and not well understood one in China.'[8] The statement reflects the Chinese government's unfamiliarity with the intricacies of Western laws when they ventured into drafting company law legislation in 1992 as a result of the leadership's determination to place State-owned Enterprise (SOE) reform at the top of the economic reform agenda.[9] This reform resulted in the transplantation of Western concepts alien to socialist Chinese enterprises, in particular, a shareholding system and diversification of enterprise ownership.[10] The chosen model of corporate governance was strongly influenced by Anglo-American models, in spite of

[7] For studies showing that statutory derivative actions have not been very popular, at least in Australia and Canada, partly because it is usually easier for shareholders to obtain relief through oppression applications, see, for Australia, I Ramsay and B Saunders, "Litigation by Shareholders and Directors: An Empirical Study of the Statutory Derivative Action" (2006) 6 *Journal of Corporate Law Studies* 397–446 at 417 & 446 (only 31 derivative actions brought in Australia between 2000 and 2005, and only 30 in the five years prior to that). Compare with the oppression remedy, where 115 oppression applications were brought in the period from 1984 to 1997: Ramsay (n 6) at 26. For Canada, see B R Cheffins and J Dine, "Shareholder Remedies: Lessons from Canada" (1992) 13 *Company Lawyer* 89 at 94 (derivative actions not common due to availability of oppression remedy); see also Stephanie Ben-Ishai and Poonam Puri, "The Canadian Oppression Remedy Judicially Considered: 1995-2001," 30 *Queen's Law Journal* (2004), 79-113 at 81 (71 oppression judgments given between 1995-2001).

[8] On Kit Tam, *The Development of Corporate Governance in China* (Cheltenham: Edward Elgar, 1999) 7.

[9] Graham Brown and Wei Xin, "Introduction to Company Law," *A Practical Guide to China Company Law* (Singapore: CCH, 2009) 7 at 7; Chao Xi, *Corporate Governance and Legal Reform in China* (London: Wildy, Simmonds & Hill Publishing, 2009) 10.

[10] On Kit Tam (n 8) 1.

many SOEs having a German-style two-tier board structure.[11] The policy reform was driven by economic arguments that this model of corporate governance could resolve the problems of incentive misalignment in a world of incomplete contracts and bring about effective monitoring, control and accountability of corporate managers.[12] The model was particularly attractive to the Chinese government, which wanted to retain control of most large SOEs whilst introducing modern managerialism into their factories and industries to increase efficiency and improve productivity.[13]

However, this partial transplantation of Western corporate laws had mixed results. Writing in 2007, Tomasic and Andrews noted that, 'Although China's economy has grown rapidly, and its listed companies have made massive strides in recent years in adopting the superficial trappings of Western corporate governance structures, their underlying structures and cultures have not embraced these ideas in the way foreigners might expect. This is especially so in regard to the protection of minority shareholder interests. For a variety of reasons, minority shareholder interests are seen as subservient to the interests of majority shareholders.'[14] The neglect of minority interests is hardly surprising, since the controlling shareholders of listed companies were in most cases Chinese government bodies or state institutions, whose aim was not

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[11] On Kit Tam (n 8) 21; Chao Xi, *Corporate Governance and Legal Reform in China* (London: Wildy, Simmonds & Hill Publishing, 2009) 38-9.

[12] On Kit Tam (n 8) 17-9.

[13] On Kit Tam (n 8) 7-21.

[14] Roman Tomasic and Neil Andrews, "Minority Shareholder Protection in China's Top 100 Listed Companies" (2007) 9(1), *Australian Journal of Asia Law*, 88 at 110.

necessarily shareholder maximization.[15] Yet even in smaller, non-listed companies, there were serious problems with controlling shareholders abusing their powers and expropriating company assets, to the detriment of the minority.[16] And the problems were exacerbated by the fact that in the previous PRC *Company Law*, no remedies were provided for shareholders to seek relief for abuses by the majority.[17]

Thus, one of the central aims of the revisions to the *Company Law* in 2005, which became effective from 1 January 2006 (the '2006 *Company Law*'), was to increase protection for minority shareholders by providing various legal remedies to counter the widespread abuses by controlling shareholders and company managers.[18] These new remedies included derivative actions, an expanded right to challenge unlawful or *ultra vires* company resolutions, and the right for shareholders to seek a share buy-out if they dissented from major company transactions such as mergers or sale of the company's main assets.[19] Article 20.1-2 of the 2006 *Company Law* also introduced a provision on shareholder abuse, which is roughly equivalent to the statutory oppression remedies of common law jurisdictions.

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[15] See Colin Hawes & Thomas Chiu, "Flogging a Dead Horse? Why Western-Style Corporate Governance Reform Will Fail in China, and What Should Be Done Instead," 20.1 *Australian Journal of Corporate Law* (Dec. 2006): 25-54 at 29-30.

[16] See Zhao Xudong, "*Gongsifa xiugai zhong de zhongxiao gudong baohu*" (The protection of minority shareholders in the revision of the Company Law), in Zhang Qiong, ed., *Xin Gongsifa Xiuding Yanjiu Baogao* (Research Reports on the New Amendments to the Company Law) (China Legal Publishing House, 2005), vol. 2, 227-235 at 227-8, 230.

[17] Ibid.

[18] Ibid 232.

[19] See, respectively, articles 152 (derivative action), 22 (invalidation of resolutions), and 75 (share buy-out rights).

B. The Chinese 'Oppression' Remedy[20]

The wording of Article 20.2 is as follows: 'Company shareholders who abuse their rights resulting in losses to the company or to other shareholders shall be liable to compensate in accordance with the law.' Though it is clear that the defendant in an action based on Article 20.2 would be one or more shareholders, it is not certain what it would mean for such shareholders to 'abuse their rights,' and how this differs from the valid exercise of majority voting power.[21] Some guidance can be found by reading the remedy in the context of Article 20.1, which sets out general principles for determining unacceptable shareholder behaviour:

> 20.1: A company's shareholders shall obey the law and administrative regulations and the company's articles, they shall exercise their shareholders' rights in accordance with the law, and must not abuse their shareholders' rights to harm the company or other shareholders' interests; they must not abuse the separate legal personhood of the

[20] The term "oppression remedy" is widely used by legal practitioners and text writers, so we continue to use it in this paper even though China and some other common law jurisdictions such as the UK do not include the word "oppression" (or its Chinese equivalent) in their current statutory remedies. A more accurate way to describe the Chinese provision is "shareholder abuse remedy," but this wouldn't mean much to non-Chinese readers.

[21] The equivalent point of contention under the oppression remedies in common law jurisdictions would be deciding whether the defendant shareholders have treated the plaintiff "unfairly," even if technically they have the legal power to approve their conduct. See Welling (n 5) 533.

company or their own limited liability to harm the interests of the company's creditors.[22]

Presumably, therefore, the 'abuse' of 'shareholders' rights' may consist of a breach of company law or regulations, or a breach of the company's articles; yet based on the wording of the provision, there may be other kinds of abuses that are also actionable if they 'harm the company or other shareholders' interests.'

One scholar has declared, without elaboration, that this remedy 'is too vague to be capable of being enforced in reality.'[23] Yet, though vaguely worded, it shares a key feature with common law statutory oppression remedies: the protection of minority shareholders from abuse by the majority, as Clarke & Howson have noted.[24] Surprisingly, no scholars have examined the many Chinese court cases where shareholders have been sued by other shareholders or by the company itself under Article 20.1-2. As we will show, the courts have created their own set of

[22] The final phrase of Article 20.1 on "harming the interests of … creditors" relates to the statutory veil lifting provision in Article 20.3, which allows creditors to make shareholders personally liable for company debts in some circumstances. This is a different area of law and will not be discussed in this paper. For discussions on lifting the corporate veil in China under the 2006 *Company Law*, see Chao Xi, "Piercing the Corporate Veil in China: How Did We Get There?" 5 *Journal of Business Law* (2011) 413; and Hui Huang, "Piercing the Corporate Veil in China: Where Is It Now and Where Is It Heading?" 60 *American Journal of Comparative Law* (2012) 743.

[23] Hui Huang, "Shareholder Derivative Litigation in China: Empirical Findings and Comparative Analysis," 27 *Banking & Finance Law Review* (2012), 619 at 625. Later in the paper, Huang suggests one reason for the popularity of the derivative action in China is that no oppression remedy is available, so minority shareholders have no option but to bring their claims as derivative actions (ibid 648), but Huang seems not to be aware of the numerous cases brought by minority shareholders under Article 20.1-2, a provision which he dismisses as unenforceable.

[24] Donald C Clarke and Nicholas C Howson, "Pathway to Minority Shareholder Protection: Derivative Actions in the People's Republic of China," Working Paper, August 2011, p.19, n.71, available at: http://ssrn.com/abstract=1968732.

interpretative practices to turn this vaguely worded remedy into an effective tool for minority shareholders (and in some cases for companies too) to gain redress for a broad range of wrongs.

The willingness of many judges to improvise solutions when faced with legislative gaps and ambiguities within what is purportedly a code-based civil law system is surprising.[25] Yet the lack of definitive guidance from the legislation or from the Supreme People's Court ('SPC') inevitably means that courts must continue to rely on their own willingness to fill interpretive gaps in the law or on the informal use of case precedents from other courts when judging company law cases: in other words, judicial activism through creative interpretation.

C. *Interpreting Codes and the Emergence of a De Facto Case Precedent System in China*

China's current legal system is a hybrid that has incorporated elements from the civil (or continental) law systems of countries like Germany and Japan, the socialist legal system of the former U.S.S.R., and more recently influences from common law jurisdictions.[26]

Civil law influences are seen most clearly in China's reliance on written codes, statutes and regulations (*fagui*) rather than judge-made precedents when adjudicating cases in the courts.[27]

[25] Having said this, Howson has shown similar "autonomous" tendencies among judges in Shanghai, both before, and to a lesser extent after, the promulgation of the 2006 *Company Law* amendments, though he questioned whether this autonomy would continue now that the amended *Law* sets out more detailed rights and remedies: see Nicholas C Howson, "Corporate Law in the Shanghai People's Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State," 5 *East Asia Law Review* (2010), 303.

[26] Jianfu Chen, *Chinese Law: Towards an Understanding of Chinese Law, Its Nature and Development* (The Hague: Kluwer Law International, 1999), 49-55.

