International
Comparative
Legal Guides

Practical cross-border insights into corporate governance law

Corporate Governance 2023

16th Edition

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Q&A Chapters

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1 Setting the Scene – Sources and Overview

1.1 What are the main corporate entities to be discussed?

There are two types of companies in China (the People's Republic of China, or "**PRC**"), namely limited liability companies and joint stock companies. A limited liability company must remain non-public, while a joint stock company can either be non-public, or be able to offer shares publicly and list on domestic exchanges or designated venues and certain overseas stock exchanges.

1.2 What are the main legislative, regulatory and other sources regulating corporate governance practices?

The primary legislation that applies to all companies in China is the Company Law of the PRC and the judicial interpretations of that law made by the Supreme Court of the PRC (together, the "**Company Law**"). Domestic companies and foreign-invested enterprises are subject to unified rules in terms of corporate governance.

The corporate governance of public companies (including companies that have publicly offered their shares and are listed on stock exchanges, or "listed companies", and companies that have offered shares publicly but are not listed on stock exchanges, and whose shares can still be traded on designated trading venues) must also adhere to a number of PRC laws concerning listed companies specifically. As the general law in this respect, the Securities Law of the PRC (or "**Securities Law**") provides certain requirements for companies, shareholders, boards of directors and management in respect of information disclosure and corporate governance procedures. Specifically, the China Securities Regulatory Commission ("**CSRC**"), the three stock exchanges (i.e., the Shanghai Stock Exchange, the Shenzhen Stock Exchange and the Beijing Stock Exchange) and other designated trading venues within the PRC provide detailed provisions regarding public companies' information disclosure and corporate governance procedures, e.g. the Corporate Governance Guidelines of Listed Companies (the "**Governance Guidelines**"), the Guidelines for the Articles of Association of Listed Companies (the "**Articles Guidelines**"), and the Rules on Shareholders' General Meetings of Listed Companies, etc.

In addition to observing the Company Law, each company must also have a principal constitutional document, known as its articles of association (the "**Articles**"). The Articles prescribe regulations and rules for the company and reflect the contract and relationship among shareholders. The Articles contain important details regarding governance issues which supplement what is provided by legislation.

1.3 What are the current topical issues, developments, trends and challenges in corporate governance?

Given the relative immaturity of the PRC corporate governance regime, as well as that of PRC capital markets generally, there are ongoing interests in and strengthened efforts toward exploring the best corporate governance practices and methods of implementation by the PRC government, as demonstrated by various legislative consultations, pilot programmes, guidance opinions and enforcement practices. In particular, in line with the registration-based share offering reforms, namely, the opening of the Star Market in 2019, the reform of the ChiNext in 2020, the opening of the Beijing Stock Exchange in 2021 and the across-the-board registration-based offering reform in early 2023, with respect to public companies, the Chinese government has been vowing and actually implementing its "zero-tolerance" toward wrongdoings of relevant parties of public companies. The current discussion focuses on the protection of public shareholders, the regulation of controlling shareholders or actual controllers, and the transparency and disclosure obligations, etc.

In the past year and to date in 2023, the previously eye-catching proposal on stage in late 2021 to revise the "basic law" of Chinese companies, i.e., the Company Law, has largely gone silent, possibly being shelved due to its notable controversies. These mainly include its lack of structural reform of the somewhat outdated Company Law (constructed on the basis of the 1993 version), the enhancement of state intervention and the respective reduction in market discretion, and the absence of responses to several predicaments in economic practices. It is still uncertain in the formally enacted legislation to what extent the changes may be adopted, or even whether the law may be revised on the basis of the earlier draft amendment at all. Nevertheless, as reflected by the draft amendment made by the standing committee of China's supreme legislative body, the People's Congress, such effort to revise the Company Law represents the tendency of the Chinese government to intervene and alter the "life blood" of business activities, among which revisions some would likely be against the interests of investors, though others may be regarded as improvements.

The major development in the corporate governance of public companies is centred on measures in connection with the continuous and escalating implementation and enforcement of the latest revision of the Securities Law of 2019, especially through the lens of China's regulatory reform on the capital markets from the approval-based IPO system to the disclosure-based registration system. In the past, the most effective legal remedy

for misconduct or wrongdoing in the capital markets had always been to seek government intervention. In the past, the CSRC may at times breaks records regarding the amounts of fines for misconduct in the secondary market (i.e., a record CNY 1.8 billion fine for a case of manipulation of a stock price was soon surpassed by a CNY 5.5 billion fine for another, similar case). However, for most wrongdoing, the CSRC's punishment had still been not much more than a slap on the wrist, especially considering that delisting rules might not be implemented in the way they were written. The legal remedies available to investors were also extremely limited. Under the earlier Chinese securities and civil procedure laws, they might not sue a company and its intermediaries for fraud, and there was no effective mechanism for class action litigation for investors to take collective action. The lack of effective deterrents and the failure to provide effective protection for investors in China were in sharp contrast to the efficient investor-protection mechanisms in developed economies. This situation has been fundamentally changed by strong measures taken by the Chinese government over the last two years, which can be framed as unprecedented efforts to hold wrongdoers accountable. A set of high-profile rules were handed down by the Chinese government during 2021–2022, among which the most consequential are:

