DIRECTOR REGULATION IN CHINA: THE SINONIZATION PROCESS

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ABSTRACT

The convergence or persistence debates as to different corporate governance models have attracted international attention in the past few years. This article looks at the development of director regulation in China in the past two decades to examine the differing standpoints in the debates.

The emergence of a modern board of directors came along with the enterprise reforms of the early 1990s in China. Thereafter, with the growing importance of the board in practice, more efforts have been made to promote its effectiveness. At first sight, the Chinese board system seems to have moved away from civil law traditions towards common law regimes in the last two decades, since more Japanese rules have been transplanted

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into China at the initial stage, whilst later American norms and concepts have had greater influence. Nevertheless, the skeleton of the Chinese board is very distinctive from advanced economies, which has persisted—albeit with some changes—through the years. Hence, it is argued that the process of adopting foreign norms and mechanisms for director regulation in China can neither be conceptualized as convergence nor persistence. Rather, it is a process of sinonization in which foreign norms and institutions are filtered and localized into the Chinese context.

INTRODUCTION

In the dynamic world of corporate governance reform, both business and academic circles have become increasingly interested in the future of different corporate governance models. In the past few years, the convergence or persistence debates have fueled a new wave of corporate governance research upsurge. While convergence optimism argues for the superiority of the Anglo–American model of shareholder capitalism over other alternatives,[1] the path dependence theorists emphasize the determining nature of both history and politics in the evolution of corporate governance.[2] This Article focuses on the development of director regulation in the context of the corporate governance reforms in China as a case to examine the differing standpoints in the convergence or persistence debates. It is argued that the process of adopting foreign norms and mechanisms for director regulation in China can neither be conceptualized as convergence nor persistence. Rather, it is a process of sinonization in which foreign norms and institutions are filtered and localized into the Chinese context.

Corporate governance in China has experienced a number of changes in the past two decades. Among them, regulation of the board of directors[3] is one classic field in modern corporate governance that Chinese laws have stepped into and developed length by length. The emergence of a modern

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1. Henry Hansmann & Reinier Kraakman, *The End of History for Corporate Law*, 89 GEO. L.J. 439, 440 (2001).

2. Lucian Arye Bebchuk & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999).

3. The "board" is understood in the narrow sense in this Article, which only refers to those members with management powers. Those members of the board whose major task is monitoring, such as the supervisory board in civil law and the independent directors in common law, are not featured in the discussions here. The sphere of director regulation in this Article involves a number of legal mechanisms which both constrain their behaviors and mold their incentives so as to align their interests with the owners, such as the appointment and removal of directors, powers of the board, civil liabilities of the board of directors, and regulations of the remuneration packages. Since directors in a company are regulated both individually and collegially, there are two layers of discussions in the article: first, the powers and rights of the board of directors; second, the duties and incentive stimulating mechanisms of the directors. Both of them are observed from the perspective of the principal–shareholders and agent–directors relationship.

board of directors comes along with the enterprise reforms of the early 1990s in China. Thereafter, with the growing importance of the board in practice, more efforts are made to promote its effectiveness. At first sight, the Chinese board system seems to have moved away from civil law traditions towards common law regimes in the last two decades, since more Japanese rules have been transplanted into China at the initial stage, whilst later American norms and concepts have had greater influence. Nevertheless, a more detailed review reveals that such an observation is very shallow. What China has borrowed from developed countries are only forms and details rather than substances and structures, and the skeleton of the Chinese board that is very distinctive from advanced economies has persisted albeit with some changes through the years. The trajectory of the evolution of the Chinese board is better described as a process of sinonization. On one hand, although a great deal of foreign regulation is imported, the substantive infrastructure established in China is unique compared with other jurisdictions. On the other hand, the effectiveness of the Chinese board is doubtful, owing to the embedded political, social and economic conditions. Hence, it is concluded that, in terms of director regulation, China is not moving towards a particular model from any other countries. Sinonization is a more appropriate description of the corporate governance reforms in China.

This Article first briefly traces the history of the board of directors and reviews the legal framework for the board of directors in the early 1990s. With real–time comparative analysis of the equivalent rules in Germany, Japan, the UK, and the US, it is discovered that Chinese legal arrangements, although borrowing more rules from Japan than other countries, form a self–contained camp due to their structural peculiarities. Rationales for such uncommon legal settings are subsequently elaborated. Then the Article assesses the efforts made at the turn of the new millennium to promote the board of directors, and considers the constant mixing nature of these new developments. It is conceived that at this stage, more US–style mechanisms have been adopted in China, but the basic structure of the Chinese board has not been substantively changed. The dysfunctions of the board after all these reforms are examined and the causes giving rise to these issues are analyzed. Followed this assessment is an analysis of the progress in 2005 and thereafter. The major legislative movements are studied, and the uniqueness of the adjusted framework is also addressed. The Article then further examines the ineffectiveness of the board of directors due to pitfalls in the law and the unchanged institutional background. Finally, the Article summarizes the full analysis of boards of directors in the whole Article with a description of sinonization of corporate governance.

I. ESTABLISHMENT OF THE BOARD SYSTEM

A. Back to the History

The development of a separate board of directors was accompanied by the emergence of modern corporate laws. Tracing back the historical roots, today's corporate board found its antecedents simultaneously in England and continental Europe during the fourteenth to sixteenth centuries.[4] Later, the norm of using a governing board was reinforced and spread to other countries such as the U.S. and Japan in the colonization process and with the introduction of western technology and ideas.[5] At the turn of the twentieth century, the board of directors, through a series of legal reforms and legislative movements, became free from interference from shareholders in the general meeting and gradually earned its independent status as a corporate organ.[6] In China, the large scale of the introduction of western civilization and institutions after the Opium War also brought about the modern corporate system, of which the board system was an indispensable part. However, the board of directors was not completely separate from the shareholders at that time, because the principle that "corporate directors should be elected from members of the corporation by the general assembly" had been maintained in corporate law revisions through the years.[7] After the founding of new China in 1949, particularly after the completion of the socialist transformation in 1956, the board system was abandoned with the demolition of modern corporate governance in China. It was not until the preliminary stage of the enterprise reforms in the 1980s that the theme of "separation between ownership and management" was picked up again.[8] Unfortunately, reform measures taken in this period, such as the factory manager responsibility system (*廠長負責制*), despite the involvement of autonomy expansion for enterprises, did not have the features of a modern board system.[9]

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4. *See* Franklin A. Gevurtz, *The Historical and Political Origins of the Corporate Board of Directors*, 33 HOFSTRA L. REV. 89 (2004).

5. *See* Franklin A. Gevurtz, *The European Origins and the Spread of the Corporate Board of Directors*, 33 STETSON L. REV. 925 (2004).

6. *See, e.g.*, PAUL L. DAVIES, GOWER AND DAVIES' PRINCIPLES OF MODERN COMPANY LAW 300-01 (2003); 1 JAMES D. COX & THOMAS LEE HAZEN, COX & HAZEN ON CORPORATIONS 410 (2d ed. 2003).

7. *See* ZHANG ZHONGMIN, JIANNAN DE BIANQIAN: JINDAI ZHONGGUO GONGSI ZHIDU YANJIU [DIFFICULT CHANGES: RESEARCH ON CORPORATE SYSTEM IN MODERN CHINA (1842-1949)] 431 (2002).

8. *See* Chen Qi, *Woguo Guoyou Qiye Gaizhi De Lishi Huigu Ji Quxian MBO De Kexingxing Sikao* [*The History of China's State-owned Enterprise Restructuring and the Feasibility of Curved MBO*], 2 BEIFANG JINGJI [NORTHERN ECON.] 20 (2006).

9. For the features and problems of the factory manager responsibility system, see Wang Yanlin & Tian Yinzhi, *Guanyu Changzhang Fuzezhi De Ruogan Wenti* [*Issues Regarding the Factory Manager Responsibility System*], 2 FAXUE PINGLUN [L.REV.] 44

B. Legislation in the Early 1990s

In 1992, the first batch of national corporate laws was promulgated by a number of governmental bodies. Among them stood out the Joint–Stock Companies Regulatory Opinions (*股份有限公司規範意見*) ("JCRO") which, for the first time in China, regarded the board of directors as completely separate from the shareholders. The law provided a number of rules governing this independent corporate organ, such as the legal status, composition, and powers of the board; the calling of board meetings; the appointment and powers of the chairperson; the appointment, term, qualifications and duties of the directors; and the restrictions on share transfers of the directors.[10] Particularly, the board of directors was hailed as the standing corporate authority and should be accountable to the shareholders' meeting.[11]

After the test of these laws, Company Law 1993 ("CL 1993"), together with Provisional Regulations on the Management of the Issuing and Trading of Shares (*股票發行與交易管理暫行條例*) ("PRMITS"), and Decision Concerning the Criminal Punishment of Violations of Company Law (*關於懲治違反公司法的犯罪的決定*) ("DCPVCL"), succinctly laid down the legal basis of the board of directors in China which had profound influence thereafter. Below is an investigation of three major facets of this system at that time, including the board of directors as a whole, the chairperson of the board, and individual directors.

Above all, the board of directors, which should be composed of five to nineteen members, was the mandatory corporate organ of all joint–stock companies (and therefore of all listed companies) and could have been held accountable to the shareholders' general meeting.[12] Generally speaking, two main aspects of the board of directors, the statutory powers of the board and board meetings, were regulated in the laws. The statutory powers of the board of directors, collectively exercised, were stated, and included a number of procedural and substantive matters, such as to convene the shareholders' general meeting and report on its work to the shareholders' general meeting; to carry out the resolutions of the shareholders' general

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(1986). For the failure of old reform measures in improving the intrinsic efficiency of the enterprises, see Jean Jinghan Chen, *Corporatisation of China's State-owned Enterprises and Corporate Governance*, *in* DAVID H. BROWN & ALASDAIR MACBEAN, CHALLENGES FOR CHINA'S DEVELOPMENT: AN ENTERPRISE PERSPECTIVE 59-60 (2005).

10. *See* Gufen Youxian Gongsi Guifan Yijian [Joint-stock Companies Regulatory Opinions] & Guojia Tizhi Gaige Weiyuanhui [State Commission for Restructuring the Economic System] (promulgated by the Standing Comm. Nat'l People's Cong. May 15, 1992, effective May 15, 1992), arts. 30(6), 52-59, 61-62 (China) [hereinafter JCRO].

11. *See* JCRO, at art. 52.

12. *See* Gongsi Fa [The Company Law of the Peoples Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong. Dec. 29, 1993, effective July 1, 1994), art. 112 [hereinafter CL 1993].

meeting; to draft and formulate a number of important plans and basic administrative systems for the company; to decide on the operational plans, investment schemes, internal organizational structure of the company; and to appoint and dismiss the senior management.[13] Contrary to what pertained to limited liability companies, the board of directors of joint–stock companies (and therefore all listed companies) was also responsible for the formulation of plans for the issuance of debentures.[14] As for the board meetings, it was required that the board should have held at least two meetings each year, the date of which should have been made known to all directors ten days prior to the meeting, except for a provisional meeting.[15] The meeting could only have been held on condition that no fewer than half of the directors were present, and the resolution of the board required the approval of no fewer than half of all directors.[16] The minutes of the board meeting had to be signed by the directors present at the meeting.[17]

Next, the chairperson of the board, who was designated as the legal representative of the company,[18] was conferred with a great deal of statutory powers under the legal framework of CL 1993. Other than procedural powers (such as presiding over the general meeting and board meetings, signing share certificates and debentures),[19] the chairperson also had a lot of substantive powers, such as inspecting the implementation of resolutions of the board, calling for a board meeting,[20] and other functions authorized by the board collectively.[21]

Third, the nominations, qualifications, terms, duties, and liabilities of the directors were also provided. The directors were appointed and replaced by shareholders in the shareholders' general meeting,[22] and could not be removed from office before the expiry of their terms by the shareholders' general meeting without cause.[23] And there was a list of passive qualifications which prevented a person from being appointed as a director.[24] The term of office of directors was limited to no more than three years, but reappointment was permitted. Furthermore, there were a number of articles concerning the statutory duties of directors. Directors were required to perform their duties faithfully, to uphold the interests of the company, and to refrain from illegal conduct. Examples of this included using their position for personal gain; taking bribes or accepting other

13. *See* CL 1993.
14. *See Id.* at art. 112(6).
15. *See Id.* at art. 116.
16. *See Id.* at art. 117.
17. *See Id.* at art. 118.
18. *See Id.* at art. 113.
19. *See* CL 1993, at art. 114.
20. *Id.*
21. *See Id.* at art. 120.
22. *See Id.* at art. 103(2).
23. *See Id.* at art. 115.
24. *See Id.* at arts. 57, 58.

unlawful monies; misappropriating or embezzling company assets; using corporate property to provide loans for other parties or to provide guarantees for the debts of shareholders or other individuals; engaging in business competition or self–dealing; and disclosing company secrets.[25] Directors were also required to sign the minutes of the shareholders' general meeting, which were related to corporate decision making.[26] In addition, they were required to report to the company on the quantity of shares they held, and the shares concerned could not be transferred during their terms of office.[27] As for listed companies, a reporting system to China Securities Regulatory Commission ("CSRC") was adopted,[28] and CSRC, after receiving this information, was required to release the reports to the public and the investors for reference.[29] Liabilities were imposed where behaviors of the directors violated these provisions. It was broadly expressed that directors were liable to compensate the company if they breached laws, administrative regulations, or the articles of association and caused damage to the company.[30] In the event that the resolutions of the board contravened laws and administrative regulations and infringed the legal interests and rights of shareholders, shareholders were conferred with the right of action to stop such breach and infringement.[31] Directors might also be responsible for the resolutions of the board and might be liable for any resulting compensation if the resolutions of the board violated laws, administrative regulations, or articles of association and caused damage to the company, except for the dissenting directors, whose opinions were recorded in the minutes of the board meeting.[32] To prevent severe misconduct by the directors, criminal liability by the directors for bribery, embezzlement, and misappropriation by taking advantage of their offices was provided for by the Standing Committee of the National People's Congress ("SCNPC").[33]

With these laws and regulations, the board of directors was established in China. And it should be noted that this was the first time that a board system independent from shareholders was introduced in China. Before that, the board system had been either nonexistent or not completely

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25. *See* CL 1993, at art. 59-62.

26. *See Id.* at art. 109.

27. *See Id.* at art. 147.

28. Gupiao Faxing Yu Jiaoyi Guanli Zanxing Tiaoli [Provisional Regulations on the Management of the Issuing and Trading of Shares], (promulgated by St. Council, Apr. 22, 1993, effective Apr. 22, 1993) art. 62 (China) [hereinafter PRMITS].

29. *See Id.* at art. 64.

30. *See* CL 1993, at art. 63.

31. *See* CL 1993, at art. 111.

32. *See* CL 1993, at art. 118.

33. *See* Guanyu Chengzhi Weifan Gongsifa de Fanzui de Jueding[Decision Concerning the Criminal Punishment of Violations of Company Law] (promulgated by The Standing Comm. Nat'l People's Cong. (Quanguo Renda Changweihui), Feb. 28, 1995, effective Feb. 28, 1995), arts. 9-11 [hereinafter DCCPVCL].

separate from the shareholders, due to overlapping identities of shareholders and directors.

C. The Borrowed but Unique Board

Relatively speaking, Chinese law pertaining to the board of directors in this period adopted a lot more from civil law jurisdictions than from common law regimes. On one hand, some Anglo–American features were shared by Chinese law, as some provisions in CL 1993 copied almost exactly the corresponding articles in common law countries. For example, the liability exemption for dissenting directors in the board meeting in China appeared to closely follow the rule of the Model Business Corporation Act in the U.S.[34] On the other hand, civil law traditions demonstrated more effect on shaping the Chinese board system. For example, the straightforward approach taken as to the term of office for directors in China resembled the normal practice in civil law jurisdictions. In Germany, members of the management board (i.e. the counterpart board of directors in Germany) were appointed for a period not exceeding five years,[35] and the Japanese maximum was two years.[36] Nevertheless, in common law jurisdictions, the term of office for directors was more complicated. In the UK, the term was determined by how the board directors were "retired by rotation,"[37] and in the U.S., it was decided by how the terms were "staggered into groups."[38] In these countries, the total number of directors was divided into several groups, and at each annual general meeting, the term of one group of board members expired and the same number of new directors was chosen. Therefore, the term of directors depended on how many groups the directors were divided into. Comparatively speaking, Chinese law was as straightforward as civil law jurisdictions in the sense that it spelled out directly the definite maximum term of office.[39]

Particularly, the newly born legislation in China shared a certain degree of similarity with Japanese law in terms of the details of legislative techniques. For example, corporate laws in both countries specified the minimum notice period for board meetings. Chinese companies were

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34. *See* MODEL BUS. CORP. ACT § 8.24(d) (1984). It was stipulated that unless the dissent of the director present at the board meeting was entered in the minutes of the meeting, the director was deem to have assented to the corporate action taken. This section is current through the 2007 edition.