However, due to the vague wording of many Chinese statutes, discrepancies frequently arise in their interpretation by courts in different Chinese regions.[28] To overcome the inequity that results from such inconsistencies, the SPC occasionally issues its own Regulations (*guiding*) and Interpretations (*jieshi*) of statutes that clarify which readings of controversial points are correct, though without citing any lower court decisions directly.[29] Scholars have criticized this practice for failing to sufficiently clarify difficult issues, leading to further inconsistent court interpretations of the Interpretations;[30] and in some situations for usurping the role of the National People's Congress in making new law rather than merely interpreting existing laws.[31]

Recognizing these problems, the SPC has encouraged various experiments with Chinese-style case precedents, seeking to provide more up-to-date guidance to courts yet without giving them free rein to 'make law' by themselves. The SPC's own judgments are effectively binding on all lower courts, and the SPC also has a longstanding practice of publishing 'case examples' (*anli*) in the *SPC Gazette*, drawn selectively from decisions made by lower courts throughout the

[27] Wang Chenguang, "Law-making Functions of the Chinese Courts," 4 *Frontiers of Law in China* (2006): 524 at 525-6.

[28] Stanley Lubman, "Looking for Law in China," 20.1 *Columbia Journal of Asian Law* (Fall 2006) 1 at 36-8.

[29] Wang (n 27) 531-2.

[30] Stanley Lubman (n 28) at 37.

[31] Wang Chenguang (n 27) 535, 545. Some of these problems may be overcome by the (probably unique) Chinese practice of "seeking advice," whereby a lower court faced with a difficult legal issue telephones or sends a message to its superior Provincial Peoples Court, or even the SPC itself, and receives informal guidance on how to decide the issue in the relevant case. Though not binding as such, the guidance will normally be followed. Yet this opaque practice has fallen out of favour in recent years, except in major or highly complicated cases, as lower courts have been encouraged to become more autonomous in deciding cases without external interference. Communist Party influence over politically sensitive cases is also common in China through the appointment of Party members to influential positions in Chinese courts, and the ability of local Party Committees to control the hiring and removal of judges in their region. This is one of the main "socialist" features of the Chinese legal system. See Randall Peerenboom, *China's Long March toward Rule of Law* (Cambridge University Press, 2002), 280-1, 284-5, 314-5.

country.[32] A summary of each case is included with commentary by the SPC on the key legal issues. Such case examples are not legally binding and cannot be directly cited in the judgments of other courts, but they are tacitly accepted as authoritative statements of the law by lower courts on the specific issues contained in the cases.[33] Since 2010, the SPC has sought to give more weight to its tacit approval of 'case examples' in the *SPC Gazette* by creating an explicitly endorsed system of 'guiding cases' (*zhidaoxing anli*) that all courts in China are instructed to 'refer to' when deciding similar issues of fact and law.[34]

Alongside these Chinese-style case precedent experiments, following the rapid growth of the internet in China since 2000, many courts throughout the country began to post their judgments on their websites with the encouragement of the SPC. The initial aim was to reduce corruption by making judges' decisions more transparent, and to improve the quality of judgment writing by having complete judgments publicly available rather than merely the kinds of brief case summaries published in edited collections and the *SPC Gazette*.[35] While not originally

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[32] For a detailed study of this practice, see Liu Nanping, *Judicial Interpretation in China: Opinions of the Supreme People's Court* (Hong Kong: Sweet & Maxwell Asia, 1997).

[33] Ibid 151-7; Wang (n 27) 541-2. Since the early 2000s, the SPC has also permitted experiments by local courts with case precedents. Most notably, Tianjin Municipality introduced a system where precedents are selected and adopted by the trial committee of the Tianjin City High Court and followed as guidelines by all the courts in Tianjin, including the High Court itself, two intermediate courts, and a number of city courts. See Chris X. Lin, "A Quiet Revolution: An Overview of China's Judicial Reform," *Asian Pacific Law & Policy Journal* (Summer 2003), 225 at 300-3; and for more detailed analysis of this and other local experiments, Xu Jinghe, *Zhongguo panli zhidu yanjiu* (Research on China's case precedent system) (Beijing: Zhongguo jiancha chubanshe, 2006), esp. 75-82.

[34] The guiding cases are published on the SPC website at http://www.court.gov.cn/spyw/ywdy/alzd/. See English translations of around 22 guiding cases at Stanford Law School's China Guiding Cases Project: http://cgc.law.stanford.edu/guiding-cases/. This site also contains useful information on the origins and significance of guiding cases in China, and is regularly updated.

[35] For earlier online databases and their justification, see Colin Hawes, "Seeds of Dissent: The Evolution of Published Commercial Law Court Judgments in Contemporary China," 5 *Australian Journal of Asian Law* (2003), 1-41 at 30.

intended to facilitate reference by judges and lawyers from other courts, the exponential growth of these online judgments and their consolidation into searchable national databases such as the Chinacourt.org site has made it almost inevitable that such informal cross-referencing will take place, especially when difficult legal issues or vague statutes are involved.[36]

The SPC has not endorsed the unfiltered use of online court judgments as case precedents. But unfortunately, its adoption of the 'guiding cases' approach continues to reflect a top-down mentality that reduces the utility of these cases to lawyers and judges. It takes too long for cases to be selected – only 26 guiding cases were published between 2010 and early 2014, approximately 8-10 cases per year, with most of these originally adjudicated at least two years prior to being selected. And the cases often leave open more questions than they answer.[37] In the area of corporate law, only four guiding cases have been approved, none of which deals with the 'oppression' remedy, so they are irrelevant to courts seeking guidance on this remedy.[38] Thus the

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[36] For the Chinacourt judgments database, see http://www.chinacourt.org/paper.shtml. For a recent announcement by the SPC that Chinese courts should send all their judgments to be published on a national online case database, see Li Hong, "Quanguo fayuan caipan wenshu jiang jizhong yu tongyi wangluo pingtai gongbu," 27 November 2013, available on the SPC's website at: http://www.court.gov.cn/xwzx/sytp/201311/t20131127_189869.htm . Based on this announcement, the Chinacourt database will be subsumed into a new, more comprehensive, Chinese Judgments Network (*Zhongguo caipan wenshu wang*), but at time of writing the new Network is not yet publically available.

[37] For example, the SPC's commentary to Guiding Case 9, which deals with the liability of shareholders who have delayed beginning the liquidation of an insolvent company, declares that courts should find all shareholders personally liable for delays that lead to losses to creditors, even when those shareholders never took part in managing the company, but it does not clarify how long the liquidation process should take once it is started, which has been a point of contention in several cases. See a translation of this Guiding Case at http://cgc.law.stanford.edu/wp-content/uploads/2013/04/CGCP-English-Guiding-Case-9.pdf. One professor at Beihang University criticized Guiding Cases 1 & 2 in similar terms: "The main points of the adjudication are overly concise, and some facts of the case stated later have been simplified. Therefore, the rules as set in the main points of the adjudication remain abstract, like legislation." Prof. Huang Hui, quoted on China Guiding Cases Project website at https://cgc.law.stanford.edu/guiding-cases/guiding-case-1/ (accessed 3 February 2014).

[38] They are Guiding Cases 8-10 and 15, dealing with the following issues respectively: application by shareholders to dissolve the company under Article 183; liability under Article 20.3 (veil lifting provision) for delays in commencing company liquidation; rules for invalidating directors' resolutions under Article 22.2; and liability of

positive impact of the guiding cases in terms of bringing about consistent interpretation by lower courts is likely to be extremely limited for many years to come.

By contrast, the currently available online case databases provide a much more useful resource for Chinese lawyers and judges endeavouring to deal with a range of corporate law cases every day. The database we used for this study, Westlaw China, contains over 1.6 million judgments in total (covering all areas of Chinese law), and is updated frequently.[39] This gives remarkable specificity when one searches by statute name and article number. For example, we located 72 judgments specifically addressing the Chinese oppression remedy in Article 20.1-2.

With the growing availability of published judgments, it is likely that creative interpretations by courts to resolve ambiguities or gaps in the statute, if reasonable, will quickly be followed by courts elsewhere, albeit without acknowledgment or citation. Thus through online publication of judgments and informal cross-referencing by judges, a body of accepted practice builds up enabling courts to continue their work of adjudication while maintaining the required fiction that they are merely applying the law, not 'making' new law.[40]

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affiliated companies under Article 20.3 for each others' debts due to commingling of assets, with reference to each company's separate entity status under Article 3.1.

[39] These are cases in Chinese, for which the complete judgments are included. There are currently only around 4,600 case head notes available in English and no complete English translations of cases. Information on numbers of cases comes from the Westlaw China site at http://app.westlawchina.com.ezproxy.lib.uts.edu.au/maf/china/app/document?docguid=CNScopeGUID&crumb-label=Westlaw+China+Scope&crumb-action=reset#chinesescopeTypes

[40] Even the SPC seems to realize that such a de facto precedent system is beneficial: one reason the Court gives for promoting a national database of all court cases is "to ensure the correct and unified application of laws." Li (n 39).

D. Data Set for This Study

To locate cases on the Chinese ‘oppression’ remedy, we conducted a search for the Chinese phrase *gongsifa di ershi tiao* (‘*Company Law* Article 20’) on Westlaw China, one of the most comprehensive searchable national databases of Chinese court judgments. The search was limited to judgments given between January 2006 and December 2012, as the amended *Company Law* containing the ‘oppression’ remedy became effective at the start of 2006, and at the time of our search the database did not contain any judgments later than December 2012. A total of 412 cases were identified from this search, and we classified these into ‘oppression’ cases (those that relied on Article 20.1-2); and corporate veil cases (relying on Article 20.3). After removing the corporate veil cases and any lower court cases where the appeal also appears in the database, we ended up with 59 cases with shareholders as plaintiffs and another 13 cases in which the company itself was the plaintiff suing its own shareholders, for a total of 72 cases.[41] The latter category is an unusual feature of the Chinese ‘oppression’ remedy, which we will discuss further in a later section. Plaintiffs obtained either full or partial relief in 44 of these cases, giving a success rate of 61.1%. The data set included 29 cases decided by basic level courts, 39 by intermediate courts, and 4 by high courts. There was no significant difference between the success rates at the different levels.[42]

[41] The total number of cases is higher than the number of derivative action cases located by Clarke & Howson (n 24) and Hui Huang (n 23), both of whom found approximately fifty cases. However, those studies only searched up to the end of 2010 (rather than 2012 for this study), so it is likely that the use of the oppression remedy and derivative actions is more or less equally popular among Chinese litigants.

[42] Success rates for different court levels were as follows: basic = 55.2%; intermediate = 64.1%; high courts = 75%. While these figures seem to show a rise in success at higher court levels, the numbers of cases are probably too small to draw any clear inferences, especially at the high court level (only 4 cases in total). We haven’t located any cases on Article 20.1-2 decided by the Supreme People’s Court. Compare Australia, where Ramsay found a success rate of approximately 45% in oppression cases: Ramsay (n 6) 28.