- on July 6, 2021, the General Office of the Communist Party of China Central Committee (the "**General Office of CPC**") and the General Office of the State Council (the "**General Office of State Council**") jointly issued The Opinions on Strictly Cracking Down on Illegal Securities Activities in accordance with the Law (the "**Opinions on Illegal Securities Activities**"). This is an unprecedented joint legislative action taken by the two top power centres specifically relating to securities regulation. The Opinions on Illegal Securities Activities specifies the targets to upgrade securities law enforcement and the judicial system by 2022 and 2025, respectively, including effectively curbing the frequent occurrence of major illegal and criminal cases, as well as making notable advances in transparency, standardisation and credibility. Specific measures are being put forward with 27 different aspects. In accordance with the Opinions on Illegal Securities Activities, efforts should be made to improve the securities legislation mechanism, while strengthening criminal punishment and market discipline;
- on December 30, 2021, China's Supreme People's Court issued the Several Provisions on the Trial of Cases of Civil Damages for False Statement Infringement in the Securities Market (the "**Provisions**"), effective from January 22, 2022. The Provisions mainly clarify the determination of false statements, the materiality of false statements, the causality of transactions, and the determination of liability. Particularly, the Provisions scrapped the pre-litigation requirements insisted on by Chinese courts for acceptance of false statement litigations. Accordingly, administrative penalties or criminal judgments will no longer be preconditions for people's courts to accept such civil compensation cases, lifting the restrictions for victims to file lawsuits, which will be likely to boost civil cases in connection with securities-related false statements; and
- on March 29, 2022, the General Office of CPC and Generally Office of State Council took another joint legislative action to issue The Opinions on Advancing the High-quality Development of the Construction of the Social Credit System in Furtherance of the Shaping of a New Development Pattern. In this legislative paper, the general offices of both the governing party and the top government administration, apart from the rhetoric of improving transparency and information disclosure for capital market players, specifically required to establish a national capital market credit system and emphasised reinforcement of a delisting system in China's capital market.

The Chinese government is seeking to, greatly and more efficiently, "crack down" on capital market misconduct, which is epitomised by the abuse of power by controlling shareholders and senior management of IPO applicants and public companies, and false statements by the relevant capital market participants. Most eye-catchingly, in contrast to the government's increasingly frequent administrative and investigative actions in relation to the capital markets, which increase the penalties imposed on wrongdoers, the door to American-style class actions being opened by the Securities Law has sent shivers down many people's spines. Article 95 of the Securities Law provides that in civil lawsuits pertaining to false statements, litigation representatives may be appointed to participate in the legal proceedings (the Ordinary Shareholder Representative Proceeding), and an investor-protection organisation entrusted by more than 50 investors may participate in the lawsuit as a representative on behalf of rights holders, except for investors who clearly state that they are unwilling to participate in the lawsuit (the "**Special Shareholder Representative Proceeding**"). These provisions alter previously existing procedures by permitting implied opt-in and express opt-out mechanisms for investors where investor-protection organisations (e.g., the China Securities Investors Service Center, or the "**ISC**") participate in litigation as representatives. The way these procedures will operate is that, e.g., the ISC, may "register for investors" with the court once the investors' information has been verified by the securities registration and clearing organisation. Under this "opt-out" principle, most eligible plaintiffs will be included in the litigation. If a Special Shareholder Representative Proceeding is filed against a listed company or its directors, officers, or supervisors, the civil liability and damages they would face could be huge. The opt-out principle under the Securities Law thus enables a US-style class action environment.

In 2022, nearly 200 penalties were handed down by the CSRC and its local branches to the found wrongdoers in capital market which has significantly surpassed the likewise fines in years before combined; in the starting three months in 2023 alone, 50 fines have been stricken for relevant violations. Most of these findings are for violations of rules of public company governance. In terms of the ISC, up until March 31, 2023, it has launched 55 class-action style and shareholder lawsuits towards relevant rule breakers in accordance with the Securities Law, and already won almost all of them.

Going forward, the focus should remain on improving corporate governance for public companies in the areas of transparency, protection of public shareholders and regulation of controlling shareholders or actual controllers, in particular, the government efforts to address: (i) the imbalance between controlling shareholders and minority shareholders; (ii) the transparency and disclosure obligations; (iii) the operation of the board of directors; and (iv) the promotion and management of employee share schemes.

1.4 What are the current perspectives in this jurisdiction regarding the risks of short termism and the importance of promoting sustainable value creation over the long term?

Over the long period since China's economic normalisation from the late 1970s, the tension between short-termism and long-termism in corporate governance has never drawn too much attention outside of academia and the practices of the legislature and judiciary. This particularity has multiple reasons, but among them

the most important three are: the legal principle; the very common concentration of ownership; and the embedded political nature of state-owned companies' governance. Starting with the legal principle, PRC laws keep a near-paranoid commitment to shareholder protectionism; by law, shareholders enjoy absolute supreme authority in corporate governance, to the extent that shareholders have the absolute power to decide any important issues in a company's existence and operation, while the board (or sole executive director if there is no board) and management team are merely executive bodies deputised by the shareholders. In theory, even if the board has made a decision, shareholders can still overturn it and decide otherwise, and shareholders can remove or change directors, even without cause, almost at their own discretion; accordingly, even if a conflict between shareholders and management arises, theoretically it can simply be solved by shareholders voting down the management. As for the concentration of ownership, due to cultural and historical factors, non-state-owned companies, public or private, in China are commonly owned or majority-owned by insiders in very close communities, mostly characterised by family, kinship or other close personal relationships; therefore owners and managers are often part of the same group of people. Even if there is a clash in corporate governance, it is much more likely to be one between majority shareholders and minority shareholders, which does not necessarily concern the question of short-termism and long-termism as opposed to one between owners and managers. Lastly, for state-owned companies that control the strategically important sectors of the Chinese economy and contribute nearly half of the economic output, (although owners and managers do not overlap), in terms of corporate governance, aside from the aforesaid absolute power of shareholders over managers, it is much less a solely legal or commercial issue than it is a political one. That said, even with the inevitable tension between the government and managers in state-owned companies' governance, it is never comparable or solved in the same way as Western-style agency problems.

Some spotlight cases concerning listed companies' governance significantly expose the primitiveness and weakness of the legal framework in this regard. The so-called "takeover war" for Vanke (ticker number: 000002.SZ) between new shareholders and management, and for Zhenxing Biotech (ticker number: 000403.SZ) between private equity and controlling shareholders, and the clash between small shareholders and the management of Gree (ticker number: 000651.SZ), while often headlined as a clash between management's short-termism and shareholders and companies' long-term value, are actually rather legally unsophisticated because there are so many loopholes and grey areas in corporate governance that even the presumably straightforward and procedural questions such as a quorum of a board meeting and effectiveness of certain board members' abstention can be interpreted and characterised in starkly opposite ways. These cases did spark serious debates among various parties at that time. However, over the last two years, these cases have failed to lead to a wider scale debate in academic, legal and business groups. They are believed to be treated mostly as single cases; therefore, the significance of the risks of short-termism and the importance of promoting sustainable value creation over the long term have not prompted further legislative reaction and judicial solutions. This norm is hard to change.