35. *See* s. 84, para. 3, Aktiengesetz [AktG] [Stock Corporation Act], Sept. 6, 1965, BGBL. I, last amended by Vorst [AG], July 31, 2009 (Ger.), *available at* http://www.bundesrecht.juris.de/aktg/.

36. *See* SHŌHŌ [COMM. C.] art. 256. (Japan).

37. *See, e.g.*, Companies Act, 1985, c. 6, tbl. A, art. 73 (Eng.).

38. *See, e.g.*, MODEL BUS. CORP. ACT § 8.06.

39. *See* CL 1993, at art. 115.

required to have a ten day notice period,[40] while the requirement in Japan was one week.[41] In contrast, other countries (including other civil law countries) usually left it for the corporation to decide how long such a period should be. German law stated that the working methods of the board were provided by the bylaws issued by the management board, implying that there was no mandatory notice period for a board meeting.[42] And in common law regimes, the notice period for a board meeting was not prescribed in the statutes, either. In both the UK and the U.S., a reasonableness test is laid down in case law pertaining to the minimum period of notice for a board meeting. The "reasonable" period could be a matter of days, hours, or even minutes, depending on the circumstances.[43] It was concluded that both Japan and China regulated matters regarding the board more strictly. The similarities of the board system in both countries could further be witnessed by their regulatory approach to the duties of directors, where the duty of loyalty was underscored and placed at the centre of the rules governing director behaviors. In common law countries including the UK and the U.S., duties of the directors were usually categorized into several types, such as the duty of loyalty and the duty of care.[44] In contrast, civil law countries usually stressed one kind of duty that was supposed to be able to cover others. In Germany, the duty of care stood out to be the general principle of the duties of the directors, which covered a number of more specific applications of this general duty.[45] In Japan, the duty of loyalty was regarded as the general principle which included other rules as to director behavior in corporate legislations.[46] By this comparison, it was noted that Chinese company law adopted the same approach as its Japanese counterpart, where only a duty of loyalty could be found in company law while a duty of care was absent.[47] In sum, more features of Japanese law were learned by the Chinese legislature than those of other countries.

More commonalities between the Chinese board and the board in civil law countries, nevertheless, did not mean that Chinese law governing the board of directors was converging towards civil law, or more specifically, Japanese law, because these similarities were only in form and detail rather

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40. *See* CL 1993, at art. 116.

41. *See* SHŌHŌ [COMM. C.] art. 259, para. 2 (Japan).

42. *See* AktG, § 77.

43. *See* Denis Keenan, SMITH & KEENAN'S COMPANY LAW 398 (12th ed. 2002); COX & HAZEN, *supra* note 6, at 422.

44. *See* DAVIES, *supra* note 6, at 370-71, 380; COX & HAZEN, *supra* note 6, at 476.

45. *See* AktG §§ 77, 93.

46. *See* Hideki Kanda & Curtis J. Milhaupt, *Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law*, 51 AM. J. COMP. L. 887, 894 (2003).

47. Actually, the duty of care could also be found in the Japanese Civil Code, but this duty is only in a general sense instead of aiming at the duty of a director. *See* NIPPON NO MINPŌ [CIV. C] art. 644 (Japan).

than in substance and structure. In fact, the differences between the board system in China and that of developed countries were so acute that they gave the Chinese legal arrangement its own distinctive features and placed it in a camp of its own. At the board level, the Chinese board had far fewer powers than its equivalents in advanced economies.[48] In the UK, directors might "exercise all the powers of the company" unless there were limitations in the law or the memorandum and articles, and directions given by special resolutions.[49] In the U.S., similar provisions could be found in Delaware General Corporation Law[50] and the Model Business Corporation Act.[51] In Germany, the Stock Corporation Act conferred on the management board the sole duty to manage the corporation which could not be delegated to others apart from a few exceptions.[52] In Japan, the Reform of Commercial Code in 1950 had created a board of directors which managed all the business affairs of the company except for those under the scope of powers of the shareholders' general meeting.[53] It was noteworthy that boards of directors in these countries were all treated as the final, decisive authority of a very broad scope of corporate affairs superior to the general assembly. This was the so–called "board centralism."[54] In contrast, the Chinese board did not have a range of decision–making powers and rights as such. Under the legal framework of CL 1993, the shareholders' general meeting was empowered with the rights of deciding the business policies and investment plans,[55] while the board of directors was only entitled to the rights as to business plans and investment programs.[56] These wordings implied that the general assembly, rather than the board of

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48. *See* Wu Jianbin, *Gouzhu Woguo Xiandai Qiye Zhidu De Kexue Falv Jichu: Jianlun Jinyibu Wanshan Woguo Gongsi Lifa De Jige Wenti* [*Building up a Scientific Legal Basis of China's Modern Enterprise System: Also on Several Issues as to the Further Improvement of China's Corporate Legislations*], 1 ZHONGGUO FAXUE [CHINESE LEGAL SCI.] 30, 32-34 (1998).

49. *See* Companies Act, 1985, c. 6, tbl. A, art. 70 (Eng.).

50. *See* DEL. CODE ANN. tit. 8, § 141(a) (2010). It was stated that the business and affairs of every corporation should be, generally speaking, managed by or under the direction of the board of directors saving the exceptions in the laws or the certificate of incorporation.

51. *See* MODEL BUS. CORP. ACT § 8.01(b). The idea of this section was generally the same as Delaware General Corporation Law.

52. *See* Martin Gelter, *The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance*, 50 HARV. INT'L L. J. 129, 157-60 (2009).

53. *See* Zenichi Shishido, *Reform in Japanese Corporate Law and Corporate Governance: Current Changes in Historical Perspective*, 49 AM. J. COMP. L. 653, 662-65 (2001).

54. *See* Wu Jianbin, *Xiandai Gongsi Zhili Jiegou De Xin Qushi* [*New Trends of Modern Corporate Governance*], 4 FAXUE ZAZHI [L. SCI. MAG.] 16 (1996). *See also* Michael J Whincop, *The Role of the Shareholder in Corporate Governance: A Theoretical Approach*, 25 MELB. UNIV. L. REV. 418, 442-45 (2001); SHANGSHI GONGSI FALV GUIZHI LUN [ON THE LEGAL REGULATIONS OF LISTED COMPANIES] 26-29 (Zhou Yousu ed., 2006).

55. *See* CL 1993, at art. 103.

56. *See* CL 1993, at art. 112.

directors, was the ultimate authority for making corporate strategies. Most of the powers of the board were very soft, since the preliminary plans and schemes made by the board[57] were subject to the approval of the shareholders' general meeting.[58] And the board of directors was also required to report on its work to the shareholders' general meeting and implement the resolutions passed by the shareholders' general meeting,[59] which meant that the residual powers as to the business operation of the company not listed in the Law belonged to the general assembly rather than to the board. From these prescriptive articles, it was found that the board of directors in China was chiefly charged with the implementation of shareholders' resolutions and was not in the center of corporate management.[60] Therefore, the legal setting in China was "shareholders centralism" rather than "board centralism" and should be distinguished from that of other countries.

Another important aspect that sets the Chinese board apart from other jurisdictions is the legal representative system. In many jurisdictions, the function of externally representing the company in dealings with third parties was achieved by the board of directors collegially, which in turn could authorize one or more directors to represent the company on occasions at discretion. In the UK, the board as a whole acted as the external representative of the company,[61] and might delegate any of their powers to any managing director as they considered desirable.[62] In the U.S., the board of directors collectively was thought of as the primary agent with powers as extensively as the objects and purposes of the corporation required.[63] In theory, every director was entitled to represent the company externally.[64] In Germany, the power of externally representing the corporation was given to the management board collegially, and the articles of incorporation or internal management (or job) allocations could entrust individual members to execute certain specific managerial functions.[65] In Japan, the function of externally representing the company was fulfilled by the representative director system (*代表取締役* or *daihyō torishimariyaku*)[66]

57. *Id.*

58. *Id.*

59. *Id.*

60. Chenxia Shi, *What Matters in the Governance of the Board?—A Comparative Perspective*, 17 AUSTL. J. CORP. L 1, 14 (2004).

61. *See* K. L. ALEX LAU, A COMPARATIVE STUDY BETWEEN THE BOARDS OF DIRECTORS IN MAINLAND PEOPLE'S REPUBLIC OF CHINA AND HONG KONG 8 (2005).

62. *See* Companies Act ,1985, c. 6, tbl. A, art. 72 (Eng.).

63. *See* COX & HAZEN, *supra* note 6, at 453.

64. *See* Gan Peizhong, *Gongsi Daili Zhidu Lunlüe* [*Analysis of the Company Agency System*], 6 ZHONGGUO FAXUE [CHINESE LEGAL SCI.] 71, 72 (1997).

65. *See* JEAN J. DU PLESSIS ET AL., GERMAN CORPORATE GOVERNANCE IN INTERNATIONAL AND EUROPEAN CONTEXT 50-51 (2007).

66. Andreas Moerke & Harald Dolles, *Corporate Governance in Multinational Corporations During Turbulent Times—Cases from the Automotive Industry* 17 (Deutsches

after the Reform of Commercial Code in 1950. The board, by its resolution, could designate one or more directors as the representative director of the company, and a company could appoint several representative directors at the same time to represent the company separately.[67] In sum, the law in advanced economies usually assigned the board to represent the company collectively. Flexibilities were provided so that the particular director and the scope of authority to represent the company could be determined by internal corporate decisions.[68] In this regard, the legal representative system in China was extraordinary, due to its singular and statutory nature. Under the Chinese system, the legal representative was a natural person authorized either by law or the articles of association of a company to act on behalf of and to bind the company.[69] Only one director could be appointed statutorily as the legal representative and had the right to conduct business with outsiders on behalf of the company, even if there were several directors in the company. The purview of the legal representative was stipulated by the laws, leaving no room for corporate autonomy to step in. So, the flexible board representation and delegation system in other countries was replaced by the one–person and stereotyped legal representative system in China that should be distinguished from other jurisdictions. In general, the board system established in this period was featured with Chinese characteristics in the sense that on one hand, the board of directors was inferior to the shareholders' general meeting; but on the other hand, within the limited powers of the board, the legal representative, by controlling the power to conduct external transactions with third parties on behalf of the company, dominated a substantial portion of them.

D. Rationale for the Uncommon Legal Settings

The Chinese–style legal settings as to the board of directors should be read in the socio–economic context at that time. Above all, abandoning board centralism did not mean that Chinese policymakers were not aware of the international prevalence of this trend in the drafting of company laws in the early 1990s. In fact, they were very hesitant to empower the board, as could be seen by the deviations between JCRO and CL 1993. Although it

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Institut Für Japanstudien, Working Paper No. 04/3, 2004), *available at* http://cosmic.rrz.uni-hamburg.de/webcat/hwwa/edok05/f10908g/WP04-03.pdf.

67. *See* SHŌHŌ [COMM. C.] art. 261 (Japan).

68. *See* Yang Ji, *Zhongguo Gufen Gongsi Fading Dabiaoren Zhidu De Cunfei* [*The Maintanence or Abolition of the Legal Representative System in Chinese Joint Stock Corporations*], *in* ZHUANXING ZHONG DE GONGSIFA DE XIANDAIHUA [MODERNIZING COMPANY LAW IN TRANSFORMATION] 137 (Wang Baoshu ed., 2006).

69. *See* Minfa Tongze, Diliujie Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui [General Principles of Civil Law] (promulgated by the Standing Comm. of the Nat'l People's Congress, Apr. 12, 1986, effective Apr. 12, 1986), art. 38 (China) [hereinafter GPCL].

was clearly stated in the former that the board of directors was the standing corporate authority,[70] this expression was removed in the latter and substituted with the provision that the general assembly was the corporate authority.[71] This change signaled the truth: that the transferring of powers from the board to the shareholders' general meeting was deliberate and purposeful. Generally speaking, the powerlessness of the board reflected the fact that the government did not have full confidence in this corporate organ due to a number of reasons.

First, empowerment of the board did not fit into the need for the protection of state–owned assets. Undeniably, corporate legislative movements in the early 1990s were to facilitate the establishment of a modern enterprise system in state–owned enterprises ("SOEs"). As the most important feature, state–owned assets took up the vast majority of the total assets of SOEs, and protection of these assets was one of the major concerns during the law drafting process.[72] Legal arrangements for the board of directors, especially the range of its rights and powers, should also serve the purpose of transforming SOEs into modern enterprises and should not conflict with the protection with state–owned assets. If the board centralism model utilized in other countries were adopted by China, the Chinese board would have the final decision–making powers on the vast majority of corporate matters and become the corporate organ, which, at least in law, actually directed the SOEs. However, such arrangements were not desirable in the Chinese context, because it implied that hundreds of billions of state–owned assets would be in the hands of the board. In so doing, the board might hold discretion to sell, or even dispose of, state–owned assets where such a decision was thought to accord with the business strategies of the company. Regardless of whether such business behaviors would benefit the incorporated SOEs or not, the direct result of them would have been the loss of state–owned assets, or reduction of the total quantity of state–owned assets in the whole economy, which might eventually threaten the cornerstone of socialism, where public ownership dominated by state ownership should account for the majority position of the whole economy.[73] Furthermore, it would also open the door for misappropriation and encroachment of state–owned assets by the directors. Although *ex post*

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70. *See* JCRO, at art. 52.

71. *See* CL 1993, at art. 112.

72. *See* Ma Zhen-Jiang, *Goujian Dongshihui Zhongxin Zhuyi De Gongsi Faren Zhili Jiegou* [*Establishing Corporate Governance Structure Centered with Board of Directors*], 2 DONGBEI SHIDA XUEBAO (ZHEXUE SHEHUI KEXUE BAN) [J. NORTHEAST NORMAL UNIV. (PHIL. & SOC. SCI)] 75, 77 (2009).

73. Guanyu Jianli Shenhuizhuyi Shichangjingji Tizhi Ruogan Wenti de Jueding [Decision on Some Issues Regarding the Establishment of a Socialist Market Economic System] (promulgated by 3rd Plenary Meeting of the 14th Session of the Standing Comm. of the Chinese Communist Party, Nov. 14, 1993, effective Nov. 14, 1993), arts. 8-9 [hereinafter DSIRESMES].

administrative and judicial actions to correct these misbehaviors made disgorgement likely, these actions could be ineffective, incomplete, or even, in some cases, fruitless. The disadvantages of *ex post* actions to curb directors' misbehaviors rendered the empowerment of the board inappropriate in China. In this regard, to put state–owned assets in the hands of the managing directors would possibly not be in line with the sanctity of public property, on which there was an emphasis in a socialist economy like China.[74] If board centralism was not introduced, this evil door would be closed, or at least not open so widely because the board was not at the power center of dealing with state–owned assets. Hence, empowerment of the board of directors was not regarded as advantageous. Instead, it was thought safer to confine the rights and powers of the board to avoid any trouble.

Second, the witnessed tension between empowerment of the board of directors and the appropriate constraints over them in developed countries also discouraged the establishment of a powerful board. Obviously, if board centralism was set up as the general principle, then the law had to be concerned with providing a framework of rules which constrained the potential abuse of powers by directors. Unfortunately, the right balance between these two ends was not struck in an appropriate manner even in advanced economies with hundreds of years of corporate law practice. Actually, this had been an age–old problem which was constantly revisited by generations of rule makers, who usually changed company law in order to address the last corporate scandal rather than successfully identify where the next risk would come from.[75] And in the years before the drafting of CL 1993, the defects of board centralism were gradually exposed by the abuse of powers of directors case by case in other jurisdictions. To remedy the deficiencies reflected, the board centralism model, though not abolished, was being modified by setting up more checks and balances in corporate governance, such as interference of institutional shareholders in insider control, employee participation in corporate governance, and supervision of banks and other financial institutions.[76] However, the hot debates that drastically increased from 1980s onwards still did not have any definite conclusions by the early 1990s. In the UK, the significant Cadbury Report came out in 1992, with the longest chapter discussing various aspects of the

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74. *See* XIANFA art. 12 (1982) (China); XIANFA art. 12 (1993) (China).