While the data results provide some indication of the frequency of different legal issues and forms of relief that appear in the cases, our main focus in this paper is not on robust statistical analysis but on the reasoning of courts and how they have creatively interpreted the statutory 'oppression' remedy in a way that appears quite similar to common law-style judicial activism.

II. ANALYSIS OF ‘OPPRESSION’ CASES

A. Shareholder-Plaintiff ‘Oppression’ Cases: Categories of abuse and relief sought

Among the 59 shareholder-plaintiff ‘oppression’ cases, the alleged abuse can be broadly divided into the categories set out in Table 1:

Table 1: Types of Alleged Shareholder Abuse[43]

Category of Abusive Behaviour:	Number of Cases:
Unauthorized, unlawful or unfair payments to shareholders	16
Unauthorized or fraudulent share transfers	13
Poor management leading to company losses	10
Invalid director elections or other exclusion of shareholders from management	9

[43] Some cases involve more than one kind of alleged abuse, so the totals in this table add up to more than 59 cases. There are also two other cases that defy classification due to their uniqueness: in one case, a shareholder had been found personally liable for a corporate debt under Article 20.3 and he then brought an action under Article 20.1 suing the other shareholders for restitution, claiming that they had engaged in the same abusive behaviour. In the other case, a company had previously claimed that its own shareholder was liable for a corporate debt; when the creditor’s suit against the shareholder was dismissed, the shareholder then sued the company and the other shareholders under Article 20 for malicious prosecution.

Unauthorized shareholder agreements (not including share transfer agreements)	4
Shareholders competing with the company	4
Unauthorized appropriation of company seal or books	4
Failure to pay in capital, or unauthorized capital increase	2

In terms of relief sought, as Table 2 illustrates, the largest group of cases involves claims for compensation, but there are also sizable groups of cases where the shareholder plaintiffs are seeking non-monetary relief instead, including rescission or enforcement of company resolutions, share transfer and other shareholder agreements, and other contracts. This kind of non-monetary relief is not included in Article 20.2, which mentions only ‘compensation’ (*peichang*), but as we will show below, Chinese judges often find creative ways to justify their granting of relief in the majority of such cases. At the same time, there are also some cases where judges deny relief based on a narrow technical reading of Article 20, so vagueness is not always beneficial to the plaintiff. But in the majority of cases Chinese judges have tended to adopt a more liberal interpretation of the kinds of relief they can grant under Article 20.

Table 2: Different Forms of Relief Sought by Shareholder Plaintiffs under Article 20.1-2[44]

Relief sought:	No. of cases in which relief sought:	No. (and percentage) of cases granting relief:
Compensation	28	14 (50%)
Invalidation of company resolutions	11	8 (72.7%)
Invalidation of agreements including share transfers	12	8 (66.67%)
Enforcement of agreements	8	1 (12.5%)
Return of or access to company seal and/or books	5	2 (40%)
Winding up order	2	2 (100%)
Invalidate shareholder appropriation of company's intellectual property	1	1 (100%)

[44] In some cases, plaintiffs sought more than one kind of relief, so the total in column 2 adds up to more than 59 cases.

In the following sections, we will analyse these categories of relief and the creative interpretation of Article 20.1-2 by Chinese courts in more detail.

B. Compensation Cases and the Definition of 'Shareholders Abusing Their Rights'

Approximately half of the cases in our data set involved claims for compensation, and relief was granted in 50% of those cases. In some cases, the losses were suffered directly by the plaintiff shareholder, for example a 2009 decision of the Ningbo Municipality Intermediate Court, where the plaintiff claimed that the defendant shareholder had forged the plaintiff's signature on an agreement and on shareholder resolutions to transfer the plaintiff's shares to a third party. Rather than seeking invalidation of the share transfer, the plaintiff successfully sought compensation for the value of the shares.[45] In other cases, the losses primarily affected the company and only indirectly impacted on the shareholder, so the compensation was paid to the company rather than to the plaintiff shareholder. For example, a decision of the Shanghai No.2 Intermediate Court involving a Sino-foreign joint venture ('JV') found that the defendant shareholder (a Chinese state enterprise group) had used its power over the JV's management to secretly divert assets from the JV without shareholder authorization required under the JV's articles. The defendant shareholder was required to compensate the JV for the value of the assets removed.[46]

While the relevance of Article 20 seems clear, as both these cases involve compensation and Article 20.2 allows claims for losses 'to the company or to other shareholders,' there is little

[45] (2009) *Zhe yong shang zhong zi di 985 hao.*

[46] (2008) *Hu er zhong min wu shang chu zi di 23 hao*.

explanation of how the courts are interpreting the phrase 'shareholders … abusing their rights.' Some guidance is provided in a decision of the Jiaxing Municipality Intermediate Court in Zhejiang Province.[47] This case involved the majority shareholder of a construction company causing the management to approve several huge construction projects that committed the company to expenditures over ten times its registered capital without seeking the required shareholder authorization under the company's articles. When the company lost money on these projects, the plaintiff shareholder successfully applied under Article 20 for the offending shareholder (a joint stock company) to compensate the company for its losses. The court stated:[48]

> In the process of managing a business, it is impossible to avoid some decision-making errors, but … the consequences of such errors will normally be borne by the company, not by the decision makers. However, the precondition for this is that the decision makers, when exercising their allotted roles, have not breached the law, the administrative regulations, or the rules set out in the company's articles. The articles of Defeng Corporation clearly stipulate that all operational plans and investment projects must be decided and implemented by the shareholders in general meeting and by the board of directors…
>
> The three defendants have not provided evidence to support their claim that their investment decisions had been discussed by the shareholders, and none of the

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[47] (2008) *Jia min er chu zi di 67 hao.*

[48] Ibid.

shareholder and board resolutions of the corporation … mention the relevant investment projects.

[The defendants] … used their position as actual controllers of the corporation to make decisions that had not been authorized at properly convened meetings of shareholders or the board, resulting in investments amounting to almost ten times the registered capital [of the company]. They should be liable to compensate for the losses caused by this.

In response to arguments raised by the defendants that they lacked the intention to harm the company and that the construction projects had been approved by relevant government departments, the court also added the following interesting remarks:[49]

Even though the investment decisions of Defeng Corporation were reported to the relevant government departments for approval, those investment decisions should themselves have been initially approved by board and shareholder resolutions based on the *Company Law* and the company's articles. The legality of the investment projects cannot absolve the decision makers of liability towards others within the corporation. As for the claim that there was no malicious intent to harm the interests of the corporation and the other shareholders, this does not prevent a finding that [the defendants] abused their rights as shareholders.

[49] Ibid.

While this decision gives some sense of how courts have interpreted the phrase 'shareholder … abuse of rights,' further clarity is found in cases where courts have denied relief to the plaintiff, since the judges must explain why the behaviour in question was *not* abusive. One example comes from a 2011 decision of the Shaoyang Municipality Intermediate Court in Hunan Province. In overturning the first instance decision, which had found the company's shareholder liable, the court explained:[50]

> The key point in dispute on this appeal is whether … Xiao Shiliang's [behaviour] constituted abuse of rights. … During the period when preparations were being made to form Shaoyang Times Travel Agency Ltd., Xiao Shiliang purchased three touring passenger vehicles in his own name on behalf of the company, and while he was general manager and legal representative of the company, responsible for its day-to-day management, he dispatched vehicles to engage in passenger transport and Spring Festival holiday transport based on the operational needs of the company and in compliance with a declaration … approved by all the shareholders. Due to the company's cash flow crisis, he also borrowed money from others in the company's name and used the funds for a range of company purposes. All these actions were part of his regular employment function; they did not breach any laws, administrative regulations or rules in the company's articles. In the process of fulfilling these employment duties, various expenses were incurred, including interest on the loan, a

[50] (2011) *Shao zhong min er zhong zi di 14 hao.*

> traffic accident leading to damages, and a fine after the company failed to obtain a road transport operating licence. All these costs should be borne by the company. Since there is insufficient evidence to prove that Xiao Shiliang intentionally breached the law or the rules in the company's articles, or failed to carry out his duties in good faith, … there is no basis for the [plaintiff shareholders'] demand that he pay compensation, and Article 20 of the *Company Law* … is inapplicable to this case.

In other words, shareholders cannot claim compensation with respect to conduct by a shareholder/manager that they themselves have explicitly or implicitly authorised.

Another case, from the Mengjin County People's Court in Henan Province, deals with the central importance of proving that the abuse caused 'losses.'[51] In this case, the defendant shareholder who was also the acting general manager of the company, allowed a creditor to forcibly remove the company's main assets (two industrial washing machines) in part payment of a debt, thereby causing the company to cease operations. The defendant claimed that he was acting under duress, but did not report the removal of the assets to the police or make any efforts to recover them. The plaintiff shareholder sued for compensation from the defendant for the losses caused by this 'unauthorised' behaviour. The court agreed that the defendant's conduct amounted to 'abuse' under Article 20.2 because he should have sought prior shareholder approval under the company's articles. However, the court refused to award any compensation, as the plaintiff had not provided any evidence of the amount of losses caused by the offending behaviour. It was not sufficient for the plaintiff to simply demand repayment of his initial capital

[51] (2008) *Meng min er chu zi di 78 hao.*

investment, the court found, because there was no proof that the company's value was still the same as when he first purchased his equity.[52]

From these decisions on compensation, both for and against the plaintiffs, we can begin to trace the outlines of a relatively consistent interpretation of the phrase 'shareholder … abuse of rights.' The abuse must apparently involve some kind of breach of the company's articles, or some other clearly unlawful or fraudulent behaviour such as forging another shareholder's signature. However, where the plaintiffs themselves explicitly or implicitly approved the conduct, courts will not grant relief, as the Xiao Shiliang case shows. Demonstrating the amount of losses caused by the abuse is essential for receiving compensation. And according to at least one intermediate court, government approval of the offending transactions and the defendant's lack of intent to cause harm will not act as a defence to liability.

While it is obvious from the wording of Article 20.2 that compensation is an appropriate kind of relief for plaintiffs, there are numerous cases where plaintiff shareholders have applied for non-monetary relief under Article 20, and surprisingly these plaintiffs have been successful in the majority of published cases. We will now examine these other main categories of relief to find out how Chinese courts justify their apparently incorrect reading of the statutory provision.