2 Shareholders

2.1 What rights and powers do shareholders have in the strategic direction, operation or management of the corporate entity/entities in which they are invested?

In general, the shareholders' meeting is the highest decision-making authority of a company. Shareholders entrust and delegate day-to-day operation and management of companies to the board through the Articles, and a separate supervisory board is set up to supervise the performance of the board and senior management which reports to the board. The Company Law reserves certain important matters to the shareholders' meeting. Such matters include: review and approval of the company's business strategy and investment plans; appointment and dismissal of directors and supervisors; review and approval of the annual budget and final accounts; review and approval of the Articles; increasing or decreasing registered capital; and merger, division, liquidation or change of corporate form.

In the case of public companies, additional matters must also be decided by the shareholders' meeting; for example, acquisition or sale of material assets above a certain threshold and provision by the company of security for its shareholders or actual controllers. The Listing Rules provide further examples of specific transactions subject to the shareholders' approval, including material transactions, as well as material related party transactions.

While shareholders have the right to reserve any other matters for their decision by stating so in the Articles or through a shareholders' resolution, public companies in the PRC, as a matter of practice, typically only reserve matters that are required by law to be decided by the shareholders.

Although PRC laws have allowed the offering of preferred shares by joint stock companies, preference shareholders are generally not entitled to attend the shareholders' general meeting, unless the matters to be resolved relate to the material interests of the preference shareholders (such as an amendment to the Articles which relates to the preference shares, a single or cumulative reduction of the registered capital of the company exceeding 10%, merger, division, liquidation or change of corporate form, and issuance of new preference shares), in which case the preference shareholders will be entitled to vote at a separate class meeting with respect to these matters. There are also circumstances where preference shareholders will be entitled to vote at shareholders' general meetings together with ordinary shareholders, such as failure by the company to pay dividends to preference shareholders, as agreed, for three financial years in aggregate or two consecutive financial years, until the full amount of the relevant due dividends has been paid.

2.2 What responsibilities, if any, do shareholders have with regard to the corporate governance of the corporate entity/entities in which they are invested?

Shareholders are under a general requirement to comply with laws, regulations and the Articles. Other than that, most shareholder responsibility in respect of corporate governance rests with the controlling shareholders. The general principle is that controlling shareholders shall not abuse their position to impair the interests of the company or any other shareholders. If they do cause harm in this manner, they may be held liable for the damages caused.

The duties of controlling shareholders of a listed company extend further. Under the Governance Guidelines, controlling shareholders are obliged to support the reform of labour, personnel and distribution systems of the listed company. When nominating directors and supervisors, controlling shareholders have a duty to ensure that the nominated candidates have the sufficient professional expertise and management capabilities to perform their roles.

2.3 What kinds of shareholder meetings are commonly held and what rights do shareholders have with regard to such meetings?

Companies may have regular shareholders' meetings and

extraordinary shareholders' meetings; in particular, it is mandatory for public companies to have an annual general meeting (i.e., listed company's shareholders' meeting). At the annual general meeting, which should be held within six months of each financial year end, shareholders typically vote on the following: review and approval of annual budget and financial reports; appointment of the company's auditors, directors and supervisors; and the declaration of dividends. Extraordinary general meetings may be held as needed (for example, to approve a specific corporate action or a material transaction) and, in addition, the Company Law requires an extraordinary meeting to be held within two months of the occurrence of certain circumstances, such as when the number of directors of the company falls below two-thirds of the number prescribed by either the Company Law or the Articles.

Shareholders (including preference shareholders who are entitled to voting rights, as described in question 2.1 above) are entitled to receive notices of all shareholders' meetings. A company must formally notify its shareholders (including preference shareholders who are entitled to voting rights, as described in question 2.1 above) at least 20 days (in the case of the annual meeting) or 15 days (in the case of an extraordinary meeting) prior to the date of the meeting. Listed companies must deliver the notice of the shareholders' meetings via a public announcement.

Voting at shareholders' meetings requires either an ordinary resolution (requiring a simple majority of those voting in person or by proxy) or a special resolution (requiring a majority of no less than two-thirds of those voting in person or by proxy). Special resolutions are required for specific matters, such as amendments to the Articles, an increase or decrease of registered capital, the acquisition or sale of material assets and the adoption of stock incentive schemes.

Shareholders (including preference shareholders who are entitled to voting rights, as described in question 2.1 above) individually or collectively holding 3% or more of the shares of a company may require certain matters of their choosing (which are within the power of the shareholders' committee) to be included on the agenda of a shareholders' meeting.

While the default position is for the board to convene, and the chairman to chair, shareholders' meetings, shareholders (including preference shareholders who are entitled to voting rights, as described in question 2.1 above) individually or collectively holding 10% or more of the shares of a company for a consecutive period of at least 90 days may convene and chair a shareholders' meeting if the board (as well as the supervisory board) fails to do so.

Shareholders may attend shareholders' meetings in person or by proxy. Public companies are encouraged to make online voting platforms available to shareholders, and the stock exchanges also prescribe a list of matters for which online voting platforms must be set up, including resolutions relating to new issues of shares, material restructuring and related party transactions. Where a shareholder intends to appoint a proxy to attend the meeting, the power of attorney must be in writing and an original must be submitted during the meeting.

Beneficial ownership of PRC listed shares is not common and is only used in limited circumstances (for example, foreign exchange-traded, RMB-denominated shares and shares traded under the Shanghai-Hong Kong Stock Connect Pilot Scheme and the Shenzhen-Hong Kong Stock Connect Pilot Scheme). Beneficial owners must exercise their shareholders' rights through nominees.