75. *See* DAVIES, *supra* note 6, at 370; Gordon Walker, *Corporate Governance in East Asia: Prospects for Reform, in* CORPORATE GOVERNANCE: AN ASIA-PACIFIC CRITIQUE 589-90 (Low Chee Keong ed., 2002).

76. *See* Zhu Bo–Yu, *Gongsi Faren Zhili Jiegou De Lishi Yanbian Ji Dianxing Moshi* [*The Historical Evolution and the Typical Model of Corporate Governance Structure*], 6 SHANDONG DAXUE XUEBAO (ZHEXUE SHEHUI KEXUE BAN) [J. SHANDONG UNIV. (SOC. SCI.)] 66, 69-70 (2001).

board,[77] but the feasibility and impact of this report was yet to be seen at that time. And in the U.S. (the origin of the debates on corporate governance movements), although corporate law amendments had taken place in some of the states,[78] a nationwide consensus— a product of years of development and preparation—was still on its way.[79] Against the background that the board centralism model in other countries was facing unprecedented challenges, it would be understandable that China did not adopt this model immediately since this model might or might not be retained in the near future in advanced economies. Particularly, as a country where the modern corporate system was only in place for a few years and corporatization was still in its infancy, it would have been too demanding for China to foresee the future of the retaining but modified board centralism.[80] Taking all these elements into consideration, a conservative but safe measure was not to strengthen, but to weaken the role of the board of directors.

In addition, the legal representative system was a continuation of the previous factory manager responsibility system in SOEs. In the 1980s, the ambiguous responsibility systems were identified as one of the roots of the low efficiency of SOEs. To change this vague status, the simplest method was to center all the responsibilities on one person. And as a necessary condition for the establishment of this mechanism, all powers should also be concentrated on one person. The product of this idea was the factory manager responsibility system, which was pushed forward to the frontier of SOE reforms swiftly during the whole of the 1980s. Under this system, powers and responsibilities in the management of SOEs were all centered in one person, i.e. the factory manager. By occupying the central position in the firm, this leader was then the single head of the enterprise and responsible for the whole system of production, operation and

77. *See* COMM. ON THE FIN. ASPECTS OF CORPORATE GOVERNANCE & GEE & CO., LTD. REPORT OF THE COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE (1992) [hereinafter FINANCIAL ASPECTS].

78. In 1983, Pennsylvania was the first state that passed a constituency statute which permitted the exercise of fiduciary duties with regard to the effects on stakeholders for the sake of the modification of board centralism. This was followed by twenty-eight other states over the next decade. *See* Adam Winkler, *Corporate Law or the Law of Business?: Stakeholders and Corporate Governance at the End of History*, 67 LAW & CONTEMP. PROBS. 109, 123 (2004).

79. The major report from the American Law Institute, namely PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS, which had a standing on the legal functions, powers and duties of the board of directors, was published in 1994, one year after the promulgation of CL 1993. *See generally* A.L.I., PRINCIPLES OF CORPORATE GOVERNANCE, ANALYSIS AND RECOMMENDATIONS (1994).

80. For an analysis of the modified board centralism model, see Bo–Yu, *supra* note 76, at 70.

management.[81] As part of the major management powers of the company, the power to represent the company was also exclusively given to the factory manager.[82] Later, this kind of representation was legitimately confirmed as the legal representative system in GPCL,[83] which designated one person to enjoy the unique power to represent the company externally.

Owing to the broad scope of application of this piece of basic law, the legal representative system was, at this time, made applicable to all legal entities in China in addition to SOEs. Corporate legislation in the early 1990s went on with this special representation system, which reflected the fact that Chinese policymakers did not completely emancipate from the old system that emphasized the leading role of a single head in the power structure of corporate management and operation. Although the introduction of a board of directors under CL 1993 made collective exercise of corporate management powers a necessary requirement, with the maintenance of the legal representative system, power concentration in one person was maintained to a large extent. Under the legal arrangement of this Law, one single board member attained a legal status superior to that of other directors due to the unique and extensive powers in representing the company externally. In so doing, a substantive amount of power of the board was concentrated on a single person, which partially mirrored the old practice. Possibly, apart from the inertial thinking about enterprise management, the preservation of the idea of a single leader was to reduce the pain in the reform process. Under this legal setting, the former factory manager could be easily transformed into the legal representative of the company, and therefore his central position in the enterprise, by monopolizing the power to deal with external business with third parties, was sustained.[84] In short, the legal representative system reflected the endurance of the old factory manager responsibility system and the continuity of the systems before and after reform.

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81. *See* Quanmin Suoyouzhi Gongye Qiyefa [Law of Industrial Enterprises Owned by the Entire People] (promulgated by 1st Mtg. Nat'l People's Cong. [Diqijie Quanguo Renmin Daibiao Dahui Diyici Huiyi], Apr. 13, 1988, effective Aug. 1, 1988) art. 45 (China).

82. *See* Liu Jing-wei, *Lun Fading Daibiaoren* [*On Legal Representative*], 2 GUIZHOU DAXUE XUEBAO (SHEHUI KEXUE BAN) [J. GUIZHOU UNIV. (SOCIAL SCIENCE)] 13, 17-19 (2002); LIU JINGWEI, DANGDAI ZHONGGUO MINSHI LIFA WENTI [ISSUES OF CIVIL LEGISLATIONS IN MODERN CHINA] 70-73 (2005).

83. GPCL, at art. 38

84. *See* Xu Yanbing, *Lun Fading Daibiaoren Zhidu De Biduan Jiqi Wanshan* [*On the Drawbacks and Improvement of the Legal Representative System*], *in* GONGSI ZHILI: GUOJI JIEJIAN YU ZHIDU SHEJI [CORPORATE GOVERNANCE: INTERNATIONAL REFERENCE AND INSTITUTION DESIGN] 1 (Bintian Daodai & Gu Gongyun eds., 2005).

II. Actions at the Turn of the Century

A. Efforts to Promote the Board

The limited legal position of the board of directors in black letter law did not necessarily mean that the board was powerless in reality. According to two surveys of the companies listed on the two domestic stock exchanges, the Chinese board had a much more important role in the governance of many listed companies than prescribed in the laws. In a survey of the companies listed in Shanghai, 71.7% of the interviewed companies thought that the board of directors was the key to the promotion of corporate efficiency and competitiveness, and 50.3% of them chose the board of directors as the proper organ to be responsible for the drafting of corporate development strategies.[85] Another survey of the companies listed in Shenzhen found that 42% of the boards of directors in the investigated companies had relatively broad investment decision–making powers, and these companies had better corporate performance.[86] This implied that a more powerful board could contribute to superior corporate performance.[87] Furthermore, with the continuous authority expansion of the board, the practical position of the monopolistic legal representative in corporate governance was also upgrading. Without proper checks and balances, this key player in the company might abuse the exclusive powers in dealing with third parties. Responsive to the potential problems associated with the gradual empowerment of the board in practice, more laws and rules followed. Among them, the Guidelines for the Articles of Association of Listed Companies 1997 ("GAALC 1997") and Code of Corporate Governance for Listed Companies ("CCGLC") stood out. These rules, generally speaking, dealt with issues regarding two layers of the board system: the board as a whole and the individual board members. These aspects of the reform are now reviewed in turn.

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85. Shanghai Zhengquan Jiaoyisuo [Shanghai Stock Exchange], *Shangshi Gongsi Zhili Wenjuan Diaocha JieguoYu Fenxi* [*Results and Analysis of the Survey of Corporate Governance for Listed Companies*], 12 SHANGSHI GONGSI [LISTED COMPANIES] 11, 25 (2000).

86. *See* He Weidong, *Shenjiaosuo Shangshi Gongsi Zhili Zhuangkuang Diaocha Fenxi Baogao* [*Report on the Survey of Corporate Governance for Listed Companies of Shenzhen Stock Exchange*], ZHENGQUAN RIBAO [SEC. DAILY], Dec. 18, 2003.

87. The value orientation of the board of directors is efficiency. A corporate power structure centralized on the board is advantageous to quick response to the ever–changing market. *See* Huang Zikai, *Dongshihui De Zhidu Jiazhi: Gongsi Liyi* [*Institutional Value of the Board of Directors: Corporate Interests*], 3 ZHEJIANGSHENG ZHENGFA GUANLI GANBU XUEYUAN XUEBAO [J. ZHEJIANG C. POL. & L.] 22 (2001). Therefore, the gap between law and practice of the Chinese board could be understood in the sense that, with the deepening of market–oriented reform, the enterprise has to be more swiftly responsive to market changes, and therefore a centralized board emerges.

1. *Confirming Powers of the Board*

As a response to its rising status in reality, more powers were conferred on the board of directors in laws and rules, such as formulating the listing plan of securities; the plan for major mergers and stock repurchases; the revision of the articles of association; deciding on security matters under the authorization of the shareholders' general meeting; the reward and punishment issues of senior management; managing the disclosure of corporate information; putting forward to the shareholders' general meeting the proposal relating to the appointment or removal of accounting firms;[88] and interpreting the articles of association of the company.[89] The board also enjoyed the discretion of whether to include the proposal submitted by shareholders in the agenda of the general meeting[90] and had the power of using proxy solicitation in the shareholders' general meeting.[91] The board was further granted power to exercise any rights authorized by the shareholders' general meeting.[92]

2. *Building up Checks and Balances Within the Board*

To establish a more appropriate system of power distributions, more checks and balances were built within the board. First, in spite of the maintenance of powers of the chairperson,[93] some restrictions were imposed on the collective authorization of powers on the chairperson by the board.[94] Some procedural remedies were also given where the chairperson, as the legal representative, failed to perform his duties.[95] Second, some rules were provided to avoid the undue influence of an interested director, such as abstention in the voting procedure[96] or withdrawal from a board meeting.[97]

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88. *See* Shangshi Gongsi Zhangcheng Zhiyin [Guidelines for the Articles of Association of Listed Companies] (promulgated by the Securities and Futures Commission No. 16, Dec. 16, 1997, effective Dec. 16, 1997), art. 94 [hereinafter GAALC 1997].

89. *See Id.* at art. 194.

90. *See Id.* at art. 59.

91. *See* Shangshi Gongsi Zhili Zhunze [Code of Corporate Governance for Listed Companies] (promulgated by the Standing Comm. Nat'l People's Cong., Jan. 7, 2002, effective Jan. 7, 2002) art. 10 (China), [hereinafter CCGLC]; Guanyu Jiaqiang Shehui Gongzhonggu Gudong Quanyi Baohu De Ruogan [Guiding Provisions on Strengthening the Protection of the Rights and Interests of General Public Shareholders], (promulgated Dec. 7, 2004, effective Dec. 7, 2004) art. 1(3) (China) [hereinafter PSPRIGPS].

92. *See* CCGLC, at art. 7.

93. *See* GAALC 1997, at art. 99.

94. *See* CCGLC, at art. 48.

95. *See* Qiye Faren Fading Daibiaoren Dengji Guanli Guiding (99 Xiuding) [Provisions for the Management of Registration of Legal Representative in Enterprises as Legal Persons (1999 Revision)] (promulgated by Nat'l Admin. Bureau of Indus. & Commerce, June 23, 1999, effective June 23, 1999) art. 7 (China).

96. *See* GAALC 1997, at art. 83; Guanyu Shangshi Gongsi Wei Taren Tigong Danbiao Youguan Wenti De Tongzhi [Circular on Issues Concerning Providing Guarantees

Third, certain matters were required to be approved by the board of directors by a special resolution.[98] Fourth, committed structures, such as corporate strategy committee, audit committee, nominating committee, and remuneration committee were developed by the board.[99] Fifth, separation between the board and senior management was also emphasized so that the board could be more independent in monitoring the management team. The number of directors who also acted as the managers, vice managers, or other senior management staff was set as not exceeding half of the total directors.[100] In answering the increasing adoption of chief executive officers in China,[101] division between the chairperson of the board and the chief executive was highly recommended.[102]

3. Strengthening the Duties of Directors

Due to the weaknesses in CL 1993,[103] subsequent changes were made to revolutionize duties of directors in two aspects. First, the former duty of loyalty was further elaborated by more specific prohibitive acts, such as: not exercising their powers beyond their scope of duties, not using inside information to reap benefits for themselves or others, not availing themselves or others of invading or accepting business opportunities of the company, not accepting the commission associated with the transaction with the company without informed approval of the shareholders' general meeting,[104] and not suspending or delaying a general meeting which might

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for Third Party of Listed Companies] (promulgated by the China Securities Regulatory Comm., June 6, 2000, effective June 6, 2000) art. 5 (China).

97. *See* CCGLC, at art. 71.

98. *See* Guanyu Guifan Shangshi Gongsi Yu Guanlianfang Zijin Wanglai Ji Shangshi Gongsi Duiwai Danbao Ruogan Wenti De Tongzhi [Circular on Several Issues Concerning the Regulation of Financial Transactions Between Listed Companies and Affiliated Parties and External Guarantees of Listed Companies] (promulgated by the China Securities Regulatory Comm., Jan. 7, 2004, effective Jan. 7, 2004) art. 2(3) (China) [hereinafter Circular on Several Issues Concerning the Regulation of Financial Transactions between Listed Companies and Affiliated Parties and External Guarantees of Listed Companies]; Guanyu Guifan Shangshi Gongsi Shiji Kongzhiquan Zhuanyi Xingwei Youguan Wenti De Tongzhi [Circular on Regulating the Transfer of Actual Control over Listed Companies] (promulgated by the China Securities Regulatory Comm., Jan. 7, 2004, effective Jan.7, 2004) art. 3 (China).

99. *See* CCGLC, at arts. 52-58.

100. *See* GAALC 1997, at art. 118.

101. *See*, *e.g.*, Han Qi, *Cong Geren Yezhu Dao CEO* [*From Individual Entrepreneur to CEO*], 5 GUAN LI XIAN DAI HUA 20, 24 (2001) (China).

102. *See* Guanyu Shenhua Daxing Qiye Jituan Shidian Gongzuo Yijian De Tongzhi [Opinions on Deepening the Pilot Reforms in Large Enterprise Groups] (promulgated by St. Council, Apr. 29, 1997, effective Apr. 29, 1997) art. 2(3) (China).

103. *See* Mary L. Riley, *Directors' Liability in PRC Companies*, 6(8) INT'L COMPANY & COMMERCIAL L.REV. 292 (1995).

104. *See* GAALC 1997, at art. 80.

pass a resolution against them.[105] And the listed companies were allowed to impose more specific duties on the directors where they thought fit.[106]

Second, two new kinds of duties, the duty of care and duty of good faith, were established for board members. Directors were required to exercise the rights conferred by the company "carefully, earnestly, and diligently."[107] Listed companies were encouraged to lay down specific measures as to the effective implementation of "the duty of good faith."[108] The content of these new duties was also outlined by listing a number of specific prescriptions, such as reading the business and financial reports of the listed companies carefully and keeping abreast of the business operation and management of the company; exercising the rights of management and disposal conferred by the company in person without the manipulation of others;[109] ensuring adequate time and energy for the performance of their duties;[110] attending the board meeting in a diligent and responsible manner and expressing clearly their opinions on the topics discussed;[111] strictly fulfilling the undertakings they made publicly;[112] attending the relevant training to learn more about their rights, obligations, and duties; familiarizing themselves with relevant laws and regulations; and mastering relevant knowledge necessary for acting as directors.[113] It was even stated that all directors in a listed company bore the duty of good faith for the regular convening of the shareholders' general meeting.[114]

4. Enhancing the Accountability of Directors

A number of devices were enacted in this period to reinforce the accountability of directors. First of all, the board may propose the shareholders' general meeting to dismiss a director who failed to attend two

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105. *See* Shangshi Gongsi Gudong Dahui Guifan Yijian (1998 Nian) [Regulatory Opinions on the Shareholders' General Meeting of Listed Companies (1998)] (promulgated by China Sec. Reg. Comm'n, Feb. 20, 1998, effective Feb. 20, 1998) art. 15 (China) [hereinafter ROSGMLC 1998)].

