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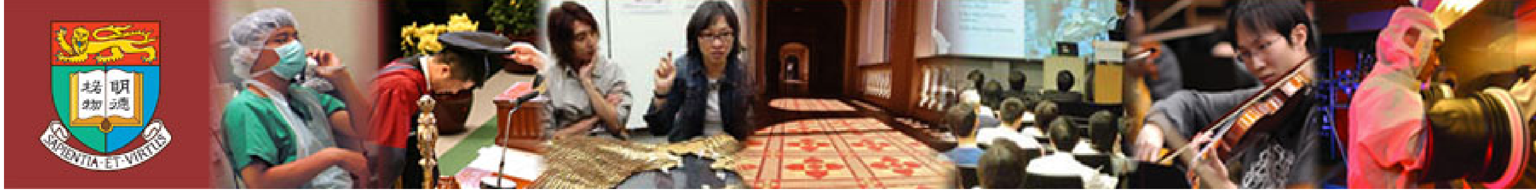

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Author(s)	Tokley, IA
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prises; and (5) other appointees. The Regulations require the manager of an enterprise as its legal representative to establish targets for the protection and growth of the value of state-owned property in the enterprise, whether on a contractual or leasing management basis (arts 31–3). Approval of state supervisory organs shall be obtained in order to transform state enterprises into share-holding companies, forming joint ventures, merger, and transfer of title to individuals, private firms, or overseas investors (arts 34–7).

Step by Step: Introducing the Latest Chinese Securities Regulations

Introduction

The promulgation by the State Council of the latest regulations regarding companies represents another step towards full regulation of corporate activity in the People's Republic of China (PRC).[1] The Regulations only apply to enterprises or companies which intend to offer shares to foreigners by way of listing on foreign stock exchanges.[2] This paper will consider a number of the provisions contained in the Regulations and will discuss the practical effect of the provisions for overseas investors, analysing as well as of the approach taken by the Chinese authorities in producing the new regulations.

The Regulations do not define the term 'overseas investors' although article 75 of the PRC Company Law[3] includes a requirement that promoters of a company domiciled in the People's Republic of China hold more than 50 per cent of the shares in a Chinese company, thus implying a form of residency test.[4]

1 State Council Special Regulations Concerning Issuing Shares and Listing Abroad by Companies Limited by Shares, promulgated by the State Council of the People's Republic of China on 4 August 1994, effective immediately (hereinafter 'Regulations').

2 Regulations, art 1.

3 The Company Law was promulgated by Order No. 16 of the President of the People's Republic of China on 29 December 1993, effective on 1 July 1994.

4 Company Law, art 75 provides that more than half of the promoters shall have a dwelling place (either the domicile of a natural person or the main business office of a legal person) in the PRC. This does not necessarily amount to residency. Accordingly, whether more than fifty per cent of the issued shares must be in Chinese hands is not clear on the terms of art 75; however, it is arguable that this should be the case given the historically conservative approach to foreign investment in the PRC. Should it not be then it would constitute a major concern to the PRC authorities. As to huaqiao (overseas Chinese), even though the test of Chinese nationality is based on both jus sanguinis and jus soli (rejecting dual nationality) it is arguable that the appropriate test was that of the domicile of the natural or legal person. The difficulty in making a general statement as to the level of PRC ownership in any company is that, for the purposes of Chinese law, a legal person will be treated as satisfying the residence or domicile requirements even where part of the ownership of that legal person is held by foreigners (eg a Hong Kong joint venture partner) as long as the legal person is *resident or domiciled within the boundaries of the PRC*. Moreover, not merely will this obfuscate the position as to ownership, it may result in these entities facing restrictions in investing in shares which are traded on an overseas exchange, as the Regulations differentiate between 'domestic' and 'overseas' investors. It should also be pointed out that, for the purposes of the Listing Rules of the Stock

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It is more common for the Chinese authorities to attribute nationality in the case of individuals by virtue of race rather then residence. However, despite this, it would appear from the approach adopted in article 75 that residence is the appropriate test, a test which excludes a large number of huaqiao or overseas Chinese. Presumably, though, the test would not exclude Chinese nationals who are residing overseas on a temporary basis. The provisions in the Regulations do, however, contrast with the specific exclusion of residents of Hong Kong and Macau which were contained in the Standard Opinion for Companies Limited by Shares ('the Standard Opinion').[5]