C. Invalidation of Company Resolutions: Interaction of Articles 20 and 22

Based on our data set, where plaintiff shareholders sought the invalidation of company resolutions, they were successful in 8 out of 11 cases, or 72.7% of the time. Not surprisingly, 10

[52] Ibid.

of these 11 cases cite Article 22, which specifically allows shareholders to apply for a company resolution to be set aside:

> Article 22: If the content of a resolution … or the procedure for calling a meeting or assembly of shareholders[53] or a meeting of the board of directors, or the voting practices at such a meeting, breaches the law, administrative regulations, or the company's articles, a shareholder may within 60 days after the resolution is passed apply to the people's court to have [the meeting or resolution] invalidated.

One of the main hurdles for applying under Article 22 is the short limitation period of 60 days, but where plaintiffs are able to frame their argument as an 'abuse of rights' under Article 20, even though they are still seeking invalidation of a resolution, courts appear to be less concerned about the timing of their lawsuit.[54]

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[53] In the 2006 *Company Law* the term shareholder meeting (*gudong hui*) is used for limited liability companies, whereas the term shareholder assembly (*gudong dahui*) is used for joint stock companies.

[54] Among the eight cases where the court invalidated resolutions under Art 20, only one clearly states that it was brought within the limitation period. In three cases, the judgment states that the action was brought too late for Art 22, but the court still granted relief under Art 20; in three other cases, the limitation period is simply not mentioned in the judgment, but again Art 20 is cited alongside 22, which would normally not be necessary if the suit was brought on time; and in one other case, only Art 20 is cited as authority for invalidating a resolution; Art 22 is not mentioned at all. Even in the 3 cases where the court refused to invalidate the resolution, the courts seemed unwilling to base their decision completely on the fact that the plaintiff exceeded the limitation period. While 2 out of the 3 decisions included the limitation period as one reason for denying relief, the courts were at pains to point out that the plaintiffs would not have succeeded on the substantive issues anyway, due to their failure to prove a breach of law, regulations or company articles, or other shareholder abuse.

This rather cavalier attitude towards the limitation period in Article 22 was justified by the High People's Court of Jiangsu Province in an interesting way.[55] The Court invalidated several directors' resolutions engineered by the controlling Chinese corporate shareholder of a Sino-U.S. joint venture (the 'JV'). These resolutions purported to invest several million yuan of the JV's funds into the corporate shareholder's own business (a state-owned passenger transport group). However, the signatures of the directors appointed by the plaintiff shareholder to the JV's board had been forged, and they had never been informed of the board meetings where the resolutions were passed. While agreeing that the plaintiff had missed the deadline to apply under Article 22, the Court declared:[56]

> However, in this case the two relevant directors' meetings actually never took place [because they were not convened based on the notice requirements], and the resolutions were not properly approved by the prescribed number of directors, thus the issue in this case is not covered by the provisions in the *Company Law* relating to procedural irregularities at meetings of directors, and it is not appropriate to apply the rule about exceeding the limitation period set out in *Company Law* Article 22.2.

The court then declared the resolutions invalid based on Article 20.1, because they involved a shareholder abusing its rights leading to losses to the company and other shareholders. This may

[55] (2007) *Su min san zhong zi di 0146 hao.*

[56] Ibid.

be a fair result, considering that the plaintiff shareholder was not even informed that the resolutions had been passed, but it ignores the fact that Article 20 does not provide a remedy beyond compensation. In other words, the Court is reading into Article 20 an implied remedy for rescission of offending resolutions.[57]

This kind of 'creative misreading' of Article 20 to include non-monetary relief has not been approved by all courts. In a 2009 decision of the Beijing No.1 Intermediate Court, an application for invalidation of a shareholder resolution under Article 20 was dismissed, partly on the following grounds:[58]

> When company shareholders abuse their rights … under Article 20 of the PRC *Company Law*, the remedy should be compensation. This kind of compensatory liability means monetary liability for the losses caused by the harm. … It cannot be used as the basis for a claim that … the resolutions of majority shareholders in a shareholders' meeting should be invalidated. [The court then denied relief to the plaintiff because the limitation period for bringing an application under Article 22 had already passed].

[57] The Court also cited without explanation PRC *Contract Law* 52(2), which states: "In the following situations, contracts will be invalid: … (2) where there has been a malicious conspiracy to damage the interests of the state, a collective, or a third party." But to call a director's resolution a "contract" would be misleading, so this provision presumably only covers the agreements that were signed between the JV and its corporate shareholder subsequent to the passing of the resolutions, which were also invalidated by the Court.

[58] (2009) *Yi zhong min zhong zi di 7749 hao.*

However, the opinion of the Beijing No.1 Intermediate Court appears to be in the minority, at least based on the published cases.

A more principled justification for using Article 20 to effectively waive the limitation period in Article 22 is provided by the Pinghu City People's Court in Zhejiang Province in the context of a shareholders' resolution that effectively diluted the two minority shareholders' stake from 10% to 3% of the company:[59]

> [Due to the limitation period,] the court cannot support the application of the two plaintiffs for invalidation of the resolution [under Article 22]. … Yet while a company's shareholders enjoy various rights, they must also fulfil their duty to exercise those rights appropriately. … Even though the principle of majority shareholder rule is a basic foundation of the Company Law, and the will of the majority should be respected when they exercise their shareholder rights over matters that come within the scope of majority shareholder rule, the controlling shareholders must not abuse the principle of majority rule to harm the rights of minority shareholders, and in particular, must not be permitted to forcibly deprive shareholders of the rights that they have without obtaining their consent. [The court then cited Article 20.1 to invalidate the offending resolution because it effectively deprived the minority shareholders of most of the value of their shares without authorisation or compensation].

[59] (2010) *Jia ping shang chu zi di 1114 hao.*

While the willingness of the court to seek an equitable result here is admirable, it is still unclear where the court gets its power to invalidate a company resolution under Article 20. It is apparently an example of judge-made law that has been adopted by this and several other courts before and since to avoid an unfair outcome.[60]

The kind of informal case precedent approach that we are suggesting here becomes even clearer when one examines shareholder suits to invalidate 'abusive' agreements.

D. Invalidation of Agreements Involving Shareholders

A similar number of cases in our data set involve plaintiff shareholders seeking to invalidate unauthorised share transfer agreements or other shareholder agreements to divide the company's assets or allocate profits and losses. Out of twelve such cases, plaintiffs were successful in eight (or 66.67%).

Unlike company resolutions, which are supposedly governed by Article 22, there is no other remedy in the 2006 *Company Law* for shareholders who have been harmed by a share transfer agreement or other shareholder agreement.[61] To come under Article 20, plaintiffs need to

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[60] Other examples where resolutions were invalidated include a decision of the Shanghai No.2 Intermediate Court, (2012) *Hu er zhong min si shang zhong zi di 118 hao*, where the limitation period was clearly exceeded; a decision of the Beijing Haidian District Court, (2008) *Hai min chu zi di 10313 hao*, where Article 22 was not even mentioned; and three other cases where the courts cite both Article 20 and 22 in granting relief while silently overlooking the limitation period: see (2012) *Zheng min si zhong zi di 157 hao* (Zhengzhou Intermediate Court), (2011) *Hu er zhong min shang zhong zi di 743 hao* (Shanghai No.2 Intermediate Court), and (2008) *Nan fa min chu zi di 290 hao* (Chongqing Nan'an District Court).

[61] *Company Law* Article 72 states that in a limited liability company shares may be transferred with the consent of "more than half" of the existing shareholders, but gives the existing shareholders a pre-emptive right to buy those shares rather than have them sold to a third party. However, the provision does not set out any remedy if a shareholder has transferred shares without following this procedure, which doubtless explains why plaintiffs have

demonstrate that such agreements involved an abuse of rights by a shareholder that caused losses to the company or to other shareholders. Yet as noted earlier, Article 20 does not provide for rescission of contracts or other non-monetary relief. So it is interesting to find out how Chinese judges have justified such relief in the majority of cases where shareholders have requested rescission of an agreement under Article 20.

Six of the eight judgments where plaintiffs successfully challenged an agreement cited not Article 20.2, which talks about the remedy of compensation, but Article 20.1, which is simply a general prohibitory statement without any remedy.[62] Besides Article 20.1, five of the eight judgments also cited PRC *Contract Law* 52(5), which states: '52. In the following situations, contracts are invalid: … (5) those that breach enforceable laws or regulations.'[63]

A typical example of court reasoning on this point is a 2010 decision of the Lishui Municipality Intermediate Court in Zhejiang Province, which declared:[64]

> The 'partnership agreement' signed by the three defendants included provisions that impacted [the other shareholders' rights], such as whether Hengyuan Company could

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applied under Article 20 when such abuses have occurred. Article 72 only applies in the absence of alternative provisions in the company's articles. The rules for joint stock company share transfers are more detailed, but there is no pre-emptive right given to existing shareholders, and joint stock shares must generally be sold on a regulated securities exchange (see Articles 138-144).

[62] For the wording of Article 20.1 and 20.2, see pages 7-8 above. The other two judgments did not specify which subsection they were relying on.

[63] One case instead cites *Contract Law* 52(2), which invalidates contracts that result from "malicious conspiracy … to harm third parties." And a further case cites the PRC *General Principles of Civil Law* 58, which contains wording similar to *Contract Law* 52, but invalidates not just contracts but any "civil act" that breaches laws or regulations.

[64] (2010) *Zhe li shang zhong zi di 123 hao.*

> accept new shareholders and increase its capital etc. But this agreement had not been put to the vote at any meeting of the company's shareholders; still less had it been approved by shareholders holding at least two thirds of the voting rights. The agreement therefore breached the rules in the company's articles and related legislation, and it should be invalidated … based on *Company Law* Article 20.1 … and *Contract Law* Article 52(5).[65]

In other words, even though Article 20 does not provide the remedy of rescission to shareholders challenging 'abusive' agreements, courts have developed the practice of implying a rescission remedy by reading the provision in conjunction with general statements about contract invalidity in the PRC *Contract Law*. This is another example of creative interpretation by Chinese courts.

A related group of cases underscores the fact that Chinese courts are not shy to invalidate agreements involving shareholders. As we saw in Table 2, there are eight cases where plaintiffs sought to have shareholder agreements *enforced* rather than invalidated, yet the courts rejected the plaintiffs' claims in seven of these eight cases, either because they were not properly authorized by the company, or because they were unlawful. In most of the cases that were dismissed (five out of seven), the court justified its decision to invalidate the agreements by citing Article 20 in combination with *Contract Law* 52(5).

[65] The court also cited *Company Law* 44, which states the rule that shareholders holding two thirds of the votes must approve any change to the company's articles or any increase or reduction in capital, amongst other matters. But Article 44 does not include any remedy or cause of action for breaching this rule.