106. *See* GAALC 1997, at art. 80.

107. *See Id.* at art. 81.

108. *See* Guanyu Dui Gongkai Faxing Gupiao Gongsi Jinxing Fudao De Tongzhi [Circular on Assistance for Companies Offering Public Shares] (promulgated by the China Securities Regulatory Comm. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Sep. 5, 1995, effective Sep. 5, 1995) art. 5 (China).

109. *See* GAALC 1997, at art. 81.

110. *See* CCGLC, at art. 34.

111. *See Id.* at art. 35.

112. *See Id.* at art. 36.

113. *See Id.* at art. 37.

114. *See* Shangshi Gongsi Gudong Dahui Guifan Yijian (2000 Nian Xiuding) [Regulatory Opinions on the Shareholders' General Meeting of Listed Companies (2000 Revised ed.)], promulgated by China Sec. Reg. Comm'n [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], May 18, 2000, effective May 18, 2000) art. 2 (China) [hereinafter ROSGMLC 2000].

consecutive board meetings without authorizing other directors to represent him/her.[115] In addition, all directors of the listed company would be charged with joint and several liabilities in certain cases.[116] Civil liabilities of the directors were further consolidated in GAALC 1997 and judicial interpretations by upholding lawsuits against directors. Both the company and the shareholders could sue the company directors based on the articles of association.[117] And shareholders, as clarified by judicial interpretations, were entitled to bring lawsuits against the resolution of the board of directors detrimental to their legal interests,[118] or against the directors directly where they engaged in misrepresentation of the company.[119] For administrative liabilities, CSRC and the stock exchanges could impose sanctions on directors who did not duly perform their duties, such as reprimand, warning, fine, suspension, and banning from the market.[120] The regulators might also instruct listed companies to remove incapable directors according to legal procedures in certain circumstances.[121] Criminal liabilities of directors were also enhanced in a number of ways in Criminal Law 1997 (*1997 年刑法*).[122]

115. *See* GAALC 1997, at art. 85.

116. *See* Circular on Several Issues Concerning the Regulation of Financial Transactions Between Listed Companies and Affiliated Parties and External Guarantees of Listed Companies, at art. 2; Zhengquanfa [Securities Law 1997] (promulgated by Standing Comm. Nat'l People's Cong. [Quanguo Renda Changweihui], Dec. 29, 1998, effective July 1, 1999) arts. 42, 63 (China) [hereinafter SL 1997].

117. *See* GAALC 1997, at art. 10.

118. Guanyu Zhou Zhengyi Zhuanggao Pudong Fazhan Yinhang Yaoqiu Chexiao Zengfa Xingu Yi'an Deng Yilei Jiufen De Tousu Yingfou Shouli De Fuhan [Circular Regarding the Lawsuit by Zhou Zhengyi Against Pudong Development Bank Seeking to Withdraw the Resolution of Issuance of Additional Shares by Supreme People's Court] (promulgated by the Sup. People's Ct. [Zuigao Renmin Fayuan], Nov. 21, 2002, effective Nov. 21, 2002) (China) [hereinafter Zhengyi Lawsuit].

119. *See* Guanyu Shouli Zhengquan Shichang Yin Xujia Chenshu Yinfa De Minshi Qinquan Jiufen Anjian Youguan Wenti De Tongzhi [Circular on the Relevant Issues Concerning the Acceptance of Civil Tort Dispute Cases Caused by Misrepresentations in the Securities Markets] (promulgated by the Sup. People's Ct. [Zuigao Renmin Fayuan], Jan. 15, 2002, effective Jan. 15, 2002) (China) [hereinafter Dispute Cases]; Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa De Minshi Peichang Anjian De Ruogan Guiding [Provisions Governing the Adjudication of Civil Compensation Cases Based upon Misrepresentations in the Securities Markets] (promulgated by the Sup. People's Ct. [Zuigao Renmin Fayuan], Jan. 9, 2003, effective Feb. 1, 2003) (China).

120. *See* Chenxia Shi & Hu Bin, *China*, *in* DIRECTORS' PERSONAL LIABILITY FOR CORPORATE FAULT: A COMPARATIVE ANALYSIS 115, 124-26 (Helen Anderson ed., 2008).

121. *See* Guanyu Tigao Shangshi Gongsi Zhiliang Yijian De Tongzhi [Opinions on Improving the Quality of Listed Companies] (promulgated by St. Council [Guowuyuan], Oct. 19, 2005, effective Oct. 19, 2005) art. 21 (China).

122. *See* Nian Xingfa [Criminal Law] (promulgated by the Standing Comm. Nat'l People's Cong. [Quanguo Renmin Daibiao Dahui], Mar. 14, 1997, effective Oct. 1, 1997) arts. 163, 165, 166, 169, 219, 271, 272 (China). For an introspection of criminal liabilities of directors under Criminal Law 1997, see LI YANBING, SHANGSHI GONGSI GAOGUAN ZHIWU

5. Improving Incentive Mechanisms

The incentive mechanisms of directors were also improved in two aspects. First, to boost creative corporate management of directors in a risky market without exposing them to excessive liabilities, liability insurance was encouraged to be purchased for the directors after approval by the shareholders' general meeting.[123] Second, to provide efficient managerial incentives by linking management compensation and long–term corporate performance together, equity–based incentive schemes were reintroduced.[124] At the turn of the new century, the establishment of long–term equity incentives in SOEs was referred to as one of several policies concerning SOE reform[125] and building up such mechanisms was later fully implemented in target SOEs.[126] As a result of the orientation of these policies, the number of listed companies experimenting long–term equity–based incentive packages kept increasing. By the end of 2004, there had been 149 A–share companies that implemented stock incentive plans in a variety of manners.[127]

FANZUI WENTI YANJIU [THE CRIMINALIZATION OF BREACHES OF FIDUCIARY DUTY BY THE DIRECTORS AND MANAGEMENTS OF LISTED COMPANIES] 150-53 (2006).

123. *See* CCGLC, at art. 49.

124. As a matter of fact, stock–related incentivized pay arrangements could be traced back to corporate laws prior to the establishment of New China. *See* WANG DANRU, QIYE ZUZHI [ENTERPRISE ORGANIZATIONS] 206 (1936). And some preliminary attempts were tried in the 1980s to reform the compensation system. *See* Takao Kato & Cheryl Long, *Executive Compensation, Firm Performance, and Corporate Governance in China: Evidence from Firms Listed in the Shanghai and Shenzhen Stock Exchanges*, 54 ECON. DEV. & CULTURAL CHANGE 945, 951-954 (2006).

125. Guanyu Guoyou Qiye Gaige He Fazhan Ruogan Zhongda Wenti De Jueding [Decision on the Major Issues regarding SOE Reform and Development] (promulgated by the Central Comm. of the Chinese Communist Party [Zhongguo Gongchandang Zhongyang Weiyuanhui], Sep. 22, 1999, effective Sep. 22, 1999) art. 11 (China); Guoyou Dazhongxing Qiye Jianli Xiandai Qiye Zhidu He Jiaqiang Guanli De Jiben Guifan (Shixing) [Basic Rules of the Establishment of Modern Enterprise System and the Strengthening of Management in State-owned Large-and-Medium Size Enterprises (Provisional)], (promulgated by the Gen. Office of the St. Council [Guowuyuan Bangongting], Sep. 28, 2000, effective Sep. 28, 2000) art. 4(27) (China); Zhongyang Qiye Fuzeren Jingying Yeji Kaohe Zanxing Banfa [Provisional Measures for Performance Evaluation of Leaders of Central Enterprises], (promulgated by the St. Owned Assets Supervision & Admin. Comm'n [Guoyou Zichan Jiangu Guanli Weiyuanhui], Dec. 28, 2009, effective Jan. 1, 2010) (China).

126. Guanyu Guoyou Gaoxin Jishu Qiye Kaizhan Guquan Jili Shidian Gongzuo De Zhidao Yijian [Guidelines for the Experiment of Developing Equity Incentive Mechanisms in State-owned High-tech Enterprises] (promulgated by the General Office of the State Council [Guowuyuan Bangongting], Sep. 17, 2002, effective Sep. 17, 2002) (China).

127. *See* CAO YANG, ZHONGGUO SHANGSHI GONGSI GAOGUANCENG GUQUAN JILI SHISHI XIAOGUO YANJIU [STUDY ON THE EFFECT OF THE IMPLEMENTATION OF EXECUTIVE STOCK INCENTIVES BY CHINESE LISTED COMPANIES] 75 (2008).

B. Constant Mixing and Internalization

The adjusted board system in China at this stage continued to manifest varied characteristics when compared with its equivalents in other countries. On one hand, U.S. norms of the board were gradually infiltrated into the Chinese context. This was initially visible by the adoption of committee structures (the audit, compensation, and nomination committees) in China, which were better developed in U.S. public companies than in other countries.[128] In addition, liability insurance for directors also originated from the U.S., where both jurisprudence from the courts and legislatures of the state dated from the 1940s and 1950s upheld the protection of directors from personal liability for business decisions.[129] Similar insurance polices were less developed in other countries (the UK), or without statutory backup (Germany), or had a shorter history (Japan).[130] Utilizing liability insurance for directors in China indicated an inclination towards adopting a more U.S.–based practice. Moreover, the promotion of equity–based, performance–oriented pay and award at the turn of the century was also a signal that the Chinese board increasingly emulated the American model. As a matter of fact, the contrast with incentive mechanisms in developed countries was stark in the sense that stock options and other incentivized pay with a long–term orientation were only emphasized in the U.S. at that time.[131] In other common law countries, such as the UK, variable pay of this kind was a less important component of the remuneration package.[132] And in civil law countries, like Germany, equity–based remuneration like stock options was of only negligible importance.[133] Japanese law even effectively precluded firms from using equity–based schemes like stock options as part of the compensation package for top management prior to

128. *See* Henry Hansmann & Reinier Kraakman, *The Basic Governance Structure*, *in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH, 5-15 (2004).

129. *See* Joseph P. Monteleone & Nicholas J. Conca, *Directors and Officers Indemnification and Liability Insurance: An Overview of Legal and Practical Issues*, 51 BUS. L. 573, 574 (1996).

130. Shi Tongling & Liu Zhengyu, *Gongsi Dongshi Zeren Baoxian Falv Wenti Yanjiu* [*On Legal Issues of Company Directors Liability Insurance*], 3 LIAONING SHIZHUAN XUEBAO (SHEHUI KEXUEBAN) [J. LIAONING TEACHERS COLL. (SOC. SCI. EDITION)] 137 (2007).

131. After the enactment of the 1950 Revenue Act, the use of stock options has continued to skyrocket in the U.S. to earn a major share of managerial pay as a response to the favorable tax consideration. *See* Symposium, *Current Issues in Executive Compensation*, 3 N.Y.U. J.L. & BUS. 519, 522 (2007).

132. *See* Brian R. Cheffins & Randell S. Thomas, *The Globalization (Americanization?) of Executive Pay*, 1 BERKELEY BUS. L.J. 233, 241-42 (2004).

133. Stefan Prigge, *A Survey of German Corporate Governance*, *in* COMPARATIVE CORPORATE GOVERNANCE: THE STATE OF THE ART AND EMERGING RESEARCH 967 (Klaus J. Hopt, Hideki Kanda, Mark J. Roe, Eddy Wymeersch & Stefan Prigge eds., 1998).

1997,[134] and qualifications and experiences of the directors were the more important factors that impacted their incomes.[135] The shift towards equity–based incentive plans in China constituted a significant move to the American model.

On the other hand, philosophies of other countries continued to shape the board system in China. The emphasis on the separation of chairperson and CEO was an example where China did not imitate the U.S. model. In the U.S., the combined position of board chairperson and CEO was a universal part of boardroom structure, and splitting these two roles received only modest support from listed companies.[136] The idea of separating the roles of the chairperson and the CEO of the board was taken from other business cultures, particularly Europe. In the UK and continental European countries, the roles of chair and chief executive were typically divided.[137] For example, in the UK, the Cadbury report recommended that there be a clearly accepted division of responsibilities at the head of a company, and the two roles should not be combined in one person.[138] Empirical evidence also revealed that by the mid–1990s, only about one–third of the largest publicly traded companies had a combined chairperson and CEO in the UK.[139] And in the two–tier board systems in continental European countries, such as Germany, the separation of the positions of board chairperson and CEO was also common.[140] It was noticeable that the division of chairperson and CEO in China's listed companies was more inspired by the European traditions than that of the U.S.

The overall power structure of the board of directors in China, however, was not altered because of these reform measures. It was obvious that the

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134. *See* Hideaki Kiyoshi Kato, Mi Luo & James Schallheim, *An Empirical Examination of the Costs and Benefits of Executive Stock Options: Evidence from Japan,* 78 J. FIN. ECONOMIES 435, 436 (2005). Sun Li, GONGSI ZHILI JIEGOU DE GUOJI BIJIAO: RIBEN QISHI [OF IMPROVING CORPORATE MANAGEMENT: THE ENLIGHTENMENT FROM JAPAN] 65 (2008).

135. *See* Kenji Hall, *Shouxi Zhixingguan Xinchou: Qianwan Bie Cong Riben Zhao Da'an* [*Remunerations of CEOs: Don't Seek Answers from Japan*], BW ZHONGWENWANG [BWCHINESE.COM] (Dec. 21, 2009), http://www.bwchinese.com/article/elite_platform/2009-09/458.html.

136. *See* GREGORY FRANCESCO MAASSEN, AN INTERNATIONAL COMPARISON OF CORPORATE GOVERNANCE MODELS: A STUDY ON THE FORMAL INDEPENDENCE AND CONVERGENCE OF ONE–TIER AND TWO–TIER CORPORATE BOARDS OF DIRECTORS IN THE UNITED STATES OF AMERICA, THE UNITED KINGDOM AND THE NETHERLANDS 179 (3d ed. 2002) [hereinafter CORPORATE GOVERNANCE MODELS], *available at* http://publishing.eur.nl/ir/repub/asset/8028/Maassen_9789090125916.pdf.

137. *See* RALPH D. WARD, SAVING THE CORPORATE BOARD: WHY BOARDS FAIL AND HOW TO FIX THEM 17 (2003).

138. *See* FINANCIAL ASPECTS, *supra* note 77, at 4.9.

139. *See* ROBERT A.G. MONKS & NELL MINOW, CORPORATE GOVERNANCE 189 (1995).

140. *See* Klaus J. Hopt and Patrick C. Leyens, *Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France and Italy*, 1 EUR. COMPANY & FIN. L. REV. 135, 160-61 (2004).

distinctive basis of the Chinese board was retained. First, although more powers were authorized for the board of directors by the rules of CSRC, the board continued to be a corporate organ inferior to the general assembly. The legal division as to the power allocation between the shareholders' general meeting and the board of directors was kept within these rules. The former carried forward the decisive power as to the business policies and investment plans,[141] whilst the latter was only granted power to develop business plans and investment programs.[142] The array of plans and schemes made by the board of directors was constantly subject to the approval of the shareholders' general meeting,[143] and it was accentuated that the board of directors should be accountable to the shareholders' general meeting.[144] Also, although a niche was open for the board of directors to exercise powers other than those stipulated in the laws, regulations, and articles of association, such empowerment should first gain the approval of the shareholders' general meeting.[145] So the scope of powers of the board of directors remained at the mercy of the general assembly; the general power allocation between the general assembly and the board of directors did not move from shareholders centralism to board centralism.

Second, there were not any substantive changes regarding the legal representative system even with the increasing checks and balances on the board. CCGLC did not breathe a word about the legal representative system, and GAALC 1997 only referred to this system when necessary without changing the legal arrangements provided by CL 1993. The legal representative continued to be the one and only person who could represent the company in dealing with third parties, and in bringing and defending lawsuits in the court and in signing contracts on behalf of the company. Therefore, the general structure of power allocation regarding the board of directors was not changed by the improvements made during this period.