The Regulations were foreshadowed in the Company Law under articles 85 and 155. Both of these articles entitle companies limited by shares to seek permission to raise capital overseas. The articles also emphasise the relationship between the Company Law and the Regulations. The extent to which these two laws overlap is an important consideration in determining the effect of the new securities regulations and it is thus essential for the Company Law to be considered alongside the Regulations. In addition, and by way of contrast, it is also useful to refer to the supplementary provisions to the Standard Opinion which were produced to facilitate listings of securities of Chinese enterprises on the Hong Kong Stock Exchange (known as 'H' share listings).[6]

The Supplementary Provisions were introduced to supplement the Standard Opinion where certain provisions were inconsistent or inappropriate for companies seeking a listing on the Stock Exchange of Hong Kong. In particular, a number of important mandatory provisions were introduced which provided for greater shareholder rights and minority protection.[7] When the long-awaited Company Law was introduced some twelve months later, it was generally presumed that the provisions of the Company Law replaced those of the Standard Opinion. However, prior to the introduction of the Regulations, the terms of the Supplementary Provisions, although limited to Hong Kong, were all that was available for analysis. The Regulations did not, however, replace the Supplementary Provisions and thus these appear to remain in place in respect of those shares which are to be listed on the Stock Exchange of Hong

Exchange of Hong Kong, a certain minimum percentage of shares in a listed company must be held by the public. This figure is in most cases about 25 per cent of the issued shares although the Listing Rules do not stipulate whether a Chinese resident (natural or legal) would be included in that 25 percent. As the number of shares offered overseas will constitute the total foreign ownership and it is likely that a PRC company will offer shares amounting to a figure around the minimum number, there is little likelihood of foreign control at this stage.

5 State Commission for Restructuring the Economy, Standard Opinion for Companies Listed by Shares, 15 May 1993; art 4.

6 State Commission for Restructuring the Economy, The Supplementary Provisions on the Standard Opinion for Companies Listed by Shares for Companies Listing on the Hong Kong Stock Exchange (the Supplementary Provisions), 24 May 1993.

7 See, for example, Supplementary Provisions, arts 11, 14–15.

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Kong. However, what is interesting are those instances where the Regulations depart from the Supplementary Provisions.[8]

Indeed, the status of the Regulations is perhaps the most important initial consideration. It would seem that it was the intention of the Chinese legislators[9] that the Regulations affect the implementation of the Company Law in respect of issuing shares to foreigners through listing on an overseas stock exchange. Accordingly, where the Regulations are silent on a particular matter, the provisions in the Company Law should apply. This is particularly useful as the Regulations are, in some respects, quite brief.

The Regulations are an important part of a process of controlling the issue of shares from Chinese enterprises and companies to foreign shareholders.[10] It is argued that they represent an attempt by the State Council to ensure control over the issue of capital to foreigners.[11] Ipso facto this is true, as it is not possible to issue shares to foreigners other than through the procedure established under these regulations. As a consequence of this inference, a number of apparently innocuous provisions have been perceived as an attempt to maintain control whilst inviting foreign capital to subscribe for shares.[12]

In the rapidly developing Chinese securities market, however, it is reasonable that the drafters of the regulations have had to balance the concerns of foreign investors with concern over the influence of foreigners on Chinese companies and enterprises.[13] Moreover, it would be unfair to be critical of the

8 These variations are important because of the sensitive nature of discussions between the PRC authorities and the SEHK. It would be fair to say that the Supplementary Provisions were the result of quite extensive negotiations between these bodies. Moreover, they were 'won' by the SEHK at a time when there was no listing of PRC enterprises outside of the PRC. Where the provisions in the Regulations are not as stringent as those contained in the Supplementary Provisions (or the Listing Rules of the SEHK) they may indicate that the PRC authorities are less concerned with these issues in the absence of a specifically negotiated agreement between the overseas exchange and the PRC authorities. This might also indicate that the PRC authorities recognise the tremendous success of the 'H' share listings and the general acceptability of overseas listings to international institutional investors (see, for example, 'Plunging into Foreign Markets', The Economist, 17 September 1994) and are thus less inclined to agree to the types of conditions imposed by the SEHK. Alternatively, the PRC authorities could simply be establishing flexibility for the variety of differing requirements which may be imposed by different exchanges.