If the *Contract Law* allows contracts to be invalidated whenever they 'breach enforceable laws or regulations,' then the obvious question is: why cite *Company Law* Article 20 at all? Why not simply apply *Contract Law* 52(5) by itself? Though the courts do not spell out the answer, the reason appears to be that most of these agreements involving shareholders are not unlawful as such; they merely breach the company's articles. This would not automatically place them in the category of contracts that 'breach enforceable laws or regulations' because the company's articles are only internal governance rules, not government laws or regulations. But Article 20.1 specifically states that shareholders must 'comply with … the rules set out in the company's articles.' Since Article 20.1 is an 'enforceable law,' a shareholder agreement that breaches the company's articles can therefore be treated as a contract that 'breaches an enforceable law,' which makes *Contract Law* 52(5) applicable, and the agreement can thereby be invalidated. By combining these two legal provisions in such an ingenious way, the court can effectively import a remedy of contract rescission into Article 20.

It would be too much of a coincidence to expect that in the ten decisions where these two provisions have been cited together by courts throughout China, the adjudication panels decided on this counter-intuitive interpretive strategy independently, without reference to the prior published decisions of other courts.

The other categories of relief granted to plaintiff shareholders under Article 20.1-2 appear less frequently in our data set, but they display a similar tendency of Chinese courts to read into the statute various forms of relief, often by citing Article 20 in conjunction with other tangentially relevant provisions from the *Company Law*, *Contract Law*, and the *General*

Principles of Civil Law. In this way the court justifies remedies such as ordering the destruction of an unauthorized duplicate company seal and the return of or access to corporate books removed without authorization;[66] the winding up of the company when shareholder abuses have led to deadlock;[67] and a declaration that the company, not its majority shareholder or employees, has the right to apply for patent protection over an invention.[68]

In common law jurisdictions, many of these situations could be addressed through applying for a statutory injunction or compliance order.[69] But because the PRC *Company Law* lacks a general injunction/compliance provision for breaches of the *Law* or company articles, courts seeking to fashion a more flexible remedy suited to rectifying different kinds of harm to shareholders have apparently had to improvise by reading the functional equivalent to an injunction and compliance order into Article 20.

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[66] (2009) *Zheng min si zhong zi di 458 hao*; and (2011) *Qing min er shang zhong zi di 478 hao.*

[67] (2010) *Yan min er chu zi di 8 hao*; and (2010) *Shaan min er zhong zi di 32 hao.*

[68] (2010) *Yu fa min san zhong zi di 128 hao.*

[69] See, for example, *Canada Business Corporations Act*, s.247, which allows shareholders and other affected complainants to apply to restrain various specified corporate actors including the corporation itself from breaching laws, regulations and the company's articles and by-laws, or to apply for an order that such persons comply with such provisions. Welling (n 5) 528-33, discusses the application of this provision. The statutory injunction in the Australian *Corporations Act*, s.1324, fulfils a similar function for breaches of the *Act*, but for breaches of the company's articles (known as the company constitution in Australia), injunction applications can be brought under general contract law, as the constitution forms a contract between all members and with the company. See Jason Harris, *Company Law: Theories, Principles and Applications* (Chatswood, NSW: Lexis Nexis Butterworths, 2012), 130-33.

E. Who is the Proper Plaintiff under Article 20.1-2?

One tricky point that Chinese courts have wrestled with when interpreting Article 20.1-2 is the relationship between the 'oppression' remedy and the derivative action contained in Article 152.[70] This is because majority shareholders will usually control the appointment of the company's board and senior managers, and it may be the directors or managers of the company who engage in abusive behaviour towards the plaintiffs rather than the shareholders. But directors and officers owe their duties to the company, not to individual shareholders, and the company is the 'proper plaintiff' to bring an action to protect its rights. However, the corporate statutes in most jurisdictions allow certain people including shareholders to apply to bring the action where the company (i.e. the board of directors) has refused to do so.[71]

To prevent frivolous or vexatious lawsuits, these derivative actions involve a cumbersome process where the person who wishes to bring the action must first demand that the company act, and only after the company fails to act, can then request the court for leave to bring the action on behalf of the company.[72] This procedure is time-consuming, and because the alleged harm is to the company, any relief will be awarded to the company, not directly to the plaintiff shareholders.

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[70] For excellent discussions of courts' application of the Chinese derivative action and its main defects, see Clarke and Howson (n 24); and, for statistical analysis, see Hui Huang (n 23) 619.

[71] PRC *Company Law*, Art 152, which also allows the company's supervisor to bring the action. Cf. UK *Companies Act*, part 11; *Canada Business Corporations Act*, s.238-40; Australian *Corporations Act*, s.236-242.

[72] The lawsuit is still usually brought in the company's name: see, for example, Australian *Corporations Act*, s.236(2): "proceedings … must be brought in the company's name." However Huang (n 23) 637-8, notes that the company is normally listed as a third party in China. Because Chinese companies have a separate supervisor or supervisory board that is supposed to monitor the board of directors, the initial demand will generally be sent to the supervisors rather than the board of directors, unless the supervisors are themselves potential defendants. The Chinese derivative action also requires shareholder applicants in a joint stock company to be holders in aggregate of at least 1% of the voting power in the company. There is no such threshold for limited liability companies (see 2006 *Company Law*, Art 152).

For these reasons, the derivative action in most common law jurisdictions is not a popular remedy for shareholders.

Instead, shareholders will generally try to frame their claims so that they fit within the oppression remedy or other statutory injunction provisions that provide more direct relief without the procedural rigmarole of the derivative action.[73] The broad wording of modern statutory oppression remedies in most common law jurisdictions often allows this. For example, the Australian version states:[74]

> The Court may make an order [for relief] if: (a) the conduct of a company's affairs; or (b) an actual or proposed act or omission by or on behalf of a company; or (c) a resolution, or a proposed resolution, of members or a class of members of a company is either: (d) contrary to the interests of the members as a whole; or (e) oppressive to, unfairly prejudicial to, or unfairly discriminatory against, a member or members whether in that capacity or in any other capacity.

The breadth of these provisions recognizes the fact that it is often difficult to distinguish who exactly was ultimately responsible for company decisions; instead, the key point is to ascertain whether such an act or omission unfairly harmed the interests of one or more shareholders.

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[73] See n 7.

[74] Australian *Corporations Act*, s.232. The corresponding *Canada Business Corporations Act* s.241, and UK *Companies Act* s.994(1) have a similarly broad conception of who may have committed the harm.

By contrast, the Chinese 'oppression' remedy is cast in much narrower terms: the plaintiff must prove that the abuse or harm was caused by one or more shareholders ('*company shareholders* who abuse their rights': Article 20.2). Based on this wording, if the harm to the plaintiff's interests was caused by a director or senior manager rather than by a shareholder, Article 20 would not apply, and the only other available remedies would be to prove a breach of directors'/officers' duties and bring a derivative action under Article 152, or a direct action against directors/officers under Article 153. Plaintiff shareholders who have already brought their action under Article 20 will be particularly frustrated to have that action dismissed in such circumstances and be forced to re-apply under Article 152 or 153 after they have satisfied the procedural requirements for a derivative action.[75]

There is another major difference between the Chinese 'oppression' remedy and equivalent remedies in common law jurisdictions. Most oppression remedies restrict the object of harm to one or more shareholders, the Australian remedy being a typical case in point: 'contrary to *the interests of the members* as a whole; or … oppressive to, unfairly prejudicial to, or unfairly discriminatory against, *a member or members*.'[76] This is not surprising, as the oppression

[75] Our focus here has been on the derivative action in Article 152, but Article 153 apparently allows shareholders to directly sue "directors or senior managers" without going through the derivative procedure if those people have "breached laws or regulations or the company's articles" and it "harms the interests of shareholder(s)." This remedy has not been used by shareholders very frequently, however, and the success rate of plaintiffs is very low, based on the published cases. We located only 15 cases on Westlaw China where article 153 was cited between 2006 and 2012, and the plaintiff was granted relief in only 3 of these cases. The main difficulty is that shareholders have to prove they were directly impacted by the director/officer breach, as opposed to the company's interests being harmed. Article 20 is more flexible in this respect, as is clear from the discussion below.

[76] Australian *Corporations Act* (Cth. 2001), s.232(d) and (e). Cf. UK *Companies Act*, s.994(1). The corresponding *Canada Business Corporations Act* provision (s.241(2)) is broader, including harm to shareholders and other security holders (such as bondholders), creditors, and directors/officers. But the company is not included even in this "broadest" of oppression remedies!

remedy originated as a personal action providing relief to minority shareholders; it was never a remedy designed to protect the interests of the company itself.[77]

By contrast, the Chinese 'oppression' remedy is unique in including the company as a possible victim of the abusive behaviour: '20.1. Shareholders must not abuse their rights to harm *the company* or other shareholders' interests. … 20.2. Shareholders who abuse their rights resulting in losses *to the company* or to other shareholders shall be liable to compensate.' This inclusion of the company as a potential victim of shareholder abuse has had two, possibly unforeseen, consequences in the application of Article 20 by Chinese courts. On the one hand, it has led to confusion about whether a shareholder can apply for relief under Article 20 when the *company's* interests have been harmed by other shareholders, even if the plaintiff shareholder has not been directly harmed by the abuse. The drafters have blurred the lines between the oppression remedy (which normally protects shareholders) and the derivative action (which normally protects the company). This ambiguity has led to contradictory interpretations by Chinese courts.

But on the other hand, the inclusion of the company as potential victim has also resulted in lawsuits being brought under Article 20.1-2 by the company itself against its own shareholders! Since Article 20 fails to specify who can actually bring an application, courts have apparently assumed that the person who has suffered the loss or harm can bring the action. And if this 'victim' happens to be the company, then the company can sue under Article 20. We will analyse such company-plaintiff 'oppression' cases in a separate section below.

[77] Redmond (n 2) 610-11.