Apart from the exceptions to these structural arrangements, some of the new reform initiatives also demonstrated the Chinese–style legal settings since foreign norms and institutions were filtered in a particular way. This was evident from the approach to reinforcing the duties of directors, which describes very specific acts for the directors without providing a case law basis. At this stage, whatever was the former duty of loyalty or the newly incorporated duty of care and duty of good faith, the Chinese approach was distinct both from civil law and common law jurisdictions. Civil law countries like Germany or Japan did not go as far as Chinese laws to set out so much detailed content of the duties of directors. In Germany, the duties of directors were broadly stipulated, and only a few specific prohibitions

141. *See* GAALC 1997, at art. 42 (1).

142. *See Id.* at art. 94 (3).

143. *See Id.* at arts. 42, 94.

144. *See* CCGLC, at art. 42.

145. *See* GAALC 1997, at art. 94; CCGLC, at art. 7.

were imposed on directors, such as non–competition restraints and regulations on self–dealing.[146] And Japanese law had the same feature in the sense that fewer than a dozen specific prohibitions were given to elaborate on the duties of directors, such as non–competition with the company, constraints on self–dealing, and conscientious awareness in determining the remuneration of directors.[147] Chinese law, nevertheless, provided more sub–duties than these two countries. Setting aside the prohibitive acts stipulated in other countries, it even elucidated several positive behaviors for directors, such as keeping abreast of the business operation and management of the company.[148] On the other hand, because the case law regime that laid down the foundation of duties of directors was absent in China, Chinese law stood in sharp contrast to common law countries.[149] The several types of duties of directors in common law countries were all consolidated by the vast sea of case law. For example, in the UK, the duty of loyalty was initially developed by the court of equity and was based on fiduciary principles. This duty was usually treated as an equitable duty analogous to a trustee. The duty of care required from a director had a common law basis and rested on the principle of the law of negligence.[150] It was noteworthy that the duties of directors were mostly found in the existing equitable and common law principles, both of which were composed of the case law system in the UK.[151] And in the U.S., although the trend in the past several decades was increasing attempts to codify matters that previously had been left to doctrine,[152] the concept of fiduciary duties, including the duty of loyalty and the duty of care, could be understood only in the context of specific cases. The broad and encompassing nature of fiduciary duties necessitated that the courts determine the boundaries of these obligations, and the case law system in the U.S. had developed into the foundation of these duties.[153] In contrast,

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146. *See* Rebecca Lee, *Fiduciary Duty Without Equity: "Fiduciary Duties" of Directors Under the Revised Company Law of the PRC*, 47 VA. J. INT'L L. 897, 906-07 (2007).

147. *See* Shishido, *supra* note 53, at 146-147.

148. *See* GAALC 1997, at art. 81.

149. *See* Lee, *supra* note 146, at 906-07, 910.

150. *See* DAVIES, *supra* note 6, at 380.

151. There has been a long journey over the years to reduce the duties to statutory form in the UK. *See* JOHN FARRAR, FARRAR'S COMPANY LAW 378 (1998). Although the Companies Act 2006 has codified the general duties of directors, it is clearly stated that the statutory duties set out do not have the effect of replacing those rules within existing case law. The case law rules and principles are allowed to develop thereafter and continue to be the legal basis for duties of directors. *See* LE TALBOT, CRITICAL COMPANY LAW 181 (2008); Richard Nolan, *Codifying Directors' Duties: Was It Worth It?* (Apr. 6, 2009) (paper delivered at the Faculty of Law, The Univ. of Hong Kong).

152. *See* COX & HAZEN, *supra* note 6, at 477.

153. *See* Katharina Pistor & Chenggang Xu, *Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the Incomplete Law Theory*, *in* GLOBAL MARKETS, DOMESTIC

Chinese law did not have a case law system and failed to supply binding judicial decisions to uphold those statutory duties.[154] It was submitted that, in terms of the duties of directors, Chinese law was suspended between civil law and common law systems, because it was more specific than the statutory provisions in civil law but more general than the case law in common law. The duties of directors in China neither followed civil law countries nor common law regimes.[155] They were unique and could hardly be categorized into one of the two major legal traditions.

In sum, efforts made in this period did not modify the general legal framework of the board system in China, nor did it change the fusing but exclusive nature of Chinese law.[156]

C. Dysfunctions and Embedded Problems

Legislative efforts at this stage clearly showed that Chinese policymakers discovered the weaknesses of the old laws and strived for the improvement of them piece by piece. Unfortunately, a careful and cautious observation revealed that the results of endeavor did not match expectations, because the revised framework neither promoted the effectiveness of the board of directors nor efficiently deterred the misconduct of directors. As a general piece of evidence, empirical research, which studied the correlation between the board of directors and corporate performance in companies listed on Shanghai Stock Exchange ("SHSE") from 1 January 1999 to 1 January 2003, found that the board of directors in the sampled companies did not serve as the catalyst to enhance corporate performance, and the overall effectiveness of the board was not very satisfactory.[157] As a more specific

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INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 77, 77-78 (Curtis J. Milhaupt ed., 2003).

154. *See* S.H. Goo & Anne Carver, *Low Structure, High Ambiguity: Selective Adaptation of International Norms of Corporate Governance Mechanisms in China*, *in* CHANGING CORPORATE GOVERNANCE PRACTICES IN CHINA AND JAPAN: ADAPTATIONS OF ANGLO-AMERICAN PRACTICES 206, 227-228 (Masao Nakamura ed., 2008).

155. Actually, it has been concluded that the duties of directors under Chinese law are arrived at by piecing together the foreign mechanisms of both common law and civil law. *See* Yuhua Wei, *Directors' Duties under Chinese Law: A Comparative Review*, 3 UNIV. NEW ENG. L.J. 31 (2006).

156. The cases which showed that China learned both from common law and civil law countries, such as the committee structures, liability insurance, equity–based remuneration, and the separation of chairperson and CEO were only of the encouraging nature. In contrast, those duties of directors, once adopted by listed companies, would have a binding effect. Hence, comparatively speaking, the ingredients of Chinese–style legal settings outstripped the transplanted foreign elements at this stage.

157. XIAMEN DAXUE GUANLI XUEYUAN, XIAMEN ZHENGQUAN YOUXIAN GONGSI [SCHOOL OF MANAGEMENT OF XIAMEN UNIVERSITY, XIAMEN SECURITIES CO., LTD.], WOGUO SHANGSHI GONGSI DONGSHIHUI YOUXIAOXING DE SHIZHENG YANJIU [EMPIRICAL RESEARCH ON THE EFFECTIVENESS OF THE BOARD OF DIRECTORS IN CHINA'S LISTED COMPANIES],

investigation, other research looked at the correlation between the frequency of board activities and corporate performance in companies listed on the two domestic stock exchanges from 1998 to 2001. The board convened more board meetings and acted more frequently only after corporate performance declined or the company was in trouble. And the increasingly frequent activities of the directors did not contribute much to the improvement of corporate performance, or, in some cases, went with the sharply falling corporate performance in the following year.[158] It was therefore perceived that Chinese board activities were passive and reactive rather than proactive and precautionary. And there was a high degree of efficiency waste in board activities since the increase of board activities failed to promote better corporate performance.[159] Furthermore, the large amount of regulations of CSRC and other market regulators also fell short in preventing the malfeasance of directors. Astonishing cases, such as Qiong Minyuan (*瓊民源*), where the chairperson of the board instigated the fabrication of false financial and accounting reports of the company, and Hongguang Industrial (*紅光實業*), where the board of directors collectively acquiesced in the company's falsification of the prospectus, proved that even with the growing numbers of rules, directors continued to commit malpractice in the manner that did not differ substantially from the previous period.[160]

Causes of dysfunctions of the Chinese board were two–fold. On one hand, the legal arrangement of director regulation failed to strike a right balance between corporate autonomy and legal intervention. The tremendous freedom enjoyed by the board of directors in industrialized countries was substituted by rigid and inflexible legal rules in China. An apparent point was the statutory arrangement for the predominant role of the chairperson on the board. In advanced economies, the role of the chairperson of the board was unsupported by the law and depended entirely on the usage, consent, and best practice of the company. In the UK, statute, the model memoranda and articles of association, and case law were concerned only with the chairperson in procedural terms, and a more substantive role for the chairperson was only recognized in the codes which were on a "comply or explain" basis and did not have binding powers.[161] The situation in the U.S. was quite similar, as both corporation statutes and

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SHANGZHENG LIANHE YANJIU JIHUA DIBAQI KETI BAOGAO [REPORT OF SHANGHAI JOINT RESEARCH SCHEME (Vol. 8)] 70 (2003).

158. *See* YU DONGZHI, DONGSHIHUI YU GONGSI ZHILI [BOARD OF DIRECTORS AND CORPORATE GOVERNANCE] 158-162 (2004).

159. *See id.* at 169-170.

160. *See*, ZHONGGUO GUFENZHI QIYE DONGSHI SHIDIAN [THE DIRECTOR DICTIONARY OF CHINA STOCK COMPANIES] 114-117, 175-177 (Xu Weiguo ed., 2000).

161. This attitude has sustained during the amendments of the Companies Act 2006. *See* RICHARD SMERDON, A PRACTICAL GUIDE TO CORPORATE GOVERNANCE (2007), 2.016, 8.003.

judicial decisions scarcely defined the responsibilities and powers of the chairperson of the board due to the enabling nature of U.S. corporate laws.[162] In Germany, the ranking of directors on the board was not of importance and the title of chairperson of the board was only a formality.[163] Japanese law even totally ignored the role of chairperson in the statutes.[164] In these economies, it was up to the company to decide on the powers of the chairperson as the laws does not enter into this field. Sharply contrary to all these jurisdictions, Chinese company laws stepped in deeply to construct the role of the chairperson and assigned many statutory powers to the chairperson, such as checking and prompting implementation of resolutions of the board.[165] Hence, corporate autonomy regarding the role of chairperson in developed countries was replaced by statutory intervention in China. On account of the exorbitant level of legal intervention, the operation of the board of directors became stereotyped. In some circumstances, the board had to go through stiff legal procedures to legitimatize its behaviors and was not able to respond to the ever changing market. Consequently, the efficiency of the board was sacrificed.

Excessive legal intervention into the board of directors, nevertheless, did not mean that all indispensable mechanisms regarding proper functioning of the board were established in the law. Consider the removal of directors before the expiration of their term of office. Details vary, but developed countries usually gave corporate participants who elected directors the corresponding power to remove them mid–term.[166] Nevertheless, Chinese law did not provide similar powers of removal to the corresponding corporate organs before the directors' term of office was complete. Adversely, the law spelled out clearly that the general assembly should not remove directors without cause before the expiry of their terms,[167] implying that instead of providing the power to remove directors on a mid–term basis, in normal circumstances, the shareholders' general meeting could not dismiss currently serving directors except in those circumstances where reasonable cause could be found. And although the law allowed removal with just cause, there was no clear explanation of what cause would constitute grounds for removal. In practice, even if the shareholders' general meeting successfully removed directors, directors could file a

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162. *See* COX & HAZEN, *supra* note 6, at 344-45.

163. *See* AktG, § 84(1).

164. This is continuously demonstrated in the new Japanese Companies Act 2005. *See Transparency of Japanese Law Project*, KYUSHU UNIV., www.tomeika.jur.kyushu-u.ac.jp (last visited Apr. 25, 2011).

165. *See* CL 1993, at art. 114.

166. *See* Companies Act, 1963 (Act No. 33/1963) (Ir.) § 182; MICHAEL FORDE, COMPANY LAW 152 (1999); DEL. CODE ANN. tit. 8, § 141(a) (2010); MODEL BUS. CORP. ACT (1984), § 8.08; AktG, §84(1), 85-86; SHŌHŌ [COMM. C.] art. 257, 343. (Japan); Shishido, *supra* note 53, at 136.

167. *See* CL 1993.

lawsuit against such dismissal due to the absence of a valid cause.[168] Without clarification of the cause for removing the directors, the general assembly would encounter a great deal of difficulties in winning the case. In sum, the power to remove directors before the expiration of their term was not clearly given in Chinese law, which gave rise to the potential risk for reckless behavior by directors.

Another visibly absent regime in the Chinese context was the preventive mechanism against misbehavior of directors. To avoid the potential threat to corporate and shareholders interests originating from the misfeasance of directors, the laws in advanced economies often allowed the corresponding corporate organ to turn to internal and external mechanisms before the wrongdoings gave rise to damage to the company and shareholders, such as injunction or declaration in the UK.[169] Unfortunately, there was no equivalent in the Chinese context in this regard. Article 111 of Company Law, as the only legal rule relating to the right of shareholders to stop the misbehavior of directors, was very vague. It combined the shareholder's right of action against the general assembly and the board of directors. Also, the action stipulated in this article was against the board of directors as a whole instead of the delinquent individual director. Strictly interpreted, this article was concerned with the shareholders' right of action after the malpractice of directors gave rise to damage to the shareholders, rather than to provide an injunctive mechanism against the misbehavior of directors in advance. There was no real device in China that could prevent the errors of directors before they caused real damage to the company.[170] Due to the absence of such a legal mechanism, the Chinese board might have been less responsive to the shareholders and the company and more indulgent regarding their jobs. Accordingly, the effectiveness of its function was weakened. In short, Chinese law intervened in some areas where more

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168. There were a number of cases where the legal ambiguity regarding the removal of directors caused legal disputes. *See, e.g.*, DONGZHI, *supra* note 158, at 199-202.

169. In the UK, injunction or declaration could be employed by shareholders where the breach of duties of directors is threatened, but has not yet occurred. *See* DAVIES, *supra* note 6, at 139-40, 425. In the U.S., shareholders' suit against the breach of fiduciary obligation with an injunctive nature is also allowed. *See* COX & HAZEN, *supra* note 6, at 169-70. In Germany, the right of action to cessate infringement and eliminate ill effect was also made available to shareholders. *See* GERMAN STOCK CORPORATION ACT, *supra* note 42, at 109, 171-72. And Japanese law also expressly entrusted shareholders to the right of enjoinment of acts of directors. *See* SHŌHŌ [COMM. C.] art. 272, para. 73 (Japan). This is now art. 360 under Japanese Companies Act of 2005. *See also* Thomas L. Blakemore & Makoto Yazawa, *Japanese Commercial Code Revisions: Concerning Corporations*, 2 AM. J. COMP. L. 12, 21 (1953).

170. *See* Hu Wentao, *Queli Gudong De Zhizhi Qingqiuquan He Gudong Dahui Jueyi Xiaci Susong Tiqiquan De Sikao* [*Thoughts on Establishing the Shareholder's Right of Prevention and Right to Sue for the Defective Decision of the Shareholder's Meeting*], 5 HUNAN SHANGXUEYUAN XUEBAO [J. HUNAN BUS. COL.] 59 (1999); *see also* Liang Shangshang, *Tingzhi Qingqiuquan: Dongshi Lanquan Xingwei De Zhiizhi* [*Right of Prevention: The Prevention of Abuse of Directors' Power*], 2 JIANGHAI ACAD. J. 125 (2006).

freedom should have been given to the corporation, while other areas where more rules should be posed were ignored.

On the other hand, even if these defects in the legal arrangements were remedied, the institutional environment would continue to obstruct the full discharge of functions by the board. As a matter of fact, the intrinsic institutional factors disturbed the normal operation of the board more heavily than the legal/technical deficiencies mentioned above.

Above all, the remuneration package of directors, as the major mechanism to motivate their work, failed to stimulate the positive performance of directors. First, the overall income of directors was not closely linked with the market performance of the company. Investigations showed that although the remuneration of directors was determined in law by the shareholders' general meeting, in reality, the controlling shareholder usually prescribed the gross income of the directors in advance. Based on his/her instructions, the remuneration committee under the board (if there was one) designed the performance evaluation indicators and assessment methods of the remuneration package, and then submitted them to the general assembly for approval. So the actual amount of payment directors could receive was restricted to within the range decided by the controlling shareholder, which was executive–led rather than market–oriented.[171] Particularly, in SOEs, the remuneration of directors was by and large determined by the state assets representatives on behalf of the state shareholders. As these representatives were only the working staff of the relevant government bodies, they could not decide on the remuneration based on market standards but only on government directives.[172]

Second, due to the immaturity of stock markets in China, the newly introduced equity–based incentive scheme could not motivate the enthusiasm of the directors, either. Whatever form was used, an equity–based package was closely related to the stock price of the listed company. The philosophy of equity–based remuneration was that, since the stock price was a good indication of corporate performance, linking the remuneration of directors to the stock price of the company could push them to do their best in enhancing corporate performance.[173] Nevertheless, this assumption was not valid when taking the highly speculative stock markets in China into account. It was widely reported that the domestic stock markets were

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171. *See* SHANGHAI ZHENGQUAN JIAOYISUO YANJIU ZHONGXIN [RESEARCH CENTRE OF SHANGHAI STOCK EXCHANGE], ZHONGGUO GONGSI ZHILI BAOGAO (2004 NIAN) [CHINA CORPORATE GOVERNANCE REPORT (2004)] 195-196 (2004) [hereinafter 2004 CORPORATE GOVERNANCE REPORT].