9 The State Council is not, in the Western sense, a legislative power. However, under the Chinese system it would be accurate to say that the regulations passed by the State Council with the delegated power of the National People's Congress have the status of general laws and thus the State Council can be rightly identified as a legislative power. For a more thorough discussion of the issues relating to the law-making authorities in the PRC, see the excellent text by Albert Chen, *An Introduction to the Legal System of the People's Republic of China* (Singapore: Butterworths Asia, 1992), ch 6.

10 In addition, there are a variety of approvals (not all of which are detailed in the Regulations) which must still be obtained.

11 See 'Rules Strengthen Beijing's Hand,' South China Morning Post, China Business Review, 8 September 1994.

12 Ibid.

13 And, indeed, the Chinese economy. The concern of the Chinese authorities is particularly understandable given that a number of the proposed listings are in key industries. Devices such as the golden share (which is discussed in more detail below) are mechanisms by which the authorities could maintain some control. It is interesting to note that the United Kingdom government was subject to similar criticism for its desire to insert golden share provisions into the articles of association of privatised institutions. In addition, the Chinese authorities are, to a certain extent, faced with an even greater risk than their foreign counterparts: the listing of Chinese enterprises is to occur on foreign exchanges, for the specific purpose of rasing foreign capital.

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Chinese authorities as these concerns are not limited to China. Almost every Western jurisdiction has restrictions on foreign ownership of its enterprises, some, more draconian than others.[14]

Perhaps the most interesting feature of the Regulations is the fact that they apply only to 'shares' and do not contemplate or, on some views, regulate the existence of other forms of capital.[15] Indeed, this limitation was foreshadowed in the structure of enterprises which were permitted to be listed on overseas exchanges prior to the enactment of the new regulations.[16] Whilst it is possible that the concept of a share under Chinese corporate law may be wider than that accepted under other jurisdictions,[17] it is more likely that the Regulations apply only to ordinary issued shares.[18] Thus, they fall short of covering other forms of capital raising such as convertible notes.[19] It is understood that the Chinese authorities are currently preparing draft legislation to cover the issue of convertible bonds and notes.[20]

Approval from State Council

The Regulations do not remove the need for approval from the Securities Committee of the State Council prior to the issue of shares to foreigners.[21] Moreover, the issue of such shares can *only* take place through listing on an overseas exchange.[22] Those shares are to be freely transferable[23] and will not be subject to any restrictions in the People's Republic of China.

14 See, for example, the Foreign Takeovers Act 1975 (Cth, Aust).

15 With the exception of Overseas Depository Receipts, which are discussed in more detail on page 110. As to the legal concept of a share, this has been discussed in a number of different aspects., most recently in Tokley, 'Oversubscription of Initial Public Offerings: Success or Failure? An Analysis of Directors' Duties when Issuing Shares' in Booth (ed), *Current Issues in Commercial Law* (to be published in April 1995). The uncertainty surrounding the conceptual nature of a share, capital, and property is thus no less resolved under common law principles than under those discussed in Chinese company law. See also discussion of this topic below.

16 For example, Ma'anshan Industrial, Shanghai Petrochemical, Tsingtao Brewery.

17 Eg United Kingdom, Australia. There are a number of texts and cases which have discussed issues relating to the concept of a share under those jurisdictions, eg Gower, *Principles of Modern* Company Law (London: Sweet and Maxwell, 5th ed, 1992), p 199; Ford and Austin, *Principles of* Company Law, (London: Butterworths, 6th ed, 1992), p 169.

18 For a discussion of the concept of shares under the Company Law see the forthcoming article by Tokley, 'The First Step: the PRC Company Law' (to be published in April 1995).