2.4 Do shareholders owe any duties to the corporate entity/entities or to other shareholders in the corporate entity/entities and can shareholders be liable for acts or omissions of the corporate entity/entities? Are there any stewardship principles or laws regulating the conduct of shareholders with respect to the corporate entities in which they are invested?

Since PRC laws adopt the register capital system in terms of a company's capital contribution, in general, shareholders naturally owe the duty to contribute to the company the promised share of its registered capital. The failure of such duty would lead the shareholders in default to be liable for the company and other shareholders. Moreover, it is provided by the Company Law that shareholders shall not "abuse shareholder rights" to harm the interest of the company and other shareholders, and controlling shareholders shall not use their connection with the company for their own personal interest. However, these provisions are as broad a declaration as it is an ambiguous prohibition, thus leaving great room to the judiciary to interpret and implement.

In terms of liabilities of shareholders for acts or inaction of the companies, the fundamental principle in this respect is that in a company, the liability of a shareholder is limited to the amount of capital contribution in respect of the shares for which he has subscribed or agreed to subscribe. This, combined with the principle of separate legal personality, means that, in principle, a company's "corporate veil" is not pierced and shareholders are not held liable for a company's actions. In exceptional circumstances, the corporate veil can be pierced. According to the Company Law, if a shareholder is found to have abused the limited liability status of the company and materially prejudiced the rights of the company's creditors, the shareholder may be held jointly and severally liable, along with the company, to the creditor who has been prejudiced and called for the piercing of the corporate veil. Because the statute does not specify what constitutes "abuse of limited liability status" (although such situation may be slightly changed by the future revision of the Company Law as implied by the Draft Amendment discussed in question 1.3) and given the lack of case law and official interpretation from the PRC Supreme Court, courts are left with a great deal of discretion, and concerns exist regarding the possibility of inconsistent practices arising across the country. To date, no public company (in China, a company described as a public company includes listed companies and unlisted but publicly traded companies) has, however, been subject to a court order piercing the corporate veil.

Apart from the "no-go zones" for controlling shareholders as discussed above, shareholders in China have no stewardship principles or legislation to abide by or follow.

2.5 Can shareholders seek enforcement action against the corporate entity/entities and/or members of the management body?

Shareholders can only be disenfranchised in very limited circumstances. For example, shareholders who engage in insider trading or market manipulation may be stripped of shares which they acquired as a result of such illegal behaviour, and voting rights attached to shares held by the listed company itself are suspended. A further example is that of certain related party transactions, in respect of which the relevant related party shareholder cannot vote on the relevant shareholder resolution.

In certain regulated sectors (for example, commercial banks and securities companies), shareholders' rights to dividends, appointment of management and share transfers may be restricted by the regulators if the company is in financial difficulty.

In a takeover scenario, the relevant exchanges will cancel the listing of a company where a majority shareholder, as a result of a takeover bid, holds more than 75% or 90% of the shares of the company (depending on the number of shares issued by the company). Unlike several other jurisdictions, however, PRC law does not force minority shareholders to sell their shares to the majority shareholder. Rather, a minority shareholder has the right to sell his shares to the majority shareholder after the expiration of the takeover offer on the same terms as those proposed in the general offer, even if the minority shareholder did not accept the offer during the general offer.

However, attention should be called to the aforementioned recent introduction of American-style class actions for securities fraud in China – there is little doubt that the new procedures represent a significant change in the availability of collective investor redress in China. In any event, the legal changes in China have important implications for Chinese-listed companies, their executives, their advisors, and their insurers. In a phrase, the change represents a great leap forward for investor rights, and could result in added risks for listed companies and their senior executives.

2.6 Are there any limitations on, or disclosures required, in relation to the interests in securities held by shareholders in the corporate entity/entities?

Yes. The Company Law confers the right on shareholders to bring an action against directors, supervisors or senior management for breach of law or violation of the Articles in performing their duties. Such actions may be brought in the name of the shareholders but must be in the interests of the company, with any damages awarded being payable to the company. Exercise of this right is subject to certain conditions, including that the shareholders individually or collectively have held and continue to hold no less than 1% of the shares in the company for 180 or more consecutive days and the management body, or the supervisory board, in the case of misconduct by directors or senior management, has failed to file a claim on behalf of the company after the shareholders have served a written notice of the claim.

Where directors or senior management infringe on a particular shareholder's rights by breaching laws or the Articles and such infringement results in a loss to that shareholder, the shareholder may seek enforcement action on its own behalf against such personnel. Further, under the Securities Law, a shareholder may request directors, supervisors and senior management to bear joint and several liability with the listed company if such shareholder suffers a loss due to false, misleading or incomplete disclosure by the listed company.

2.7 Are there any disclosures required with respect to the intentions, plans or proposals of shareholders with respect to the corporate entity/entities in which they are invested?

Other than in the context of the takeover of listed companies' shares, there is generally no requirement for shareholders to disclose any intentions, plans or proposals to the companies in which they invest. According to the PRC laws in connection with listed company takeovers, in the open market or by contractual transfer, a shareholder (including other parties acting in consent or in coordination, same below) who acquires a listed company's shares, subject to the percentage of shares he acquires, may be required to disclose a change of their investment in the listed company, in which they should include their intentions, plans or proposals against the listed company. A shareholder acquiring more than 30% of a listed company's shares triggers a tender offer; unless the tender offer obligation is waived, the shareholder shall go through the tender offer process, in which he should disclose: his intention to take over the listed company; the plan to acquire further shares; and the proposals (if any) to restructure, reform or adjust the listed company's assets, business, management, governance structure, Articles, etc.

2.8 What is the role of shareholder activism in this jurisdiction and is shareholder activism regulated?

Shareholder activism currently has little room at the legislative level in China, although things may change as the securities class-action measures gradually roll out. Activist shareholders, which are presumably (but not necessarily) minority shareholders, may only launch their actions from a tiny toolkit provided to minority shareholders by the virtue of law, e.g. requesting to convene a shareholders' meeting, submitting an interim proposal and bringing derivative suits to management in extreme circumstances. In practice, shareholder activism has never been common in China, and all of the small number of traceable cases were driven purely by commercial interests of shareholders rather than ethical investment needs. Shareholder activism did have a surge (in a relative sense) during the period of 2015 to 2017, launched mainly by issuance companies that were seeking to take over listed companies using their very low cost of premium capital, largely thanks to the deregulation of insurance companies' investment in listed companies. However, as the market crashed to a new low and the former top official of China's regulatory watchdog of the insurance industry was arrested and tried for corruption, this short-lived surge was quickly stifled.