172. *Id.*

173. Susan J. Stabile, *Motivating Executives: Does Performance–Based Compensation Positively Affect Managerial Performance?*, 2 U. PA. J. LAB. & EMP. L. 227, 228 (1999).

strongly influenced by government policies,[174] and the fluctuation of stock prices could deviate greatly from the true value of the firm. The performance of the stock price could not, to a large extent, reflect the firm's true performance. Thus, the adoption of an equity–based remuneration package might not align directors' personal interests with corporate performance. Consequently, the equity–based incentive mechanism might have failed to motivate the interests of directors in taking good care of corporate performance.[175]

In addition, the reckless behavior of directors was to a large extent attributable to inefficient law enforcement. There were three types of liabilities of directors in China: civil, administrative, and criminal liability. In enforcing these liabilities, the judiciary, the prosecution authorities, and the major market regulator, CSRC, were all involved. Unfortunately, none of them could make full implementation of the liabilities. It was claimed that the true actor behind the judiciary and governmental bureaus was the Chinese government. It was the government that did not pursue the disciplining of directors. And sometimes, the government even eased actions against these directors. Should the government be desirable to penalize the wrongdoings of directors, all three kinds of bodies mentioned above would have spared no effort to make the directors accountable.[176] Knowing the strong state interference in the enforcement of the liabilities, directors would like to develop a variety of social networking with government officials and seek protection of the government.[177] As a result, they were not personally exposed to the risks of punishments or lawsuits. In addition, the direct interest of the government in the listed companies also frustrated a shift in attitude towards the unsound practices of directors. The Chinese government was the ultimate controller of most listed companies

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174. *See* LENG JING, CORPORATE GOVERNANCE AND FINANCIAL REFORM IN CHINA'S TRANSITION ECONOMY 124 (2009).

175. Empirical evidence revealed that the accounting performance of companies did not increase with the introduction of an equity–based package. To make matters worse, companies which had the intention of adopting such schemes usually had better accounting performance than other companies, but after the implementation of these schemes, this advantage reduced year by year. See YANG, *supra* note 127, at 95.

176. *See* Zhengyi Lawsuit; Dispute Cases; Neil Andrews & Roman Tomasic, *Directing China's Top 100 Listed Companies: Corporate Governance in an Emerging Market Economy*, 2 CORP. GOVERNANCE L. REV. 245, 274 (2006); He Meihuan, *Zhongguo Shangshi Gongsi 'Yigududa' De Wenti: Shangweie Zhenduan, Ruhe Xiayao* [*The Predominance of First Largest Shareholder: Not Yet Diagnosed, How to Give the Prescription*], *in* TOU ZI ZHE LI YI BAO HU [PROTECTION OF INVESTOR INTERESTS], 109 (Wang Baoshu ed., 2003). Gu Gongyun, *Cong Dongshi Zeren Jiaodu Kan Gongsi Zhili Jiegou Wanshan Yu Gongsifa Gaige* [*Corporate Governance Problems in Corporation Law Reform*], *in* QUAN QUI JING ZHENG TI ZHI XIA DE GONG SE FA GAI GE [CORPORATION LAW REFORM FOR A GLOBAL COMPETITIVE ECONOMY], 25 (Wang Baoshu ed., 2003).

177. It was uncovered that whether state–owned or privately–owned, most listed companies would like to have at least one board member with strong connections with the government. *See* Andrews & Tomasic, *supra* note 176, at 269, 273.

and had a significant interest in them. Should the government have suddenly revealed and punished all the fraudulent and unlawful behavior of the directors, there would have been a stock–market crash where frightened investors would have pulled out of the market. The result of this market panic would have been the potential loss of a large number of state assets.[178] The conflicting role of the government in the stock market led to its wavering attitude towards the implementation of legal rules.[179] Hence, the crux of the difficulties in the enforcement of director liabilities stemmed from the complicated relationships among the directors, the government, the listed companies, and the stock markets. And this problem could not be resolved overnight.[180]

In general, neither incentive nor accountability mechanisms of directors were in full swing in practice because of the embedded institutional factors. The lack of institutional capacity may have partly caused directors to skimp on the quality of their performance, as well as contributed to the reduction of the overall effectiveness of the board, abuse of power to pursue personal interests, collusion with the management, insider dealing, and encroachment of corporate assets.[181]

III. PROGRESS IN 2005 AND THEREAFTER

A. New Changes Made

The inefficient board system in practice calls for the advancement of an institutional framework and legal infrastructures. With the promulgation of Company Law 2005 ("CL 2005") and Securities Law 2005 ("SL 2005"), a new round of legislative movement has been initiated.

1. Codification in 2005

CL 2005 and SL 2005 are dedicated to consolidating the Chinese board system in two layers: the board as a whole and the directors individually. Generally speaking, although rules previously issued by CSRC are rarely

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178. *See* Noëlle Trifiro, *China's Financial Reporting Standards: Will Corporate Governance Induce Compliance in Listed Companies?*, 16 TUL. J. INT'L & COMP. L. 271, 289 (2007).

179. For more discussion of the conflictive role of the state in regulating information disclosure, see id. at 289.

180. Owing to the ineffective enforcement of liabilities of directors, few listed companies purchased liability insurance for the "unexposed" directors. *See* He Min, *A Study on D&O Liability Insurance in China* [*Lun Woguo De Dongshi Zeren Baoxian Zhidu*], 5 J. NANJING U. FIN. & ECON. [南京財經大學學報] 90 (2004).

181. *See* Cheng Wei–qi & Philip Lawton, *SOEs Reform from a Governance Perspective and Its Relationship with the Privately Owned Publicly Listed Corporation in China, in* CHALLENGES FOR CHINA'S DEVELOPMENT: AN ENTERPRISE PERSPECTIVE 24, 30-31 (David H. Brown & Alasdair MacBean eds., 2005).

adopted, the new laws take the same approach of enhancing the functions of the board and directors.

In the first layer, the powers of the board of directors are expanded, and checks and balances are built into the board of directors.[182] First, although powers stipulated in the rules of CSRC are not absorbed, CL 2005 has the same tendency to expand the powers of board of directors. Apart from those powers stated in CL 1993, the board is also capable of deciding on the remuneration of corporate managers[183] and appointing members of the liquidation group.[184] Particularly, the board is authorized to exercise other powers stipulated by the articles of association of the company.[185] However, unlike the attempts of CSRC, under the new law the board of directors no longer enjoy the discretion of examining the interim proposal submitted by the shareholders; rather, the board is obliged to inform other shareholders of such a proposal and table the proposal at the shareholders' general meeting.[186]

Second, the dominant role of the chairperson is reduced to some extent. The chairperson of the board is no longer statutorily appointed as the legal representative; instead, based on the articles of association, the chairperson, an executive director or a manager can act as the legal representative of the company.[187] The statutory powers of the chairperson are also diluted. The functions of the chairperson can be substituted by other board members in some circumstances, such as where the chairperson fails to convene the shareholders' general meeting or where the chairperson fails to perform his/her other duties.[188] It is made clear that other than the chairperson, directors constituting one third of the total board members may also propose a provisional board meeting; and the chairperson should convene and chair the meeting within ten days of receipt of such a proposal.[189] And the practice of a casting vote for the chairperson in some companies is abolished under the new Laws,[190] as each director, including the

182. In addition to the mechanisms introduced here, there are other changes which have substantive influence over the board system, such as the assignation of employee representatives as board members. *See* CL 1993, at art 45. The Company Law was revised in 2005. *See* Dishijie Quanguo Renmin Daibiao Duhui Changwu Weiyuanhui (amendments promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) art. 109 (China) [hereinafter CL 2005].

183. CL 2005, at arts. 47(9), 109.

184. *See Id.* at art. 184.

185. *See Id.* at arts. 16, 47(11), 170.

186. *See Id.* at art. 103.

187. *See Id.* at art. 13.

188. *See Id.* at arts. 102, 110.

189. *See* CL 2005, at art. 111.

190. *See* JIAN FU & JIE YUAN, PRC COMPANY & SECURITIES LAWS: A PRACTICAL GUIDE 81-82 (2006).

chairperson, is said to be given only one vote for each resolution of the board.[191]

Third, the exclusion of voting powers of directors is also adopted to avoid unfair transactions from its source. In the event that the director of the listed company is a party related to the enterprise involved in the resolution of matters of the board meeting, he/she should abstain from voting on the resolution or voting on behalf of another director.[192]

In the second layer, regulations on the directors are also further advanced. First, duties of directors are refined by synthesizing the fragmented rules by CSRC. The duty of loyalty and the duty of care are clearly stipulated to be owed by the directors to the company, and the duty of good faith pinpointed by CSRC is deleted.[193] A number of misconducts in violation of the duties of directors are listed. These misconducts are, in general, akin to those in CL 1993, although several changes are made: two new misconducts, i.e. pocketing the commissions for transactions between the company and other parties, and abusing the powers to take advantage of corporate opportunities, are added;[194] the use of company funds to provide a guarantee for the debts of shareholders is no longer regarded as a misbehavior of the directors but is then subject to the approval of the shareholders' general meeting;[195] and the breach of certain duties can be ratified by the shareholders' general meeting or the board meeting.[196] A provision as to the disgorgement of illegal income in violation of the duties is also added.[197] In addition, directors are prohibited from using their affiliated relationship with the company to cause loss to the interests of the company.[198] They are required to attend the shareholders' general meeting upon request and answer queries from the shareholders, and are further required to provide assistance to the supervisors when necessary.[199] It is even emphasized, similar to the rules by CSRC, that the board of directors should duly call the shareholders' general meeting for passing resolutions in certain circumstances.[200] Last but not least, the directors, under SL 2005, have a duty imposed on them to certify information disclosed by the listed company,[201] and should bear joint liability for compensation with other

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191. *See* CL 2005, at art. 112.
192. *See Id.* at art. 125.
193. *See Id.* at art. 148.
194. *See Id.* at art. 149 (5)-(6).
195. *See Id.* at art. 16.
196. *See Id.* at art. 149.
197. *See* CL 2005, at art. 149(8).
198. *See Id.* at art. 20, 21.
199. *See Id.* at art. 151.
200. *See Id.* at art. 105.
201. *See* 2005 Zhengquanfa [Securities Law 2005] (promulgated by Standing Comm. Nat'l People's Cong. [Dishijie Quanguo Renmin Daibiao Dahui Changwu Weiyuanhui], Oct. 27, 2005, effective Jan. 1, 2006) art. 68 (China) [hereinafter SL 2005].

relevant parties where the information disclosed is false, misleading, or substantively fragmented.[202]

Second, accountability of the directors is strengthened by the enhancement of civil liabilities. The new Laws repeatedly stress the civil liabilities of directors. For example, directors who use their affiliated relationship to cause damage to the interests of the company should bear compensation liability.[203] As the implementation mechanism of civil liabilities, shareholders' right of action against directors is intensified in several ways, including the action to invalidate the resolution of the board of directors,[204] the derivative action,[205] and the direct action.[206]

Third, a few other rules related to the remuneration of directors are added. The company is required to disclose information regularly to their shareholders on the remuneration of directors.[207] And the strict restrictions on the transfer of shares held by directors under CL 1993 are relaxed for the preparation of adopting an equity–based incentive scheme: the company is permitted to repurchase its own shares for rewarding its working staff,[208] and directors, subject to the articles of association, are now allowed to transfer a limited stake of their shares within a certain period of time in their term of office.[209]

2. Other Actions Taken

The amendments of CL 2005 and SL 2005 pave the way for the revision of other relevant laws and supplementary regulations. Most importantly, the new Guidelines for the Articles of Association of Listed Companies (*上市公司章程指引*) ("GAALC 2006") , were issued by CSRC in 2006 to catch up with the changes in the two laws. In addition to reiterating those rules of the new laws, GAALC 2006 goes further, with some supplementary rules which are ascribable to the smooth functioning of the new Laws. For example, the legal procedure is provided to void any resolutions of the board which may violate laws and administrative regulations.[210] And replacement procedures are provided where the moderator of the shareholders' general meeting (usually the chairperson of the board) contravenes meeting procedures and blocks the meeting from proceeding.[211] Two situations are added to the list of negative qualifications of the

202. SL 2005, at art. 69.
203. *See* CL 2005, at art. 21.
204. *See Id.* at art. 22.
205. *See Id.* at art. 152.
206. *See Id.* at art. 153.
207. *See Id.* at art. 117.
208. *See Id.* at art. 143(3).
209. *See* CL 2005, at art. 142.
210. *See* GAALC 1997, at art. 34; *But cf.* CL 2005, at art. 22.
211. *See Id.* at art. 67.

directors, including being banned from the securities markets by CSRC and other contents prescribed by the laws, administrative regulations and departmental regulations.[212] The validity period of the duty of loyalty is also specified.[213] These supplementary rules are conducive to building a better framework for regulating directors.

What is unpredictable is that GAALC 2006 also provides some articles which are in contradiction with the two laws. For example, powers of the board listed in GAALC 1997 but not absorbed in CL 2005 reappear in GAALC 2006, with one change, which extends the decisive power on security matters to external investment, purchase and sale of assets, appointment to finance management, and related party transactions.[214] And whilst the board of directors may also enjoy the right to appoint the accounting firm of the company according to the articles of association under CL 2005,[215] this matter is regarded as being exclusively determined by the shareholders' general meeting in GAALC 2006.[216] Moreover, misconducts listed in CL 2005 are all classified as cases in breach of the duty of loyalty in GAALC 2006,[217] and a new list delineating the violation of duty of care is added, including making sure that the business of the company does not exceed the scope of activities specified by the business license; treating all shareholders equally; keeping abreast of the business operation and management of the company; ensuring that the information disclosed by the company is true, accurate and complete; and truthfully supplying relevant information to the supervisory board.[218]

There are other efforts made by CSRC and the two stock exchanges to regulate the board system around this period. First, at the dawn of the enactment of CL 2005, CSRC established a training system for senior management of listed companies including directors.[219] In particular, the chairperson of the board and the chief executive officer should attend training courses at least once every year.[220] Second, the surveillance

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212. *See Id.* at art. 95.
213. *See Id.* at art. 101.
214. *See Id.* at art. 107 (8); *cf. Id.* at art. 94 (8).
215. *See* CL 2005, at art. 184.
216. *See* GAALC 1997, at art. 159.
217. *See Id.* at art. 97.
218. *See Id.* at art. 98.
219. *See* Shangshi Gongsi Gaoji Guanli Renyuan Peixun Gongzuo Zhiyi [Working Guidelines for the Training of Senior Management of Listed Companies] (promulgated by China Sec. Reg. Comm'n. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Dec. 22, 2005, effective Dec. 22, 2005) art. 3 (China).
220. *See* Shangshi Gongsi Dongshizhang Zongjingli Peixun Shishi Xize [Implementation Rules of the Training of Chairperson and Chief Executive Officer of Listed Companies] (promulgated by China Sec. Reg. Comm'n. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Dec. 22, 2005, effective Dec. 22, 2005) art. 3(1) (China).

measures of CSRC, such as reprimand,[221] correction order, supervisory conversation, warning, bad credit record, and decisions concerning the inappropriate person for a position, are clarified under the new legal framework.[222] And more rules as to the administrative punishments and their implementation measures are issued by the two stock exchanges.[223] Third, with the promulgation of CL 2005 and SL 2005 and the implementation of the split share structure reform, equity–based incentive schemes have been pushed to the front of reform by the enactment of a series of regulations.[224]

Other legislation also sheds light on the liabilities of directors. The new Law on Enterprise Bankruptcy states that where a director's breaches of duties contribute to the bankruptcy of the enterprise, he/she is banned from assuming the same position of any enterprise within three years of the day

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221. *See* Shangshi Gongsi Gudong Dahui Guize [Rules for the Shareholders' General Meeting of Listed Companies] promulgated by China Sec. Reg. Comm'n [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Mar. 16, 2006, effective Mar. 16, 2006) art. 48 (China) [hereinafter RSGMLC].