Turning first to situations where shareholders have brought lawsuits under Article 20 to protect the company's interests from abusive shareholders, some courts adopt a conservative approach, which is to deny relief unless the shareholder plaintiffs can prove they have also been personally harmed by the abusive behaviour. This is not so different from the prevailing approach of courts in jurisdictions such as the U.K., though the issue has still not been completely settled.[78] The approach is exemplified in a 2010 decision of the Chenzhou Municipality Intermediate Court in Hunan Province:[79]

> The *Company Law* stipulates that once the shareholders have invested their capital and established a company, the company has the full rights of a legal person to deal with its property … and the capital of the company that was invested by the shareholders is now under the sole ownership of the company. … Based on the … plaintiffs' statement of claim, the alleged harmful behaviour of the two defendants actually involved a violation of the company's property rights. If a company is being controlled by someone else or manipulated so that it no longer has any independent autonomy, one could conclude that the company has lost its independent legal person status. When this happens, the company's shareholder(s) can bring a lawsuit on behalf of the company to defend its

[78] The more common view is that where only the company's interests have been harmed, either the company should be the proper plaintiff, or the shareholder must go through the derivative action procedure instead. For discussion of the debate on this issue in UK courts, see *Gower and Davies* (n 1) 687-9; but see Welling (n 5) 534-5, for Canada, which seems to be more flexible on this point. Australian courts allow shareholders to apply either under the oppression or derivative remedies, as long as they can show in the former case that the interests of one or more shareholders have been unfairly neglected as well as those of the company: see I.P. Austin and I.M. Ramsay, *Ford's Principles of Corporate Law* (looseleaf, 2014), 10.270.

[79] (2010) *Chen min er zhong zi di 23 hao.*

rights. [The court then set out the derivative action procedure for such a lawsuit in s.152]. … But Jinxing Corporation's registration documents make it clear that from 25 May 2009 onwards, the company's legal representative has been Cao Guobing [one of the plaintiffs in this action], and the company still has its independent existence at the time of this lawsuit, so the company is perfectly capable of exercising its civil rights. There is no legal basis for Cao Guobing and the other [plaintiff] shareholders to bring this lawsuit in their own names.

The Court was apparently swayed by the fact that the plaintiff was actually the legal representative of the company (as well as being a shareholder), hence he could easily have brought suit directly in the company's name.[80]

So in this conservative approach, where the *company's* interests have been harmed by a shareholder, courts have dismissed suits brought under Article 20 when the shareholder plaintiffs failed to follow the derivative procedure in Article 152.

Other courts have adopted a more flexible approach, which is to pay lip service to the fact that the precise procedural requirements of a derivative suit have not been satisfied by the

[80] A similar result occurred in a decision of the Shanghai No.2 Intermediate Court, which dismissed an application by the plaintiff shareholder to invalidate an unauthorised transfer of Company A's trademark rights over certain cartoon figures (in other words, the company's assets) to Company B for minimal consideration. The transfer agreement was signed by Mr. Zhou, the legal representative of Company A, who held shares in both companies. While agreeing that this act by Mr. Zhou clearly harmed Company A's interests, the Court decided not to rescind the unauthorized transfer, partly on the grounds that the plaintiff "has not established on the evidence that this lawsuit, by which he is seeking relief [for the company], meets the procedural requirements for a shareholder derivative suit": (2012) *Hu er zhong min si shang zhong zi di 118 hao.* Another example of such conservative reasoning can be found in a decision of the Changning District People's Court in Shanghai: (2011) *Chang min er shang chu zi di 255 hao.*

plaintiff, but to allow the suit to proceed under Article 20 anyway, because it is obvious that the controllers of the company and their management stooges will not listen to any requests by the plaintiff shareholder to bring the lawsuit, hence it would be unfair to demand that the plaintiff go through such a futile endeavour before re-applying under Article 152.

One example of this ‘flexible conservative’ approach is found in a 2010 decision of the High People’s Court of Henan Province, which addressed a situation where a significant shareholder of the company had conspired with some of the company’s employees to apply for a patent on a high efficiency motor in the shareholder’s own name rather than that of the company. After quoting Article 20.1, the judgment states:[81]

> Huada Research Centre, a shareholder of … the company, took advantage of the fact that it was doing work for the company to secretly record its own name as the rights holder on the invention patent application for the [high efficiency motor in question], and this infringed the legal rights of [the company] and of the controlling shareholder Xinpu Corporation. Since it was impossible for [the company] to exercise its own right to sue, Xinpu Corporation can bring the lawsuit in its own name, and Huada Research Centre’s contention that Xinpu Corporation is not the proper plaintiff has no legal basis.

The rather cryptic statement that it was ‘impossible for [the company] to exercise its own right to sue’ is explained in the first instance judgment of the Zhengzhou Intermediate Court, which has

[81] (2010) *Yu fa min san zhong zi di 128 hao.*

also been published.[82] The Zhengzhou Court notes that the legal representative of the company had previously brought suit against the offending shareholder in the company's name, but the defendant had managed to get hold of the company's seal and used it to send in a request from the 'company' to withdraw the lawsuit. With the seal still under the defendant's control, it was clear that the company would not bring suit in its own name.[83]

While in the above case, the plaintiffs had clearly done enough to prove that the company would not bring the action itself, thereby complying with the spirit if not the letter of Article 152, in other cases courts have adopted an even more liberal approach. They have allowed the shareholder to apply for relief on behalf of the company under Article 20 without any mention of proper plaintiffs or derivative procedures at all. For example, in a 2009 judgment of the Zhengzhou Municipality Intermediate Court,[84] Mr. Yang, the legal representative of Golden Mango Real Estate Corporation ('Golden Mango') was also the legal representative of Golden Mango's 66% parent company ('the parent company'). The other shareholders of Golden Mango were Lu Tong and his daughter Lu Hui. In 2006, the Lu's proposed a resolution of Golden

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[82] (2010) *Zheng min san chu zi di 11 hao.*

[83] A similar result occurred in a 2011 case heard by the Fengxian District People's Court in Shanghai. The defendant, who was a shareholder and also sole executive director of the company, had allegedly mismanaged the company's finances and lost all of the company's account books and records. The plaintiff shareholder sued under Article 20 for compensation from the defendant for approximately 200,000 yuan that had gone missing from the company's account. In ordering the plaintiff to compensate the company, the court noted that the plaintiff had tried to call a shareholders' meeting to get the company to pursue the defendant, but the defendant had used his voting power to block any resolutions from being passed, therefore it was clear that the company would not be able to bring the lawsuit itself: (2011) *Feng min er shang chu zi di 1862 hao.* This decision was upheld on appeal to the Shanghai No.1 Intermediate Court: see (2012) *Hu yi zhong min si shang zhong zi di 349 hao.* Compare also a decision of the Shanghai No.2 Intermediate Court (2008) *Hu er zhong min wu shang chu zi di 23 hao,* where the plaintiffs had sent a letter demanding that the company correct various abuses, but had not directly stated that the company should bring a lawsuit against the defendants: the court held that this was sufficient to satisfy the notice requirement in Article 152, and therefore to proceed under Article 20.

[84] (2009) *Zheng min si zhong zi di 458 hao*.

Mango's shareholders to remove Yang as the company's legal representative and replace him with Lu Tong. The reason was that Yang had forged duplicate seals for Golden Mango and used them to prevent the company from selling some of its property, in defiance of the shareholders' wishes. The resolution to remove Yang was passed by the required majority and Lu Tong became legal representative and general manager of Golden Mango. However, Yang then refused to give back Golden Mango's business licence and the forged company seals, and took advantage of Lu Tong's strained relationship with his ex-wife and his position in the parent company to interfere with Lu Tong's management of Golden Mango. Specifically, Yang caused the parent company to transfer its shares in Golden Mango to the ex-wife and the daughter, Lu Hui, and they then called another shareholders' meeting of Golden Mango which ousted Lu Tong as legal representative and general manager and replaced him with Lu Hui, and elected the ex-wife as company chair.

Lu Tong brought suit in his own name (as a shareholder) claiming that these shenanigans by the parent company (represented by Yang) and Lu Hui – who were the two other shareholders officially registered with SAIC – had obstructed the normal functioning of Golden Mango and also harmed Lu Tong's rights as a shareholder. He requested an order that the other two shareholders cease infringing his rights, return the company's business licence to him, since he was the properly elected legal representative of the company, and destroy the forged company seals.

In its judgment, the court goes out of its way to explain why Lu Tong should be permitted to bring suit as a shareholder against the other shareholders, even though much of the abuse was

carried out by Yang, an officer of Golden Mango, and clearly harmed the company's interests rather than directly infringing Lu's interests as a shareholder:[85]

> The company's seal, business licence and related documents are the symbols of corporate authority, and are objects that are essential for the normal functioning of the company. Yang Zhimin, as legal representative of both Golden Mango and [its parent co], … took advantage of his position and his fraudulent claim that the company's seals had been lost to forcibly obtain possession of the company's business licence and [to create duplicate] seals. He then used these objects to interfere in the normal operations of the company, which clearly constitutes infringing the rights of Golden Mango. But the true beneficiary of this conduct was [the parent co], for which Yang Zhimin also served as legal representative. Thus it is appropriate for Lu Tong to list [the parent co] as a defendant in this lawsuit and demand that [the parent co] assume liability. When faced with the objective reality that a company's legal representative has harmed the company's interests and the company's shareholders are engaged in a power struggle, Lu Tong's lawsuit, brought in his name as a shareholder to uphold the company's interests, complies with the relevant law and regulations. [The parent co's] contention that it is not a proper defendant in this action and that Lu Tong is not the proper plaintiff therefore fails.

[85] Ibid. Note that a different case involving the same company and plaintiff, but dealing with different facts and legal issues, was brought as a derivative action in the same court: it is discussed by Clarke & Howson (n 24) 24. The citation for that case is (2009) *Zheng min er zhong zi di 718 hao.*

> In the struggle for control of the company, Lu Hui also took advantage of her possession of the company's seal and business licence to obstruct the normal operations of the company, and this too constituted an infringement on the company's authority. Thus, Lu Tong's demand that [the parent co] and Lu Hui cease their infringing activities, return the company's business licence, … and destroy the forged company seal … is supported by this court … based on Article 20 of the Company Law.

There is plenty of discussion about why the parent company and Lu Hui are proper defendants, but no real explanation of why Lu Tong is the proper plaintiff. The derivative procedure in Article 152 is not mentioned at all. One can only assume that the court is interpreting Article 20 as giving the right to shareholders to sue when the *company's* interests have been harmed by the other shareholders.[86]

While this interpretation may seem incorrect in the context of common law oppression remedies, and it is not universally adopted by Chinese courts, the inclusion of the company as a potential victim in Article 20, and the failure of the drafters to state who can bring an action under this provision, have opened the door to such a reading. The variety of approaches to the interaction between Articles 20 and 152 reveal once more the enforced creativity of Chinese courts struggling to give effect to vague and incomplete statutory provisions.[87] However, to

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[86] In a decision of the Mengjin District Court in Henan, the Court didn't mention Article 152 either, even though the judgment clearly stated that it was primarily the company's interests that had been harmed, and only indirectly the other shareholders' interests. The plaintiff was given relief under Article 20.2: see (2008) *Meng min er chu zi di 78 hao*. The facts of this case are given in the main text above, on p.23.