However, it may be generally understood that in Chinese practice, in line with international practice, shareholder activism has barely caught the authorities' attention. There is no unified or generally accepted legal principle. The only exception may be the case regarding the issuance of companies' campaigns of hostile takeovers of several listed companies and challenges to the companies' management from 2015 to 2017. Back then, activist investors, mostly insurance companies, were thought to be troublemakers by the CSRC. The then Chairman of the CSRC even publicly denounced them as "demons" and "evil creatures" whose only intention was allegedly to rock the boat and collect the benefits. Soon afterwards, following a large-scale investigation into the then insurance regulatory body, the China Insurance Regulatory Commission (later restructured to the China Banking and Insurance Regulatory Commission, and then recently State Administration of Financial Supervision and Administration), a rule was put together to ban insurance companies from taking over listed companies. This selective and somewhat arbitrary regulation of shareholder activism is very controversial, and widely seen as a counter-productive, one-time and overactive measure.

3 Management Body and Management

3.1 Who manages the corporate entity/entities and how?

Companies are managed by the board, which reports to shareholders of the company and is subject to the supervision of a supervisory board (consisting of at least three supervisors). The board will also appoint senior management to manage the daily operation and business of the company. A director or senior manager cannot take a concurrent position as a supervisor of the company.

The Company Law does not expressly provide for the concept of executive directors and non-executive directors, nor for their respective responsibilities. It is common in PRC public companies that a majority of directors are internal or executive

directors. In response to this, and to protect the interests of minority shareholders, a public company is required to introduce independent directors (i.e. external directors who are independent from the company and its major shareholders) comprising at least one-third of its board. The main responsibilities of independent directors include: approval of material related party transactions before the same are considered by the board; proposing to appoint or dismiss accounting firms; and providing independent opinions to the board or shareholders on matters such as the appointment and remuneration of directors and senior management, and other matters which, in the view of the independent directors, may adversely affect the interests of minority shareholders.

Furthermore, public companies may (and in practice, do) establish several committees (although the board remains responsible for ultimate decisions), including a strategic committee responsible for long-term development strategies, an audit committee monitoring the internal audit system, a nomination committee leading the process of the selection of directors and managers, as well as a remuneration and appraisal committee reviewing the remuneration policy. Independent directors should comprise at least half of the positions on each of the nomination, audit and remuneration committees.

3.2 How are members of the management body appointed and removed?

Except for directors or supervisors appointed by employees (see question 4.3 below), shareholders control the appointment and removal of the members of the board of directors and supervisory board by a simple majority resolution. The term of office for directors and supervisors is three years, which can be extended if they are re-elected (and independent directors can have a maximum six-year term in total).

To protect the rights of minority shareholders, a cumulative voting system is encouraged to be put in place, and this system is mandatory for the appointment of directors in a listed company whose controlling shareholder holds more than 30% of its shares. Under this system, the number of votes for each shareholder is multiplied by the number of directors to be appointed, after which the shareholders need to distribute their votes among the different candidates (each vote may only be assigned to one candidate). As a result, the majority shareholder no longer automatically controls all appointments, and this system leaves room for the minority to appoint some candidates as well.

Generally, preference shareholders do not have voting rights in respect of the appointment and removal of members of the management body.

3.3 What are the main legislative, regulatory and other sources impacting on compensation and remuneration of members of the management body?

The Company Law requires remuneration of directors and supervisors to be approved by a shareholders' meeting, and prohibits directors and senior management from engaging in business similar to the business of the company without obtaining approval at a shareholders' meeting. The Governance Guidelines require listed companies to enter into engagement letters with their directors and senior management. The Governance Guidelines further set out high-level principles on setting up a transparent performance appraisal system for the board (or its remuneration and appraisal committee) to use in reviewing the performance of directors and senior management, and for supervisors and independent directors to use for purposes of self-appraisals. Where a listed company intends to adopt a stock incentive scheme, it must observe the Administrative Measures on Stock Incentives by Listed Companies issued by the CSRC, which require any such scheme to be approved by a shareholders' meeting, as well as by the CSRC. The performance report, appraisal results and remuneration of each director and supervisor must be disclosed to shareholders and included in the company's annual report. For certain regulated sectors (such as banking, securities and insurance), industry-specific regulations by the relevant authorities in connection with the remuneration of members of the management body (e.g. delayed payment of performance-related bonus) must also be complied with.

3.4 What are the limitations on, and what disclosure is required in relation to, interests in securities held by members of the management body in the corporate entity/entities?

A director, supervisor or senior manager is permitted (but not required) to hold shares in a listed company subject to notification to the company. The Company Law imposes the following limitations on the transfer of such shares by these individuals: in any given year, he may transfer no more than 25% of his total shares held in the company; the totality of shares he held prior to the listing of the shares cannot be transferred within one year from the date of the listing; and in the event of departure from the company, he cannot transfer any shares within the first six months after departure. Further, a short swing rule applies to a director, supervisor or senior manager of a listed company, pursuant to which such individual is prohibited from selling (or purchasing) shares during a period of six months after he or she purchased (or sold) such shares.

Public companies must disclose the shares held by directors, supervisors and senior management, as well as any changes, on a yearly basis in their annual reports.

3.5 What is the process for meetings of members of the management body?

The board must convene board meetings at least twice a year, with a notice being served at least 10 days in advance. Interim board meetings should be called within 10 days if proposed by shareholders collectively holding 10% or more voting rights, or by one-third or more of the directors, or by the supervisory board of the company. The public company is required to provide the notice period for interim board meetings in its Articles. The quorum for a board meeting and the votes required for a resolution are both more than 50% of all directors. Directors may attend board meetings in person or by proxy. Each director has one vote. In listed companies, directors who relate to the matters to be voted on must refrain from voting on such matters.