222. *See, e.g.*, Shangshi Gongsi Xinxi Pilu Guanli Banfa [Administrative Measures for Information Disclosure of Listed Companies] (promulgated by China Sec. Reg. Comm'n [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Jan. 30, 2007, effective Jan. 30, 2007) art. 59 (China).

223. *See* Shanghai Zhengquan Jiaoyisuo Jilv Chufen Shishi Xize [Rules for the Implementation of Disciplinary Actions in Shanghai Stock Exchange], (promulgated by Shanghai Stock Exch. [Shanghai Zhengquan Jiaoyisuo], July 1, 2008, effective July 1, 2008) (China); Shenzhen Zhengquan Jiaoyisuo Zilv Jianguan Cuoshi He Jilv Chufen Cuoshi Shishi Xize (Shixing) [Rules for the Implementation of Self-regulatory Measures and Disciplinary Actions in Shenzhen Stock Exchange (Provisional)] (promulgated June 2, 2009, effective June 2, 2009) (China).

224. Shangshi Gongsi Guquan Jili Guanli Banfa (Shixing) [Administrative Measures for the Equity-based Incentive Schemes in Listed Companies (Provisional)] (promulgated by China Sec. Reg. Comm'n. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Dec. 31, 2005, effective Jan. 1, 2006) (China); Guoyou Konggu Shangshi Gongsi (Jingnei) Shishi Guquan Jili Shixing Banfa [Provisional Measures for the (Domestic) Implementation of Equity-based Incentive Schemes in State-holding Listed Companies] (promulgated by the Min. of Fin. and State-owned Assets Supervision and Admin. Comm. [Caizhengbu, Guoyou Zichan Jiandu Guanli Weiyuanhui], Sep. 30, 2006, effective Sep. 30, 2006) (China); Guquan Jijli Youguan Shixiang Beiwanglu Yihao [Memorandum of Issues Related to Equity-based Incentive Schemes No.1] (promulgated by China Securities Regulatory Comm. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], May 6, 2008, effective May 6, 2008) (China); Guquan Jili Youguan Shixiang Beiwanglu Erhao [Memorandum of Issues Related to Equity-based Incentive Schemes No.2] (promulgated by the China Securities Regulatory Comm. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Mar. 17, 2008, effective Mar. 17, 2008) (China); Guquan Jili Youguan Shixiang Beiwanglu Sanhao [Memorandum of Issues Related to Equity-based Incentive Schemes No.3] (promulgated by the China Securities Regulatory Comm., Sep. 16, 2008, effective Sep. 16, 2008) (China); Shangshi Gongsi Dongshi Jianshi He Gaoji Guanli Renyuan Suochi Ben Gongsi Gufen Jijqi Biandong Guanli Guize [Administrative Measures for the Management of Shares Held by Directors, Supervisors and Senior Management of Listed Companies] (promulgated by China Sec. Reg. Comm'n. [Zhongguo Zhengquan Jiandu Guanli Weiyuanhui], Apr. 5, 2007, effective Apr. 5, 2007) (China).

when the procedures for bankruptcy are concluded.[225] And the criminal liabilities of the directors are also strengthened by amendments to the Criminal Code to create a new crime. It is stated that where the directors are in breach of their duty of loyalty and take advantage of their position to manipulate the listed companies, and therefore cause serious loss to the company, they should be subject to criminal imprisonment and fines.[226]

B. Lasting Selection and Perseverance

The approaches taken in these new measures to regulate the board system demonstrate the continuous fusing nature of Chinese law in the sense that both common law and civil law features are incorporated simultaneously in the new framework. First, rules from common law countries continue to influence Chinese laws. The incorporation of the duty of not taking advantage of corporate opportunity is one of the instances. In common law countries, use of corporate opportunities for a director's own profit is regarded as a breach of his duty of loyalty and is strictly prohibited, unless authorization by the disinterested directors is given or ratification in the general meeting is obtained.[227] This so–called "corporate opportunity doctrine" is mainly emphasized in common law countries, but falls short in civil law jurisdictions.[228] With the introduction of this application of the duty of loyalty, Chinese law carries forward the transplantation of common law principles. Second, the more stringent duty of secrecy reflects the influence of civil law traditions, especially the German law regime. In Germany, the duty of not divulging secrets concerning company matters is particularly stressed under the duty of care, and preclusion of this duty by the approval of the general assembly is not provided in the statute.[229] By deleting the provisions for ratification by the general meeting,[230] Chinese law further enhances this duty of the directors and adopts an approach quite close to the German rule. The new amendments are evidence of continuity of the combination of different systems.

Chinese characteristics, nevertheless, stand out distinctively from all these transplantations from other laws. First, albeit with more powers, the board of directors is reserved as a lower corporate organ vis–à–vis the

225. *See* Qiye Pochanfa [Law on Enterprise Bankruptcy] (promulgated by Standing Comm. Nat'l People's Cong. [Quanguo Renda Changweihui], Aug. 27, 2006, effective June 1, 2007) art. 125 (China).

226. *See* Xingfa Xiuzhengan [Sixth Amendment of Criminal Law] (promulgated by Standing Comm. Nat'l People's Cong. [Quanguo Renda Changweihui], June 29, 2006, effective June 29, 2006) art. 9 (China) [hereinafter SACL].

227. *See, e.g.*, DAVIES, *supra* note 6, at 416-23; COX & HAZEN, *supra* note 6, § 11.08.

228. For example, it is said that neither the duty of non–competition nor the duty of care could cover the duty of not taking advantage of corporate opportunity in Japanese law. *See* ZHOU YOUSU, XIN GONGSIFA LUN [NEW SURVEY ON CORPORATION LAW] 404 (2006).

229. *See* AktG, § 93(1).

230. *See* CL 2005, at art. 184; *cf.* CL 1992, at art. 62.

general assembly. This is visible in the unchanged wording regarding the general power allocation between the shareholders' general meeting and the board of directors in CL 2005.[231] It is further laid down in GAALC 2006 that the board of directors cannot be authorized to exercise those same powers as the shareholders' general meeting,[232] and matters of the board beyond the scope of authorization of the shareholders' general meeting should be submitted to the shareholders' general meeting for discussions.[233] The objective of GAALC 2006 is clear: the board of directors should not invade the scope of statutory powers of the shareholders' general meeting; and, although authorization of the exercise of certain powers is allowed, such authorization should not alter the basic relationship between the shareholders' general meeting and the board of directors. Overall, the board of directors is kept as a body inferior to the general assembly.

Second, even with more corporate autonomy, the modified legal representative system continues to be a unique feature of Chinese law. Although the company is free to appoint the chairperson, an executive director, or even a manager as the legal representative,[234] only one person could be designated as the external representative of the company, and the range of powers of this single representative is definitely given in the laws.[235]

Third, the civil compensation liability regime of directors for breach of their duties has, at this point, been structured into a very stringent model, departing greatly from those in developed countries. On one hand, shareholders' direct action against directors for damages is, in China, constructed into a general rule rather than an exception. In modern company law theory, directors are obliged to owe duties to the company as a whole rather than to the shareholders.[236] As a general principle, directors are not subject to shareholders' direct action for compensation, even if the interests of the shareholders are damaged due to a breach of duties of directors. In spite of discrepancies, in advanced economies, only under exceptional cases could the shareholders file such a direct action against the directors. In common law countries, such exceptions are usually given by constructing duties of directors owed to the shareholders in special

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231. *See* CL 2005, at arts. 38, 47, 100, 109.

232. *See* GAALC 1997, at art. 40.

233. *See Id.* at art. 107.

234. *See* CL 2005, at art. 13.

235. The modified legal representative system is unique in another way in the sense that even a manager can be assigned to represent the company externally. In developed countries, potential candidates for external corporate representatives are limited to board members. *See* Liu Jingwei, *Zhanbuduan, Lihailuan' De Fading Daibiaoren Zhi—Ping Gongsifa Di Shisan Tiao Guanyu Fading Daibiaoren De Xin* [*Guiding the Chopped but Tangled Legal Representative System: An Evaluation of the New Legal Representative System under Article 13 in the New Company Law*], 4 HENANSHENG ZHENGFA GUANLI GANBU XUEYUAN XUEBAO [J. HENAN ADMIN. INST. OF POLITICS & L.] 107 (2006).

236. *See* TALBOT, *supra* note 151, at 153.

circumstances. In the UK, only in particular dealings between directors and shareholders, which establish a special factual relationship between the directors and the shareholders in the particular case, can a duty be owed by the directors to the shareholders and therefore the directors be held liable for compensation.[237] In the U.S., only in limited instances could a director be obliged to owe duties to its stockholders, such as in the event that a director deals with a shareholder directly or acts in a way which injures a specific shareholder, and therefore be held liable to the shareholder.[238] In civil law countries, albeit with different approaches, the scope of shareholders' direct action against directors for damages is also very limited, since directors are subject to shareholders' direct action only in the specific cases listed in the laws. In Germany, shareholders are not entitled to damages claims except for a few special cases where directors neglect to properly handle the collection of capital contributions.[239] In Japan, directors are jointly and severally liable to the shareholders only in some special cases, too. For example, where the directors exercise their duties in bad faith or with gross negligence, shareholders, who are a third party outside the relationship between the director and the company, could hold the directors liable for compensation.[240] Opposed to the limited scope of compensation regimes in these countries, Chinese directors, in breach of their duties, are fully exposed to shareholders' direct action for damages. Under CL 2005, shareholders are entitled to sue the directors directly where the latter are in violation of the laws, administrative regulations, and articles of association of the company and infringe the interests of shareholders.[241] And since the duties of directors have been codified under CL 2005, any breach of duties is then regarded as violation of the laws by the directors. Hence, shareholders are conferred with the general right of action for damages against the breach of all duties of directors.[242] The exceptional rules in other countries have been generalized to the commonplace in China in this regard.

On the other hand, exceptions for releasing directors from civil liabilities in breach of their duties in other countries, such as the business judgment rule, are not available in China. In the U.S., the business judgment rule, which is a review standard where the conduct of directors is assessed and

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237. *See* DAVIES, *supra* note 6, at 374-76.

238. ROBERT W. HAMILTON, CORPORATIONS 423 (1997).

239. *See* Alexander Loos, *Germany*, *in* DIRECTORS' LIABILITY: A WORLDWIDE REVIEW 288 (Alexander Loos ed., 2006).

240. *See* SHŌHŌ [COMM. C.] art. 266, para. 93 (Japan).

241. *See* CL 2005, at art. 153.

242. For an analysis of shareholders direct action against directors see Liu Guiqing, *Gudong Dui Dongshi Zhi Zhijie Susong—Dui Xin Gongsifa Di 153 Tiao Fali Jichu De Fan*]*si Yu Chonggou* [*Shareholders Direct Action Against Shareholders: A Reflection and Reconstruction of the Legal Basis of Art 153 in New Company Law*], 3 FAXUE PINGLUN [L. REV.] 70 (2006).

their position is vindicated by the court, applies to limit the duty of care of directors and affords directors protection. Even if the directors' failed decision causes losses to the corporation, the business judgment rule provides a safe harbor for them where the errors are unintentional.[243] In the UK, although there is no statutory business judgment rule, both case law and statutes uphold similar rationale and achieve what U.S. courts try to redress. Directors are excused for breach of duty and are not liable for mistakes as long as they have acted in good faith and without clear misfeasance. This approach provides for similar relief as offered by the business judgment rule in the U.S.[244] In Germany, after a landmark case which opened the window for protecting directors against liability, the American concept of business judgment rule has recently been codified in the Stock Corporation Act.[245] In Japan, although there is no provision of the business judgment rule in the relevant statutes, its application in the courts has been increasing.[246] In short, in these countries, directors are protected against liabilities under certain circumstances so that they are encouraged to engage in ventures which have potential for the corporation but at the same time entail some risk. However, Chinese law does not provide such exceptions for the directors. After boldly declaring the civil compensation regimes against the directors for the company,[247] CL 2005 does not provide any rules for exempting the civil liabilities of the directors. So, where the company files a lawsuit for damages against the directors or where the shareholders file a derivative action for the same purpose, the directors are not protected by any exceptions. In sum, Chinese directors are exposed to greater risk of civil compensation in breach of their duties compared with other countries.

With a powerless board, the legal representative system, and a very stringent civil liability regime for the directors, the Chinese board under the new legal framework continues to stand apart from other models.

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243. *See* COX & HAZEN, *supra* note 6, §§ 10.02, 10.08.

244. It has been commented that there is an "implied" or "unwritten" business judgment rule in the UK concerning the judicial attitude in common law and statutes. *See* Demetra Arsalidou, *Objectivity vs Flexibility in Civil Law Jurisdictions and the Possible Introduction of the Business Judgment Rule in English Law*, 8 CO. L. 228, 231 (2003).

245. *See* DU PLESSIS, *supra* note 65, §§ 3.3., 4.2.

246. Mariko Nakabayashi, *Managerial Judgment Hazard in Corporate Governance*, *in* CORPORATE GOVERNANCE IN JAPAN: FROM THE VIEWPOINTS OF MANAGEMENT, ACCOUNTING, AND THE MARKET 79 (2006). For a discussion of the cases regarding the business judgment rule in Japan, see Cai Yuanqing, *Jingying Panduan Yuanze Zai Riben De Shiijian Ji Dui Woguo De Qishi* [*Business Judgment Rule Applied in Japan and Its Enlightenment in China*], 3 MODERN L. SCI. [現代法學] 182 (2006).

247. *See* CL 2005, at art. 150.

C. Endurance of an Unsatisfactory State of Affairs

It was expected that the effectiveness of the board of directors could be improved with all these efforts made by the legislature and other regulatory agencies. Unfortunately, the real situation is not as optimistic as imagined. It has been commented by a prestigious researcher in China that the recent board reforms are more in form than in substance,[248] which has been confirmed by the latest empirical evidence. According to the recent annual report of overall assessment for corporate governance of the top 100 Chinese listed companies, the score in "responsibilities of board of directors" keeps reducing due to its ineffectiveness.[249] More specifically, another set of data reveals that from 2007 to 2009, the average attendance of directors in board meetings in the top 100 Chinese listed companies continued to drop.[250] This implies that the newly introduced "sticks and carrots" fail to induce the directors to be more active in performing their role in the company.[251]

There are several reasons for the disappointing effects of the new reform. In the first place, the balance between corporate autonomy and legal intervention is not well struck in the new legal framework. Although more corporate autonomy is guaranteed by the new laws, the scope of this autonomy is, compared with other countries, quite limited. The powers of the chairperson of the board, although largely reduced, remain salient *vis–*

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248. Hu Yufei, *Deficiencies of Board Governance in Listed Companies: An Interview with Hu Ruyin* [*上市公司董事會治理弊病—訪上海證券交易所研究中心總監胡汝銀*], 4 DIRS. & BDS. [董事會] 48 (2009).

249. CHINESE CTR. FOR CORPORATE GOVERNANCE, CORPORATE GOVERNANCE ASSESSMENT REPORT OF THE 100 TOP CHINESE LISTED COMPANIES IN 2006, at 6, 8, 9, *available at* http://www.eaber.org/intranet/documents/26/1099/IWEP_LuTong_2006.pdf.