[87] There are thirteen cases in our data set that discuss whether the applicant is a proper plaintiff, but only six actually cite Article 152 alongside Article 20. The other seven discuss the issue, but only cite Article 20.

avoid inequitable treatment of plaintiffs, Article 20 should be amended to clarify who is the proper plaintiff when the company's interests are harmed, and what procedure that plaintiff must follow.

F. *The Company as Plaintiff Suing Shareholders under Article 20*

The other consequence of including the company alongside shareholders as a potential victim of shareholder abuse in Article 20 is that courts have allowed several suits by companies against their own shareholders. In other jurisdictions, the company is not given the right to sue under the oppression remedy because the remedy is primarily designed to protect individual or minority shareholders from unfair treatment by the majority.[88] Since the majority shareholders effectively control the company, legislators apparently have seen little point in giving the company the right to seek an oppression remedy for actions that the company has itself approved through the general meeting or board of directors. As noted above, the normal remedy for protecting the company's interests when it is controlled by an abusive majority is the derivative action brought by a shareholder or director on behalf of the company.

But our data set includes thirteen cases where the company's interests have allegedly been harmed by a shareholder, and the company has been permitted to sue for relief under Article 20. Most of these cases involve abuse by shareholders who were also acting as the company's senior manager or legal representative at the time of the abuse, and virtually all the companies had been

[88] Likewise, while most other oppression remedies do not explicitly exclude a majority shareholder from applying for relief, such cases are rare because the majority can normally use its voting power to protect against abuse by the minority. But there are a few examples of cases in Canada and the UK where majority shareholders have been granted relief for oppression: see Welling (n 5) 505; cf. *Gower and Davies* (n 1) 682, n 2.

through a recent change of control, either through share transfers or replacement of the senior managers. The new controllers were therefore seeking some form of redress for the company from the previous controller/managers for perceived abuses while they were in power. The plaintiff company was successful in eleven of the thirteen cases.

The categories of relief sought are similar to cases brought by shareholders under Article 20: seven involve demands for compensation to the company for unauthorised distribution of company assets to shareholders; four are requests for the return of the company seal, business licence and other essential company books removed by the previous legal representative/shareholder; and the other two cases involve demands for restitution from the shareholder/legal representative for company losses caused by poor management.

As noted in our discussion of non-monetary relief above, in other jurisdictions, these kinds of situations where shareholder-managers have harmed the company would normally be dealt with through an injunction application or, in jurisdictions where the articles form a contract between shareholders and the corporation, through a breach of contract action, with the company as plaintiff. Chinese courts have provided a functionally equivalent remedy through their creative interpretation of Article 20.1-2.

G. Article 20.1 Used to Deny Relief to Unworthy Plaintiffs

While the Chinese ‘oppression’ remedy is surely intended to give plaintiff shareholders (and possibly also the company) relief from abuse by other shareholders, Chinese courts have occasionally utilized the provision to *deny* relief to plaintiffs applying under other *Company Law*

remedies. In one case, brought under Article 22 to invalidate a series of shareholder resolutions amending the company's articles, the Chun'an People's Court in Zhejiang Province refused the plaintiff shareholder's request because the minority plaintiff was abusing its voting power to prevent any meetings occurring and thereby creating a deadlock.[89] The court reasoned as follows:

> [Based on the company's articles], shareholders having 80% of the votes must attend a shareholders meeting. The original purpose of this rule was clearly to protect the right of minority shareholders to participate in the company's management and decision-making via the shareholders meeting. But the plaintiff and other minority shareholders [holding 22.5% of the votes] have refused to attend any meetings since October 2004. … Clearly the plaintiffs are taking advantage of the super-majority quorum rule in the articles … to block the shareholders meeting from making any decisions according to the proper legal procedure, thereby creating a state of deadlock in which the company is unable to function normally…. This will directly harm the interests of the company and its shareholders, and will also impact the interests of all those external stakeholders with whom the company is currently engaged in construction and development projects….
>
> The plaintiffs have refused to attend any shareholders meetings, yet at the same time they are demanding the invalidation of resolutions passed at a shareholders meeting that they did not attend. This behaviour goes against the principle of good faith that shareholders should respect, and is an 'abuse of shareholder rights' by the minority. The

[89] (2008) *Chun min er chu zi di 829 hao.*

law will not support such abusive behaviour. [The court then cited Article 20.1 in dismissing the plaintiff's suit].

The Shanghai No.1 Intermediate Court used similar reasoning to deny a plaintiff shareholder's request to order the company's legal representative to hand over the company's seal and real estate certificate, based on a purported agreement between the shareholders to share custody of those objects. The court declared that the shareholders' failure to trust the company's legal representative with these objects, even in the absence of evidence that he was abusing his position, went against the principle of treating the company as a separate legal person, and therefore abused the requirement in Article 20.1 that shareholders 'comply with the law, administrative regulations and the company's articles, and exercise their shareholder rights in accordance with the law.'[90]

In these cases, Article 20.1 seems to be interpreted as creating a good faith requirement for shareholders to come with clean hands when they apply for relief under the *Company Law*.

On a slightly different tack, one court has also combined granting relief under Article 20.2 with a duty of care requirement for the plaintiffs.[91] In this case, the plaintiff shareholders had nominee directors on the board of the company, but those directors failed to request financial statements from the company's management for several years, or to notice that the company was

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[90] The court was clearly swayed by the fact that there had been numerous previous disputes between the shareholders, some involving lawsuits, over who controlled the company. See (2011) *Hu yi zhong min si shang zhong zi di 1198 hao.*

[91] See (2008) *Jia min er chu zi di 67 hao,* a decision of the Jiaxing Municipality Intermediate Court.

making huge investments in construction projects that it could not afford to complete. As a result, the court found that the plaintiff shareholders should be partly liable for the losses to the company alongside the defendant shareholder who directly caused the losses.[92] Needless to say, there is no such duty of care for plaintiff shareholders mentioned in Article 20.1-2.

H. Defining a Shareholder for the Purposes of Article 20.1-2

A final example of the creative and sometimes conflicting ways in which courts have interpreted Article 20.1-2 is in deciding who is actually a shareholder and therefore entitled to bring an action under the provision. The main problem arises when there has been a procedural defect in the registration of the plaintiff's shares; the court must decide if this defect is fatal to the application. Contrasting approaches have been adopted by courts here, with the more technical, legalistic approach exemplified by a 2009 decision of the Furong District People's Court in Changsha, Hunan Province:[93]

> The key issue in dispute here is whether or not [the plaintiff] Lu Xiu'e has the legal status of a shareholder of Heavenly Silkworm Science and Technology Company. [Lu claimed that she was one of the founding shareholders of the company, but that the legal representative had failed to record her name in the company's record of shareholders, and failed to register her name as a shareholder with SAIC].

[92] The compensation amount was reduced from around 9.7 million yuan to 8.5 million yuan to reflect this contributory negligence. Ibid.

[93] (2009) *Fu min chu zi di 1064 hao.*

Based on the rules in the Company Law, when it comes to deciding the status of a shareholder of a limited liability company, if the person in question signs the company's articles and is recorded as a shareholder in the company's articles, this will be a decisive factor in gaining the status of a shareholder. …

Secondly, if someone is recorded as a shareholder in the documents that have been lodged with the regulatory authorities, this is also convincing evidence that they should be recognized as a shareholder. . . .

Thirdly, however, paying in capital is not decisive when it comes to ascertaining the status of a shareholder, and possession of a certificate evidencing one's capital investment is not a necessary condition to become a shareholder. The capital certificate is a written statement by a limited liability company that the person owns a certain number of shares or has paid in a certain amount of capital, but by itself it cannot prove conclusively that the person has the status of a shareholder. This is because a company involves not only a contribution of capital but also a meeting of peoples' minds, so it is only when the founders sign the company's articles and thereby demonstrate that they share the intention to establish the company, that the decisive condition for them to attain the status of shareholders will be satisfied. … If they have not signed the company's articles, even if they have paid in capital to the company, it will not necessarily lead to the conclusion that there is a meeting of minds with the other shareholders to set up a company. … [The court found that even though Lu had a capital contribution certificate issued by the company, and she had participated in some management activities of the company, she had not signed the company's articles, so

based on Articles 20.1, 25.2 and 33 of the Company Law, she could not be treated as a shareholder.][94]

While it is true that shareholders are supposed to sign the company's articles, and the company should record their names in the record of shareholders, the *Company Law* is silent on whether someone whose name is not recorded on these documents can assert their right to be subsequently registered as a shareholder following agreement with the company issuing the shares and payment of capital, a right that most other jurisdictions would give in similar circumstances.[95] Article 33 only states that people can 'rely on the record of shareholders to assert their rights as shareholders,' but does not explain the consequences of the company's failure to record the person's name as a shareholder. And the company's failure to register the record of shareholders with SAIC only affects dealings with 'third parties' (Article 33); thus it presumably does not cover internal disputes among the shareholders.

Here the court has decided to interpret these provisions as preventing a person from having their status as a shareholder confirmed by the court. In justifying its decision, the court ignores the evidence mentioned earlier in the case that the three other shareholders of the company had signed an agreement with the plaintiff to establish Heavenly Silkworm, including a provision that all of them would become its shareholders; and the court also fails to take account of letters from

[94] Article 25.2 states that shareholders should sign their names and affix their personal seals to the company's articles. For Article 33, see discussion in main text below.

[95] For example, in the UK, once an agreement is signed to allot shares to a person, the person has the right to demand to have their name entered on the share register: see *Gower and Davies* (n 1) 845-6.

the company to the plaintiff in which the company refers to the plaintiff as a 'shareholder.'[96] Taken together with the issuance by the company of a capital contribution certificate to the plaintiff stating that she was a 21% 'shareholder' in the company, these documents should surely have satisfied the requirement of a 'meeting of minds' among the people who established the company – if not proving that the applicant was a shareholder then at the very least giving her the right to be recorded as a shareholder in the company's record, and subsequently enjoying the benefits of being a shareholder.

By contrast, a 2011 decision of the Ruzhou People's Court in Henan Province adopts a much more liberal approach in similar circumstances by treating the applicant as a 'de facto shareholder' (*shiji gudong*).[97] Like the Heavenly Silkworms case, there was an agreement between the parties that the plaintiff would pay in capital and become a shareholder of the company (Xukang Corporation), and the plaintiff did in fact pay in approximately 700,000 yuan, following which the company issued a capital certificate acknowledging the payment. Again, like the previous case, the two existing shareholders of the company failed to register the change of shareholders with SAIC, and no evidence was provided that the plaintiff had signed the company's articles. The two existing shareholders then took advantage of the fact that the plaintiff had been arrested and imprisoned for corruption to apply for liquidation of the company. In the liquidation process, they claimed that they were the only two shareholders (since only their names were recorded in the record submitted to SAIC), and that all creditors' claims had been

[96] See (2009) *Fu min chu zi di 1064 hao.*

[97] (2010) *Ru min chu zi di 607 hao.*

dealt with, therefore the assets of the company were divided up between these two shareholders, and the plaintiff received nothing.