The supervisory board must hold meetings at least once every six months and interim meetings may be called if proposed by a certain number of supervisors, as provided in the Articles. The law does not specify the notice period for such meetings, leaving the Articles to provide the details. A resolution may be passed by the supervisory board if 50% or more of the supervisors vote for the matter in question.

3.6 What are the principal general legal duties and liabilities of members of the management body?

Pursuant to the Company Law, directors, supervisors and senior

management are subject to duties of loyalty and diligence. These duties are not expressly defined, but are generally understood to require that these persons perform their responsibilities diligently and with due care, avoid conflicts of interest, and act in the best interests, and for the benefit, of the company.

The Company Law provides examples of acts in breach of the duty of loyalty, including but not limited to: misappropriation of company funds; the use of one's position to divert commercial opportunities of the company; engaging in business similar to the business of the company for one's own benefit (or for the benefit of another) without obtaining approval at a shareholders' meeting; accepting commissions for transactions between other parties and the company; and disclosing company secrets without authorisation.

The Securities Law, the Articles Guidelines and the Governance Guidelines set out further detailed duties and prohibited acts of a director, supervisor or senior manager, covering both the duty of loyalty and the duty of diligence. For example, under the Securities Law, directors and senior management must sign written confirmatory opinions in respect of periodic reports prepared by the listed company, and the supervisory board must review the reports and issue a written opinion on the same. All these members must ensure that there are no false statements, misleading representations or major omissions in information disclosed by the listed company in any accounting reports, annual reports, interim reports and other disclosed information in respect of which such member has provided a confirmatory opinion. Further examples under the Governance Guidelines include that directors must devote sufficient time and energy to perform their duties, and independent directors must ensure their independence and protect the overall interests of the company, with a particular focus on the protection of the legal interests of the minority shareholders.

A director, supervisor or senior manager who has breached his duties under the law or the Articles may be dismissed, required to compensate the company or investor for any loss incurred because of such breach, or may be subject to confiscation of any income obtained as a result of the breach. Administrative penalties or criminal liabilities may also be imposed.

On a related note, the Company Law expressly prescribes that collective responsibility may fall upon all directors if a specific board resolution was passed in violation of laws, administrative regulations, the Articles or a shareholders' resolution, and causes the company to incur serious loss. A director may be released from such liability, however, if he is proven to have expressed his opposition to such resolution when it was put to a vote and the opposition was recorded in the minutes of the board meeting.

3.7 What are the main specific corporate governance responsibilities/functions of members of the management body and what are perceived to be the key, current challenges for the management body?

The principal responsibility of the board is to oversee the business and affairs of the company. As a general matter, this responsibility consists of formulating the basic management system and establishing the internal management bodies of the company, identifying and hiring senior management, proposing and overseeing long-term corporate strategy, proposing the appointment of external auditors and approving the internal auditing controls and procedures and duties of internal auditors. The senior management operates the day-to-day business of the company under the oversight of the board.

The supervisory board's role is to supervise performance of the directors and senior management. Its responsibilities include, but are not limited to, examination of the financial status of the company, monitoring the board and senior management's performance of their duties and compliance with law, regulations and the Articles, proposing the removal of any director or senior manager and requiring directors and senior managers to correct any act that is harmful to the company's interests.

The key challenges facing the management body of a listed company include: (i) independence by the directors from the controlling shareholder in order to enable independent decision-making; and (ii) finding eligible directors, particularly independent directors, with sufficient industry experience and legal and accounting knowledge.

3.8 Are indemnities, or insurance, permitted in relation to members of the management body and others?

There are no statutory requirements nor prohibition in the PRC in relation to indemnities to and insurance of board members and senior management. In terms of indemnities, practically, if a board member or management officer is personally harmed or financially damaged during the course of business or otherwise discharging his professional duties, he can seek a legal remedy in accordance with labour law or tort law, rather than company law, provided that it is offered by the company's constitutional documents that indemnities should be made; however, the validity of such an indemnity can be challenged if it appears to permit a director or officer to contract out of their statutory duties, particularly if the person benefitting from the indemnity has acted in bad faith or breached his duty of loyalty to the company. Furthermore, enforcing an indemnity claim in a PRC court may not be straightforward, as PRC law does not expressly recognise the concept of an indemnity.

As for insurance, it is generally permitted that companies, subject to approval of a shareholders' meeting, maintain insurance for directors in respect of their potential liabilities, except where the liabilities result from the directors' breach of laws, administrative regulations or the Articles of the company. Although directors' and officers' insurance has rarely been purchased by PRC companies, since the newly adopted Securities Law has been speeding up the government's "zero tolerance" policy on capital markets misconduct and greatly increased the risks and costs of committing financial misconduct, it is not a losing bet that directors' and officers' insurance will gradually be much more popular.

3.9 What is the role of the management body with respect to setting and changing the strategy of the corporate entity/entities?

Save the special arrangements of EJV and CJV companies which are allowed to exist within a five-year transition period after January 1, 2020, according to PRC law, the shareholders' meeting has the authority to decide on the company's strategy, and the board has the authority to propose company strategy for shareholders to approve and is responsible for implementing the shareholders' meeting's decision. There is a non-binding guidance of listed companies' Articles of Association issued by the CSRC, providing that the power of the general meeting shall not be deputised to the board, which means it is generally unwelcome if the authority to decide a listed company's strategy is deputised to the board. However, for unlisted companies, such deputising is not against PRC law.

4 Other Stakeholders

4.1 May the board/management body consider the interests of stakeholders other than shareholders in making decisions? Are there any mandated disclosures or required actions in this regard?