19 These should be distinguished from company bonds which may be issued by companies under Company Law, arts 159–63. The purpose of the issue of company bonds under the Company Law is said to be to 'raise production and operation' funds (art 159). Company bonds, however, are specifically defined under Company Law, art 160 to mean 'securities ... the principal of which [the] company agrees to repay, together with interest,' within a specified time frame. A strict interpretation of this definition would exclude convertible notes.

20 See 'Rules Strengthen Beijing's Hand' (note 11 above).

21 Regulations, art 2.

22 Ibid.

23 Regulations, art 2. One must look carefully at the meaning of this particular provision. There is, of course, a distinction between foreign and local shares — corresponding with the ownership of the share. When the Regulations state that the shares are freely transferable it is likely that the free nature of the transfer is limited to transfer *amongst foreigners* and, more particularly, on the overseas exchange. This analysis is supported to some extent by the limited access granted to foreigners to the Shanghai and Shenzhen exchanges.

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The shares, however, can only be listed on a foreign exchange in a jurisdiction where the relevant Chinese authority (in this case, the China Securities Regulatory Commission ('CSRC')) has entered into an agreement (usually a form of memorandum of understanding or agreement) in relation to joint supervision of the listing and issue of shares by a Chinese enterprise or company.[24] At present, there are a limited number of jurisdictions with whom the CSRC has entered into agreements, the principal jurisdictions being Hong Kong and the United States. It is anticipated that agreements will be reached shortly with a number of other jurisdictions,[25] thus allowing Chinese companies to seek listing in those jurisdictions within the near future.

Prior to approval of the State Council, applicants must submit an application which contains information relating to the proposal to issue shares to foreigners.[26] The Regulations do not specify the information which is required to be given nor do they indicate the basis on which approval may be given.[27] It has been argued that this approach maintains central control by allowing authorities a high degree of discretion.[28] However, it is possible to have an indication of the types of documents which are required by looking at Company Law, article 84. This Article sets out the documents required to issue shares.[29] Accordingly article 84, there are seven documents which are required to be approved for the issue of shares to the public: (i) formation documents;[30] (ii) articles of association;[31] (iii) opinions on the operation of the business; (iv) valuations;[32] (v) names of promoters; (vi) the prospectus;[33] (vii) the name and address of the collecting bank; and (viii) the details of the underwriting agreement.

These details should be compared with those, for example, which are required under the Rules Governing the Listing of Securities on the Stock

24 Regulations, art 4.

25 For example, Singapore; see China Daily, 6 September 1994 at page 3 where the comments of the Chairman of the China Securities Regulatory Commission were reported as to the possibility of future listings of Chinese enterprises on the Singapore Stock Exchange; see also South China Morning Post, Business Post, 7 September 1994.

26 Regulations, art 5.

27 Although the provisions of the Company Law will operate to a certain extent here as Company Law art 84 stipulates that certain documents must be provided with any application. In addition, the CSRC has recently issued further guidelines as to information to be contained in prospectuses. It could be imagined that certain additional information such as the justification for the enterprise or company seeking additional capital would also have to be provided.

28 See 'Rules Strengthen Beijing's Hand' (note 11 above).

29 See discussion of the concept of a share below.

30 These are the documents which witness the approval of the relevant authorities (the State Council authorised department or the People's Government at provincial level) to establish a company: Company Law, art 77.

31 For discussion of the provisions contained in this document see Company Law, art 22 as well as the Mandatory Provisions discussed below.

32 Again, whilst the provisions are silent as to the nature and content of such documents, assistance can be gained from looking at the Company Law, arts 25–8.

33 On 27 August 1994, the State Council Securities Commission announced that they had completed work on the new guidelines for information to be contained in prospectuses ('the Mandatory Provisions'). These are discussed more specifically below but will be addressed in a forthcoming article by Feng and Tokley.