In awarding the plaintiff compensation for the amount that he had paid into the company, the court did not seem troubled by the plaintiff's ambiguous status, simply declaring that when the plaintiff 'signed the agreement to purchase shares with [the two existing shareholders] and paid in the agreed-upon investment funds, he then became a de facto shareholder of Xukang Corporation.'[98] As one of the major 'shareholders,' the court held, based on Article 184 of the Company Law, the plaintiff should have been notified that the company was applying for liquidation so that he could be part of the liquidation group and receive a fair distribution of the residual amount after the company's creditors had been paid off. The fraudulent behaviour of the other two shareholders in declaring that they were the sole shareholders constituted an abuse of their shareholder rights that caused 'serious harm' to the interests of the plaintiff shareholder, in breach of Article 20.2, and if not addressed would 'seriously impact the economic order and security of society, which surely goes against the original intention of the drafters of China's shareholder limited liability legal system.'[99] The defendants should therefore compensate the plaintiff for the loss of his capital.

The concept of a 'de facto shareholder' is an interesting innovation for dealing with these kinds of irregularities in shareholder registration, but it is not supported by any provisions in the *Company Law*. However, this is an area that the Supreme People's Court pronounced upon in a

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[98] Ibid.

[99] Ibid. This case is also interesting because the plaintiff shareholder was in prison serving a sentence for corruption, but the court found that his property rights (including his rights as a shareholder) were still enforceable.

2011 Regulation (the 'Third Regulation'), doubtless to try to deal with these very kinds of inconsistent interpretations by Chinese courts.[100] Article 24 of the Regulation states:

> If a party has fulfilled its duty to pay in capital or has received title to shares through lawful inheritance, but the company has not issued a signed capital confirmation certificate or recorded the person's name in the record of shareholders and completed registration formalities with the registration authorities, the Court should approve the party's request to order the company to complete the above duties.[101]

This provision would have covered the facts in both the above cases, but the Heavenly Silkworms case was decided in 2009, two years before the Third Regulation came out, so Ms. Lu did not receive the benefit of it. The Xukang Corporation decision was issued on 28 April 2011, two months after the Third Regulation became effective, but it is not clear if the Ruzhou Court was following the Regulation in its judgment, as no citation is given to it.[102]

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[100] *Zuigao renmin fayuan guanyu shiyong 'Zhonghua renmin gongheguo gongsifa' ruogan wenti de guiding*, effective from 16 February 2011.

[101] Ibid. Article 23 clarifies the information needed to prove ownership of the shares: either the person "has already paid in the capital or paid for a share subscription according to law," or the person "has already received the share rights through transfer or inheritance by law" and the above payment or transfer did not breach any enforceable law or regulation.

[102] The Ruzhou Court's use of the term "de facto/actual shareholder" (*shiji gudong*) looks similar to the term "actual capital investor" (*shiji chuzi ren*), which appears in Articles 25-26 of the Third Regulation, but the Regulation never refers to such a person as a "shareholder," only as someone who can demand that the registration be completed so that he or she becomes a shareholder, similar to allottee under the UK *Companies Act*.

However, other courts have now begun citing the Third Regulation to deal with situations where there is a dispute between the legally registered owner of shares and a transferee, whom the Regulation refers to as an 'actual capital investor' (*shiji chuzi ren*).[103]

III. CONCLUSION

The SPC's Third Regulation certainly seems to have cleared up the ambiguities over the rights of unregistered shareholders, or 'actual capital investors', but the Third Regulation did not appear until over five years after the amended *Company Law* came into effect in January 2006. During those years, there have presumably been numerous other decisions, like that in the Heavenly Silkworms case, where plaintiffs have been unfairly deprived of their rights as shareholders in a company due to defective registrations by the company.

Even more importantly, the SPC still has not provided clarity on other key issues surrounding the interpretation of Article 20.1-2, such as who is the proper plaintiff to bring the action; whether a shareholder must go through the derivative procedure to obtain relief where the company's interests have been harmed by other shareholders; and whether Article 20 permits the

[103] Common law jurisdictions would refer to these people as the legal and beneficial owners respectively. A 2012 decision of the Zhuzhou Municipality Intermediate Court in Hunan Province, (2012) *Zhu zhong fa min er chu zi di 15 hao*, is typical: the defendant shareholder had signed a share transfer agreement to transfer a portion of his shares in the company to the plaintiff, and payment was made, but the defendant failed to register the plaintiff as a shareholder; the defendant then sold the same shares to another buyer, who was subsequently registered as a shareholder. The court cited Art 25 and 26 of the SPC's Third Regulation and Company Law 20.1-2 in finding that the plaintiff had been unfairly deprived of his shares, which was an abuse of rights by the defendant shareholder, and the plaintiff should be compensated for being deprived of the shares based on their value at the time of the offending share transfer to the third party. Art 25 of the Third Regulation creates the categories of "nominal shareholder" (*mingyi gudong*), for the person who is registered as shareholder, and "actual capital investor" for the person who pays to buy the shares from the nominal shareholder. Art 26 makes the nominal shareholder liable if the actual capital investor suffers losses due to a defective registration of the transfer.

granting of non-monetary relief such as rescission of agreements, orders for the return of company books and seals, and invalidation of abusive company resolutions beyond the 60-day limitation period in Article 22. Many Chinese courts are willing to adopt creative approaches in interpreting Article 20 and other *Company Law* provisions in order to provide such remedies and therefore grant what they see as just outcomes to applicants in the face of statutory vagueness and ambiguity. But in the absence of a system of binding case precedents, they would doubtless appreciate more guidance from the SPC in the form of more regular Interpretations or Regulations and much faster issuance of Guiding Cases on a broader range of corporate legal issues.

Such guidance would be particularly important in cases involving small individual shareholders bringing suit against powerful controlling state shareholders. Due to Chinese courts' relatively weak status in the local political hierarchy, it is difficult for them to rule against such politically-connected defendants, and for this reason they may not even accept minority shareholder lawsuits against the managers and shareholders of large listed Chinese companies. Clarke and Howson suggest that there are internal regulations prohibiting Chinese courts from accepting cases where joint stock companies are defendants, and this explains the lack of any published derivative lawsuits involving such companies.[104] Hui Huang has questioned the existence of such internal regulations, but he too finds no derivative suits involving joint stock or large state enterprises. His explanation is that the ownership threshold for shareholders to bring a derivative suit on behalf of a joint stock company is too high (requiring 1% of the votes in the

[104] Clarke and Howson (n 24) 22. Chinese joint stock companies (*gufen youxian gongsi*) are roughly equivalent to public companies elsewhere in the world: all listed companies in China must be joint stock companies, but not all joint stock companies are listed. By contrast, limited liability companies (*youxian zeren gongsi*) are equivalent to private or proprietary companies elsewhere: they cannot issue shares broadly to members of the public.

company), and the vast majority of non-state shareholders in Chinese joint stock companies would not be able meet this threshold.[105]

Our study did not find any special reluctance of Chinese courts to accept cases involving joint stock companies or large state-controlled enterprises. Altogether, out of the 72 cases in our data set, we found 3 cases involving joint stock companies as defendants and 2 involving large state-controlled corporate groups as defendants, which together make up approximately 6.94% of the total number of oppression remedy cases. Considering that joint stock companies make up only a small percentage of the total registered companies in China, this proportion of cases does not appear unusual.[106] In 4 of these 5 cases, the defendants were found fully or partly liable for abusing the rights of the plaintiff, which is a high success rate.

Nevertheless, there is still a strong perception among the minority shareholders of Chinese listed companies (all of which are joint stock companies) that current legal protections are not adequate, and that courts need to be more proactive about enforcing minority rights, especially in companies that have controlling state shareholders.[107] This is one reason why it is so important

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[105] Huang (n 23) 649-50 and n 128. He gives the example of Sinopec, where the largest non-state shareholder has only 0.29% of the votes, and the aggregate percentage holding of the largest nine non-state shareholders is still less than 1%.

[106] It's difficult to find precise statistics on the total numbers of different kinds of companies in China, but according to the *China Statistical Yearbook*, among "domestic industrial enterprises" with annual revenues of over 5 million yuan in 2010, there were around 19,849 registered joint stock companies, and 262,692 limited liability companies, in other words, joint stock companies made up around 7.55% of the total. It is likely that there are many more LLCs with annual revenues below 5 million yuan. *Zhongguo tongji nianjian shuju ku* (Beijing: Zhongguo xue shu qi kan dian zi za zhi she, 2011). Note also that in common law jurisdictions, the oppression remedy is much more frequently granted in cases involving private companies rather than publicly listed corporations. See Ramsay (n 6) 27.

[107] This was the conclusion in a survey of 233 retail stock market investors conducted over one year in both Hong Kong and China: see Alex Lau, Danny Ho and Angus Young, "An Exploratory Study on the Perception of Minority Shareholders' Legal Protection in China and Hong Kong" (2014) *Company Lawyer*, forthcoming.

for the SPC to clarify the rights and remedies available under the oppression and other shareholder protection provisions in the *Company Law*.

Unfortunately, due to resource constraints and the sheer numbers of laws and regulations being issued constantly at various levels of government, it is unlikely that the SPC will be able to effectively keep up with the pace of legal development using its current, glacially slow, top-down approach. As a result, numerous interpretive gaps in corporate legislation will emerge for years to come.[108] Even if the SPC were able to improve its response times, the inherent ambiguity of words means that there will always be some wiggle space for interpretation of difficult points, such as the meaning of 'shareholder abuse.' One can predict that Chinese courts will fill these gaps through their own creative interpretations, and through increasing use of the kind of informal or *de facto* case precedent system that we have identified. Perhaps it is time for such a precedent system to become more formalized on a national basis.

[108] Legislative amendments are even slower to respond to gaps. Recently announced amendments to the 2006 *Company Law*, due to become effective in March 2014, do not address any of the remedies provisions, but focus only on removing the requirements for companies to have minimum registered capital. See Zhou Tian, "*Gongsifa xiugai yi'an huo tongguo, zhuce renjiaozhi queli* (Discussion draft for amending the Company Law is passed: a system of subscribed capital will be established), *Caixin Online* (29 Dec. 2013), at: http://china.caixin.com/2013-12-29/100623093.html.