Chinese companies may, or under some circumstances are even required to, take account of other interests than their shareholders', but it is due to very different reasons and not in the same way as their Western counterparts. To limit the discussion, in this section we set aside the basic and somewhat universal requirements to comply with rules regulating economic externalities (e.g. environmental protection, public safety, employee welfare, etc.), and only touch on matters which companies usually refer to as their social responsibilities, or ESG (environmental, social and corporate governance) issues in developed economies. Compared to the recent trend to echo the well-meaning and new form of collective capitalism in the West which calls on business to help fix broad economic and social problems (to be discussed in question 5.3), Chinese companies face the question of stakeholders' interests with certain socialist characteristics. Divided by ownership structure, state-owned companies (or "**SOEs**") and private companies may be subject to requirements of different sorts, or in the event of the same requirements, of different degrees.

Generally, SOEs are regulated under a widely accepted belief that the purpose and mission of SOEs are never just about narrow self-interest but are entrenched with much broader social responsibilities. In legal terms only, this can be summarised in two points. First, the Party is legally dubbed "the leading role" in SOEs. Second, SOEs, being wholly or majority-owned by the government, are chartered to shoulder important social functions beyond their economic function. It is inaccurate to say that SOEs, being the most important economic establishments in China, are Party and government apparatuses in any sense. However, SOEs are sometimes expected to promote the Party and government's social agenda, such as economic planning, social stability, industry policies, employment promotion, etc. Therefore, the management team of an SOE, whether being the board or other senior managers, may take the social need and impact into consideration during certain important decision-making. Meanwhile, there are many *ad hoc* or fragmented required actions for SOEs in connection with their social responsibilities. For example, SOEs are mandated to earmark certain managerial roles to the delegates of employees, to centre on the development of certain critical industries, and so on.

The case of private companies is less straightforward. The weighing and actions of social responsibilities are certainly not on the management's daily schedule as in the case of their peers in SOEs. However, it is still considered essential, sometimes maybe even of existential gravity, to answer the Party and government's call to respect its authority and to be aware of policy boundaries to various extents. For instance, profit maximisation shall not empower the management of a private company to sail the company into "sensitive" industries either because the areas may be intertwined with critical governmental interests (e.g., finance) or because they are deemed unwelcome due to the allegedly negative impact (e.g., bookmaking). Speaking of requirements, it is by law encouraged, but in practice compulsory, for private companies passing certain thresholds to set up Party apparatchiks, although without the significance of "the leading role". Also, any companies having a supervisory board must ensure the employee delegates constitute at least one-third of the seats.

It is noteworthy that the social responsibilities of private companies with Chinese characteristics were further reinforced by the Party's "Common Prosperity" campaign, which is evidenced by the number of high-profile companies and entrepreneurs that committed to contribute a large amount of monies to charity or to tackle poverty, or joined other public interest programmes. In addition, and as mentioned above, the requirements for companies to consider interests of other stakeholders such as employees and consumers implied by the Draft Amendment of the Company Law is the first on a national level.

4.2 What, if any, is the role of employees in corporate governance?

Employees do not currently play a direct role in the corporate governance of a company, but they may have some influence through representatives serving on the board or supervisory board, as well as consultation rights on certain matters. Under the Company Law, the board may (but is not required to) include employee representatives and at least one-third of the members of the supervisory board must comprise representatives of the company's employees. The influence of employees in big companies' corporate governance may increase in the future if the Company Law is to be revised on the basis of the Draft Amendment discussed in question 1.3, which requires employee directors to be appointed in companies with more than 300 employees. Further, a company should consult with its labour union and gather the thoughts and recommendations of the employees in its decision-making process with respect to restructuring, company operations or the formulation of important company rules and systems.

4.3 What, if any, is the role of other stakeholders in corporate governance?

Please refer to questions 4.1 and 4.2 for details.

4.4 What, if any, is the law, regulation and practice concerning corporate social responsibility and similar ESG-related matters?

The development of ESG in China is largely driven by policy incentives and regulations as the country seeks to achieve ambitious carbon goals and improve social equality. The current Company Law expressly requires all companies to observe social morals and commercial ethics, act in good faith, accept the supervision of the public and undertake social duties. While these provisions are seen more as promotional provisions rather than as imposing mandatory obligations *per se*, the principles that they articulate are reflected in other areas of PRC legislation, and are expected to lead over time to greater consciousness of social responsibility on the part of companies, government agencies and courts. Below is a brief timeline of the government's efforts in promoting ESG matters in China:

- In 2016, seven authorities, including the People's Bank of China (the "**PBOC**") and the CSRC, jointly issued the Guiding Opinions on Building a Green Finance System, laying a foundation for the establishment of a mandatory environmental information disclosure system for listed companies.
- In 2017, the CSRC and the Ministry of Environmental Protection signed the Cooperation Agreement on Jointly Developing Environmental Information Disclosure of Listed Companies.

- In 2018, the CSRC revised the Listed Company Governance Code, stipulating that listed companies have the responsibility to disclose ESG information. The Asset Management Association of China issued the first Green Investment Guide (Trial) and the Research Report on ESG Evaluation System for Chinese Listed Companies (2018), guiding fund managers to carry out green investment activities and promoting listed companies to improve information disclosure and corporate governance.
- In 2020, the PBOC issued a trial guideline to pilot financial institutions spelling out the framework and content for financial institutions' environmental information disclosure; the same year, Chinese President Xi Jinping announced that China aimed to hit its carbon emissions peak by 2030 and achieve carbon neutrality by 2060.
- On March 1, 2021, Shenzhen started implementing the Regulations on Green Finance of the Shenzhen Special Economic Zone, which fleshed out requirements on the subjects, basis, time, and form of environmental information disclosure.
- On June 28, 2021, the CSRC revised the format standards for annual reports and semi-annual reports of listed companies, which separated relevant provisions on environmental and social responsibility into an independent chapter to highlight the environmental protection and social responsibility of listed companies.
- In 2021, China's carbon peaking and carbon neutrality goals were written into the Government Work Report – this means that the central government has officially put reducing carbon emissions on its agenda. In November, China released an action plan for reaching the carbon emission peak before 2030. China and the EU published the "Common Ground Taxonomy – Climate Change Mitigation", a list of economic activities conducive to fighting climate change recognised by both sides.
- On December 21, 2021, the Ministry of Ecology and Environment released the Measures for Enterprises to Disclose Environmental Information by Law (the "**Measures**") to regulate enterprises' disclosure of environmental information by law. The Measures, which will come into force on February 8, 2022, require five types of enterprises to disclose environmental information. The five categories of enterprises are: key pollutant-discharging enterprises; enterprises that are subject to mandatory review for clear production; listed companies and their subsidiaries at all levels; enterprises that issue enterprise bonds, corporate bonds, and debt financing instruments for non-financial enterprises; and other enterprises that should disclose environmental information under laws and regulations.
- On January 20, 2022, the Shanghai Stock Exchange announced that it will ask the Science and Technology Innovation Board ("**STAR**") market companies to disclose ESG information in annual reports beginning in 2022. As China has pledged to hit peak carbon emission before 2030 and achieve carbon neutrality by 2060, the Shanghai Stock Exchange also stressed that companies should disclose their sustainable development plans in alignment with the 30-60 goals.