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Exchange of Hong Kong ('the Listing Rules of the Stock Exchange of Hong Kong'). Under the Listing Rules of the Stock Exchange of Hong Kong a large number of documents or items of information must be provided. Included amongst those items or documents are (i) listing agreements;[34] (ii) audited profit and loss accounts and balance sheets; (iii) the articles of association; (iv) group accounts; (v) an accountant's report; (vi) any certificates or documents of title; (vii) copies of all resolutions of shareholders; (viii) copies of board resolutions; (ix) certificate of incorporation; (x) business registration certificate; (xi) a statement as to sufficiency of capital; (xii) a certified copy of every letter, report, financial statement, statement of adjustments, valuation, contract, resolution, or other document any part of which is extracted or referred to in the listing document; (xiii) copies of experts' consents; (xiv) sponsor's submission; (xv) draft contracts between the company and its directors; (xvi) contracts with supervisors; (xvii) copies of the draft contract between the company and its sponsors; (xviii) a declaration as to other business activities and undertakings; and (xix) a draft legal opinion prepared by the company's Hong Kong legal advisers.

Under the Regulations either existing companies (that is, those established under the Company Law) or state-owned enterprises which have been restructured can apply to offer shares.[35] The Regulations make it clear that the requirement of a minimum of five subscribers contained in the Company Law is waived.[36] Thus, it is possible for enterprises with a single shareholder to be entitled to issue shares. Again, any flexibility which might appear to arise from these provisions is likely to benefit the State which is the most likely single shareholder.

[34] A significant amount of additional information is to be provided by Chinese companies, inter alia, in the Listing Agreement. For example, information must be supplied on:
(i) a breakdown of the company's shares already issued;
(ii) the identity of each legal person or individual holding such securities constituting 10% or more of the existing issued share capital of the Company, and the number of shares held by each such legal person or individual; and
(iii) particulars of the quorum and voting requirements for general meetings of shareholders and for separate meetings of holders of domestic shares and foreign shares.

[35] Regulations, art 6.

[36] Regulations, art 6; see also the Company Law, art 75 which requires that there be five shareholders. Perhaps more interesting is the issue of whether the promoters need be Chinese. art 75 provides that 'To form a company limited by shares there must be more than five promoters, of whom over 50% must have a dwelling place within the boundaries of the People's Republic of China.' Article 6 does not indicate whether, in having removed the requirement for five promoters, it also removes the need for there to be a greater than fifty per cent Chinese interest. It would be surprising, however, if that were the case. Moreover, the provisions in the Company Law entitle promoters to establish a company in one of two ways: the promotion method or the subscription method. The first method involves the promoters subscribing for all of the capital in the company and the second involves the promoters subscribing part of the shares with the remainder being offered to the public. Where a state-owned enterprise is to be restructured into a company, the enterprise itself will generally be used as the promoter and art 6 will allow this restructuring to occur without the need for other initial promoters. This is particularly useful where it is necessary to establish a separate holding company for both the company which is to be listed and the company which is to retain control of the non-profit-making activities of the state-owned enterprise (such as schools, hospitals etc).

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Meaning of 'shares'

The most contentious issue in the Regulations is the meaning of 'shares.'[37] As was noted before, the promulgation of the regulations has been said to be motivated by a desire of the Chinese authorities to prevent the use of 'backdoor' listings.[38] This has occurred through use of either Hong Kong incorporated companies or by virtue of injecting Chinese assets into an already existing overseas listed firm. However, the question is whether the legislation goes far enough. A number of Chinese companies have apparently attempted to utilise the concept of convertible notes or bonds to avoid the fairly stringent restrictions on raising further capital contained in the Company Law and exercised by the State Council.[39] It is argued that the lack of clarity over the meaning of shares could lead to similar difficulties under the Regulations. This is because article 8 of the Regulations maintains the need for approval from the State Council prior to issue of any *shares*. Thus, the companies have attempted to use other forms of capital (such as convertible notes) to avoid having to seek approval of the State Council.[40]

This matter is obviously one of great concern to the Chinese authorities. In the first instance, it could lead to greater concentration of foreign control over Chinese companies[41] and enterprises and, second, because it may affect central planning of money supply in the economy. The extent to which the authorities will respond to this dilemma is not clear but it would not be surprising to see significant penalties imposed.[42] Cautious and prudent foreign investors should ensure that the enterprise has sought and received approval from the appropriate *central* as well as local authorities[43] or otherwise risk confiscation or loss.