250. *See* Zhongguo Shehui Kexueyuan Shijie Jingji Yu Zhengzhisuo Gongsi Zhili Yanjiu Zhongxin [Chinese Centre for Corporate Governance of Chinese Academy of Social Science], 2007 Niandu Zhongguo Shangshi Gongsi 100 Qiang Gongsi Zhili Pingjia [Corporate Governance Assessment Report of the 100 Top Chinese Listed Companies in 2007] 22 (2007); Zhongguo Shehui Kexueyuan Shijie Jingji Yu Zhengzhisuo Gongsi Zhili Yanjiu Zhongxin [Chinese Centre for Corporate Governance of Chinese Academy of Social Science], 2008 Nian Zhongguo Shangshi Gongsi 100 Qiang Gongsi Zhili Pingjia [Corporate Governance Assessment Report of the 100 Top Chinese Listed Companies in 2008] 19 (2008); Zhongguo Shehui Kexueyuan Shijie Jingji Yu Zhengzhisuo Gongsi Zhili Yanjiu Zhongxin [Chinese Centre for Corporate Governance of Chinese Academy of Social Sciences], 2009 Nian Zhongguo Shangshi Gongsi 100 Qiang Gongsi Zhili Pingjia [Corporate Governance Assessment Report of the 100 Top Chinese Listed Companies in 2009] 19 (2009).

251. With the establishment of the training system of CSRC in 2005, directors are supposed to be fully aware of, or at least generally clear about, the amendments to the law, especially the stringent civil liabilities under the new framework. So theoretically speaking, the information asymmetry problem between the promulgation of new laws and the perception by the directors is not an impacting factor regarding the continuing passive behavior of the directors.

à–vis other board members. CL 2005, like CL 1993, statutorily appoints the chairperson to prompt and check the implementation of the resolution of the board.[252] And although the rule that the chairperson can exercise other powers authorized by the board of directors is deleted from CL 2005, this provision reappears in GAALC 2006. It is even clearly stipulated that routine or lengthy authorizations are permitted, provided that the "principle of caution" is followed by the board.[253] Accordingly, the chairperson has a statutory dominant role on the board, and may even become the standing authority of the board. Furthermore, limited corporate autonomy is exhibited by the inflexible ratification of prohibited acts of the directors. Under CL 2005, most of the prohibited acts of the directors could not be ratified; and in the few cases where ratification is possible, there are few alternative ways to ratify the acts.[254] For example, the use of corporate opportunity, as a specific act in breach of the duties of directors, can only be ratified by the shareholders' general meeting. Neither the board of directors nor a change of the articles of association of the company could ratify such an act. This approach is, in fact, too inflexible, because the convening of the shareholders' general meeting is very expensive and time consuming.[255] With these kinds of stringent rules, directors are continuously required to spend their time and energy on the legal procedures to justify their behaviors and the overall efficiency of the board is low. As a result, its functions cannot be fully displayed.

Moreover, the legal framework stays fragmented as the necessary legal intervention into the board of directors remains absent. In terms of the dismissal of directors before the expiry of term of office, there are few improvements in the new laws. Although CL 2005 deletes the provision that directors should not be dismissed by the shareholders' general meeting without causes,[256] this provision re–emerges in GAALC 2006.[257] This indicates that a cause is still required to remove a director. However, very few examples of what constitute "cause" are given. The only case for dismissing the directors under CL 2005 is where the director triggers a negative qualification.[258] Other than this, the law remains silent. Puzzles persist where the corresponding corporate organ thinks of removing a director before the expiry of the term of office. As far as the preventive mechanism against the misbehavior of directors is concerned, there is no

252. *See* CL 2005, at art. 110.

253. *See* GAALC 1997, at art. 112.

254. The only exception is the use of company funds to make loans or provide guarantees to third parties, where the board of directors, the shareholders' general meeting, and the articles of association could ratify such act. *See* CL 2005, at art. 149.

255. Companies Act 2006 in the UK has built in many ways to ratify such acts. *See* Companies Act 2006, c. 46, §§ 175, 180.

256. *See* CL 2005, at art. 46; *cf.* CL 1993, at art. 47.

257. *See* GAALC 1997, at art. 96.

258. *See* CL 2005, at art. 147.

improvement. Under the new legal framework, no articles stipulate a right or action that has an injunctive nature. In line with Article 22 of CL 2005 (a replacement of Article 111 of CL 1993), shareholders are only entitled to bring an action where there are irregularities of the board meeting or where the resolution of the board is in violation of the articles of association. They cannot file a lawsuit against an individual director or several directors based on misbehavior that may potentially pose risk to the interests of the company. In addition, there are two new articles concerning shareholders right of action. Articles 152 and 153 stipulate shareholders' derivative action and direct action respectively. Under these articles, shareholders can only file a lawsuit after they suffer substantial losses. They cannot bring a lawsuit against the directors before any real infringement happens. An action with an injunctive effect is therefore not available under the current framework. In sum, the new laws fail to introduce the indispensable devices which have the effect of motivating directors from various perspectives.

In addition, even with amendments to all these pitfalls in the new legal framework, the unchanged institutional background carries on impeding the effective functioning of the board. In the first place, remuneration of directors is not enough to motivate the enthusiasm of directors in their work. On one hand, the overall income of directors is still not aligned with the market valuation of the company. Statistics show that on the main board of Shenzhen Stock Exchange ("SZSE"), the total net profit of listed companies in 2008 declined by 40% compared with 2007; however, the average income of directors increased by 10% over the same period.[259] This means that the correlation between the remuneration package of directors and the market performance of the company is very weak. As a matter of fact, salaries of some directors are paid by other parties related to the listed company instead of the listed company itself. These directors previously worked in the parent company, group companies, or affiliated shareholders of the listed company, and after taking position in the listed company, continue to receive remuneration from their former company rather than from the listed company itself.[260] In listed SOEs, directors also act as government officials in the corresponding bureaus, and only receive

259. Xu Rong, *2008 Nian Shenzhi Zhuban Gongsi Gaoguan Xinchou Ji Guquan Jili Fenxi* [*Analysis of the Remuneration and Equity-based Incentive Mechanism of Senior Management on the Main Board of Shenzhen Stock Exchange in 2008*], 7 ZHENGQUAN SHICHANG DAOBAO [SEC. MARKET HERALD] 34 (2009).

260. *See, e.g.*, Jia Li, *Chuanhua Gufen Dongshizhang 'Lingxinchou' Beihou: Qunian Fenhong Shouru Da Wubaiduowan* [*Behind the "Zero-pay" of Chairperson of Chuanhua Stock: Dividend Income Reaches More Than 5 Million Last Year*], ZHENGQUAN RIBAO [SECS.DAILY], Apr. 30 2009, at C2.

compensation from the government.[261] Since decision–making power as to the remuneration of directors is not vested in the hands of a listed company, there can be a great discrepancy between the overall income of the directors and the market performance of the company. On the other hand, the improved equity–based incentive regime in the new law is not fully functioning due to the speculative nature of China's stock markets. From 2005 to 2008, the Shanghai Stock Index skyrocketed six–fold from 998.23 to 6124 within two years, and then shrank 70% to 1664 within one year.[262] Although major stock markets in other jurisdictions also experienced a dramatic fluctuation in the same period, the amplitude of major indices in other financial markets was not as large as Shanghai. The high volatility of Chinese stock markets reveals its continuous speculative nature which prevents it from reflecting the true market valuation of firms. Plagued into this highly speculative market, the vigorously pursued equity–based incentive mechanism may fail to align the personal interests of the directors with the performance of the corporation they work for, and may be unsuccessful in stimulating the enthusiasm of directors.

Next, the enforcement of the liabilities of directors has not been much improved. This phenomenon is fully embodied in criminal cases. In a typical criminal case, CSRC, the prosecution authorities and the judiciary are all involved,[263] and the number of criminal cases then serves as a gauge of the level of participation of these major bodies in enforcing the liabilities of directors. Disappointingly, although the number of administrative sanctions imposed by CSRC keeps increasing, the number of criminal cases has not risen correspondingly. Particularly, among those cases where CSRC imposes administrative sanctions on directors, there is a substantive portion where directors are in violation of their duties in information disclosure, such as making fraudulent financial reports of the listed

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261. *See* Pi Haizhou, *Dongshizhang Xinchou Zhineng Zai Shangshi Gongsi Lingqu* [*The Chairperson of the Board Can Only Receive Remuneration from the Listed Company*], SHANGHAI ZHENGQUAN BAO [SHANGHAI SECS. NEWS], May 5, 2009.

262. *See* Dong Dengxin, *Cong Zhongguo Gushi 20 Nian Baozhang Baodie Kan Weilai Sannian Zoushi* [*A Prediction of the Chinese Stock Market in the Next Three Years Based on Booms and Crashes in the Past 20 Years*], 21 SHIJIWANG [世紀網] [21ST CENTURY INTERNET], http://www.21cbh.com/HTML/2009-12-31/160023.html (last visited Jan. 12, 2011).

263. CSRC is usually in the frontline of investigating the misbehavior of directors, and where the wrongdoings of directors are suspected of triggering criminal liabilities, CSRC will take the initiative of referring the case to the corresponding prosecution departments. *See.*, *Jicha He Sifa Jinmi Xiezuo Shanghai Shiyong Xing Liu Diyi'an Luomu* [*Close* Collaboration Between Inspecting Departments and Judicial Departments: The First Case Regarding the Sixth Amendment of Criminal Law Ended], CHINA SEC. REG. COMM. [中國證券監督管理委員會], *available at* www.csrc.gov.cnhttp://www.csrc.gov.cn/n575458/n870399/n1337798/10782046.html (last visited Jan. 13, 2010).

company.[264] Although criminal liabilities of directors concerning such kinds of wrongdoing have long been codified,[265] very few of these suspected directors are subject to criminal liability. And in the rare cases where criminal punishments are imposed on directors, the penalties are minimal.[266] It is therefore observed that the relevant bodies are still very ineffective in prosecuting directors suspected of crimes. This implies that the government which has the substantive power to mobilize the relevant bodies to enforce liabilities of directors continues to be reluctant in doing so, due to the entrenched relationship between the directors and the government and the conflicting role of the government in the stock markets. In sum, although the legal framework has been improved, institutional factors which could not immediately be changed continue to frustrate efforts for an effective board.

CONCLUSION

To mitigate the agency cost generated from the separation between ownership and management, director regulation is of vital importance. For centuries, this issue of corporate governance has been addressed in developed countries and regions. In China, special attention has been paid to director regulation from the very beginning, when the modern corporate law system was introduced, and has progressed step–by–step over the past nearly two decades through the building up of a series of mechanisms and devices. In the early 1990s, civil law factors, particularly Japanese law, have shown more impact on the Chinese system in terms of the details of legislative techniques. Later, common law regimes, especially the U.S., have shaped Chinese law more substantially. By looking at these changes, a

264. For a list of administrative sanctions imposed by CSRC, see CHINA SECS. REG. COMM., http://www.csrc.gov.cn/pub/zjhpublic/index.htm?channel=3300/3313 (last visited Jan. 12, 2010).

265. *See, e.g.*, Criminal Law 1997, at art. 160. Compared with advanced economies, the criminal liabilities of directors stipulated in Chinese law are much heavier. *See* 2004 CORPORATE GOVERNANCE REPORTS, *supra* note 171, at 209.

266. *See*, *e.g.*, *Yuan Sanjiu Qiye Jituan Zongjingli Zhao Xinxian Deng Siren Lanyong Zhiquan Huoxing* [*Former Chief Executive of Sanjiu Group Zhao Xinxian and Other Three Senior Managers Were Sentenced to Imprisonment Due to Abuse of Power*], FAZHI RIBAO [LEGAL DAILY], Aug. 2007, at 9. In the following cases, although the sentence bands ranged from six months to seven years, the punishments against the defendants were kept no more than two years. Li Junying and Xiao Bo, *Zhang Jie Beixin Sunhai Shangshi Gongsi Liyi An—Beixin Sunhai Shangshi Gongsi Liyizui De Rending Yiji Zuiming Jinghe Shi De Chuli* [*Zhang Jie Case Regarding Breaching Fiduciary Duties and Causing Damage to the Interests of Listed Company: Determination of the Offense of Breaching Fiduciary Duties and Causing Damage to the Interests of Listed Companies and the Handling of Competing Accusation*], SHANGHAISHI PUDONG XINQU FAYUANWANG, *available at* http://www.pdfy.gov.cn/pditw/gweb/gww_xxnr_view.jsp?pa=aaWQ9Mjc1NTMmeGg9MQPdcssPdcssz (visited Jan. 12, 2010).

misconception may be formed that director regulation in China is shifting from the civil law family towards the common law tradition.

A more careful scrutiny can, nevertheless, pinpoint the underlying problem of such understanding. In the first place, director regulation in China has, from the beginning, never converged with a certain model in another jurisdiction. The Chinese model is a combination of different systems. Although more civil law ingredients were incorporated into Chinese law in the early 1990s, common law features, to a lesser degree, have also been shared by China. As time goes by, more U.S. norms of the board, such as the committee structures, liability insurance, and equity–based incentive regimes, have been promoted and gradually absorbed, but simultaneously, philosophies of civil law countries, such as the separation between chairperson and CEO, have kept on shaping the Chinese board. It is evident that Chinese law shows itself to be made up of a mix of aspects of other models, rather than shifting from one particular model towards another.

Furthermore, albeit with all these transplantations and mixes, a number of significant features, such as the limited powers of the board vis–à–vis the general assembly; the legal representative system; the approach of regulating duties of directors; and the civil compensation liabilities of the directors; stand out to show the Chinese characteristics which differ greatly from those of advanced economies. Compared with those ideas that exhibit the mixing nature of the Chinese board, these features are more substantive in the sense that the borrowed elements only refer to the details of legislative techniques or are of a recommending nature, while the features with Chinese characteristics are of a statutory and mandatory nature. These features are like the skeleton of the Chinese board, and distinguish the Chinese system greatly from its counterparts in other countries.

In addition, as far as enforcement is concerned, the Chinese board encounters the problem of low effectiveness which is not an issue of such importance in other jurisdictions. The embedded institutional factors both prevent the remuneration package from motivating the performance of the directors and deter the legal liabilities of directors from being fully enforced. Due to the sustainability of these factors in the foreseeable future, the Chinese practice of director regulation will continue to be plunged into the ineffectiveness issue and will remain differentiated from other countries. Accordingly, in terms of director regulation, corporate governance in China has always walked its own road rather than moving from one model to another model.

The evolution of director regulation in the last nearly two decades is better summarized as sinonization, by which foreign norms and institutions are altered to compromise with the Chinese conditions. This can be observed from both legislation and enforcement. First, foreign norms and institutions are diffused into the Chinese context during the legislation process. At this point, if none of the foreign systems available seems to be suitable for the case of China, the foreign rules are deformed and bent into a shape that departs greatly from that of the original countries. For example, even though board centralism has been adopted in developed countries long before China started working on its own board system, this conception has not yet been accepted in China after two rounds of corporate law legislative movements due to the potential loss of state–owned assets. And in response to the need of smooth transition, some unique systems were constructed in China after referring to the foreign rules. The legal representative system is such a case, which sets up a special mechanism in the board based on power authorization regimes in other countries, so that the former factory managers could find places under the new system. It is noteworthy that after this shaping and reshaping process, some indispensable mechanisms (e.g. the removal of a director before the expiry of the term of office) are lost, while some unnecessary legal burdens (e.g. the statutory powers of the chairperson of the board) are at the same time imposed. Therefore, legal reform striking the right balance between corporate autonomy and legal intervention is further needed: on one hand, the powers of the chairperson of the board of directors should be further reduced and its role should not be preserved as superior so as to avoid the monopoly of powers of the chairperson, and the prohibited acts of the directors should be allowed to be ratified more easily; on the other hand, the mechanism of dismissal of directors before the expiry of a term of office should be further improved by clarifying the causes of dismissal, and a preventive mechanism against the misbehavior of directors should be given in law.

Second, in terms of implementation, concepts transplanted to China may not be as effective as they are in their countries of origin, owing to special Chinese social and political conditions. For example, good intentions of introducing the equity–based incentive scheme in China may be frustrated by the highly speculative nature of the Chinese stock markets. And, more importantly, with the state having a substantial interest in the stock markets and standing behind the whole scenario, the wrongs of directors that have triggered the sanctions in the law may, very likely, go unremedied and directors not held accountable by the market regulators and the judiciary. Such problems will serve as barriers to the true application of foreign institutions even though they are fully adopted in China, and will keep the Chinese systems distant from the foreign concepts. To effectively change this situation, a better social and infrastructural environment for director regulation is needed, such as healthier and more mature stock markets and the more distant role of the state. To keep their remuneration subject to market discipline, directors should be paid by the companies they work for, not by another company or government department.

In general, sinonization is the appropriate diction to depict director regulation in China from legislation to enforcement.