In most cases, the disclosure of social responsibility reports is not mandatory but recommended. Increasingly, listed companies are including annual corporate social responsibility reports in their annual reports (or publishing them separately), covering the topics mentioned above.

5 Transparency and Reporting

5.1 Who is responsible for disclosure and transparency and what is the role of audits and auditors in these matters?

Public disclosure (except for any disclosure made by the supervisory board) by public companies is prepared and issued in the name of the board as a whole. However, each director, supervisor and senior manager is responsible for the truth, accuracy and completeness of such information disclosed by the company. In particular, directors and senior management must each give a written confirmatory opinion on the periodic reports of the company, and the supervisory board is responsible for reviewing the report and issuing a written verification opinion.

A public company is required to engage an external accounting firm to audit its internal control system for such matters as corporate governance, capital structure and any deficiency in respect of internal controls. The internal control audit may be conducted separately or together with the audit of the financial accounts of the company and must be disclosed to the public.

5.2 What corporate governance-related disclosures are required and are there some disclosures that should be published on websites?

Corporate governance-related disclosures are mandatory for public companies. The Governance Guidelines provide that at least the following corporate governance-related information must be disclosed: (i) the composition of the board and the supervisory board; (ii) reports on the work of the two boards and the evaluation of their performance; (iii) reports on the work of independent directors and the evaluation of their performance; (iv) the composition and work of each board committee; (v) a general description and commentary on the corporate governance of the company and any deviation from the Governance Guidelines, if any; and (vi) the definitive plan and measures intended to improve corporate governance. Additionally, a public company must periodically disclose financial reports to the public. All such disclosed information must be made available to investors by efficient and economical means (for example, over the internet). In practice, all information that needs to be disclosed by public companies relating to corporate governance is available on the website of the relevant stock exchange and of the company itself.

5.3 What are the expectations in this jurisdiction regarding ESG- and sustainability-related reporting and transparency?

Although ESG-related topics are not new for China, previously they had only been welcomed by a lukewarm nod among policymakers, business leaders and investors in the country. For instance, it was only mandatory for certain public companies such as heavy polluters to make environmental protection disclosures, and sustainability reporting was mainly driven by businesses' self-interest, for instance, by banks in extending credits. However, we may soon witness a leapfrog moment for China in ESG reporting, driven by a new, green wave of force from both the government and the market.

Speaking of the government side, Xi Jinping, the President of the PRC, has announced China's goal to be carbon-neutral by 2060, which will undoubtedly fuel the transition to a low-carbon economy. Developing a sound ESG reporting

system that provides comparable emission data and climate-related practices would set a strong foundation for China's journey towards a low-carbon economy. Although there are still no generally mandatory ESG disclosures in China yet, both of the stock exchanges in China have published disclosure guidance for their listed companies to take the ESG-related disclosures into their evaluation of the quality of information disclosures of listed companies. Considering that Hong Kong's stock exchange (HKEx) has required listed companies to issue ESG reports since 2016, market participants expect that regulators will issue new ESG reporting requirements for companies listed in Shanghai and Shenzhen.

In terms of the market side, globally, assets under management by United Nations Principles for Responsible Investment ("**PRI**") signatories surpassed US$100 trillion in 2020, an increase of 75% over 2015. The PRI has provided a voluntary framework since 2006 that investors can use to incorporate ESG issues into their decision-making and ownership practices. Large international asset managers, most of which are PRI signatories, have already stepped up their ESG engagement with China's Hong Kong and New York-listed large-cap companies. They are now increasing their holdings of mid- and small-cap A-share companies and are factoring ESG issues into their investment decisions. At the same time, a growing number of China-based asset owners and asset managers are committing to the PRI, which redesigned and, in November 2020, released a new reporting framework to better capture the ESG practices of its signatories.

As a response to the driving forces, we have seen the number of A-share listed companies making ESG-related disclosures growing to 1,267 in 2022, representing more than three-fold increase from 2009, among which 237 companies released special ESG reporting (https://www.stcn.com/article/detail/846088.html (in Chinese)).

The content of ESG reports in China is highly qualitative. Quantifiable metrics, which are vital for investment analysis, are limited. The transparency of the methodology and the consistency of disclosure are additional concerns for investors. As with third-party providers, overseas investors without local language resources may sometimes struggle to get the full picture as companies listed only on the onshore market tend to report only in Chinese. Considerably large gaps still exist both for companies trying to improve ESG performance and investors trying to integrate ESG into their investment processes. However, it is not difficult to predict that ESG- and sustainability-related reporting will soon evolve from a decorative design to a serious consensus and actual point of focus for the government and the market.

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Ray has acted as lead counsel for many influential transactions in various industries such as TMT, healthcare, finance, new energy, semiconductor, and high-end manufacturing, and thus possesses in-depth experience and unique insights into the business models, industry regulations, and market practices of these industries. He is particularly skilled in handling complex and unprecedented major transactions that require cross-border and cross-legal jurisdictional considerations, as well as the integration of legal, financial, and tax-related dimensions.

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