There is little doubt that this approach to interpreting Chinese Company Law is flawed. The approach of the Chinese legislators and regulatory authorities has been to limit, rather than increase, the mechanisms for capital raising. It would be entirely inconsistent with this approach if the Regulations could be read so widely as to allow a variety of new forms of unregulated capital to be created. The approach of the Chinese legislators can be clearly demonstrated by reference to the provisions on shares and company bonds. First, Company Law, article 139 specifically states that the board of directors of a company must apply for approval 'to a department authorised by the State Council or to the

37 Regulations, arts 3 & 7.
38 See 'Rules Strengthen Beijing's Hand (note 11 above).
39 Most importantly, this exercise is in accordance with state planning.
40 The argument being, of course, that there are *no* restrictions on the issue of other forms of capital. The falsity of this argument is discussed below.
41 That is, greater foreign control without the sanction of State Council.
42 See discussion of the penalties contained in Company Law, art 210 on page 111.
43 For further discussion of the difficulty regarding establishing the appropriate authority see below at page ???.

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People's Government' at provincial level. Second, in relation to company bonds, the provisions are even more strict. Not merely does the definition of company bonds under Company Law, article 160 exclude the possibility of conversion of bonds into capital, but Art 161 sets out stringent conditions as to the company's financial situation. Moreover, articles 163–4, confirm the control of the State Council by making the issue of company bonds subject to State Council approval and by ensuring that the bonds may not exceed the amount specified by the State Council. Where, under article 173, company bonds can be converted into shares, the Company Law specifically requires that the proposed issue must be submitted to the 'State Council's department for the administration of securities.'[44] Thus, it is clear, municipal authorities do not have the power to authorise the issue of convertible notes.

Non-bearer shares

Under Article 3, shares which are issued to foreigners must be non-bearer and have their nominal value in renminbi although payment for shares may be made in a foreign currency. Presumably, future issue of shares will also be made in foreign currency. The selection of non-bearer shares is inconsistent with provisions in the Company Law.[45] As the Regulations relate to foreign ownership of shares, this variation makes sense bearing in mind that the Chinese authorities wish to have some transparency of ownership through the share register.[46]

Payment in a foreign currency

A number of additional points, however, arise in relation to the decision to allow payment for shares to be made in foreign currency. First, it may be that a Chinese enterprise which seeks listing on two or more overseas exchanges[47] will end up having payment for shares made in a number of different currencies. Second, whilst the provisions entitle applicants for shares to subscribe in a foreign currency, there is no mention of the way in which winding up of a company will proceed.[48] It is curious that although the Regulations deal with

44 The CSRC.

45 See, for example, Company Law, art 133 which permits the use of bearer shares (although also provides for the registration of other than bearer shares).

46 Although this provision should be contrasted with Regulations, art 16 which is discussed below on page.

47 For example, Shanghai Petrochemical, which is listed on both the New York and Hong Kong stock exchanges.

48 Winding up is, however, covered under the Company Law. One case which might be considered somewhat analogous under the common law is that of *Re Scandinavian Bank* [1988] Ch 87. In that case the Scandinavian Bank was allowed to have its shares denominated in foreign currency. The provisions as to winding up were contained in the articles of association and there is no reason why similar provisions should not be contained in the articles of association of the Chinese enterprise. Moreover, there is no criticism of the English legislation which contains no special provisions for winding up in these circumstances.

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the question of dividend, allowing dividends to be paid in foreign currency at particular exchange rates,[49] they do not cover the issue of winding up.[50]

Accordingly, overseas investors who proceed to apply for shares with payment in foreign currency will need to consider carefully the consequences of winding up. It may be, for example, that the answer to the issue lies in the treatment of winding up under the Company Law and that document will need to be consulted to understand the way in which winding up takes place.[51]

Partly paid shares

Third, the Regulations do not deal with partly paid shares or redeemable preference shares. Again, it would be unwise to attempt to read the definition of shares in such a manner as to presume that the issue of partly paid or redeemable preference shares was allowed.[52] Indeed, the better approach is to seek guidelines from the appropriate regulatory authority in China such as the State Council Securities Committee or the CSRC. In particular, care ought to be exercised when dealing with municipal authorities in the absence of

49 Regulations, art 27. Indeed, art 27 goes on to establish the procedure for the payment of dividends in foreign currency, allowing a Chinese company to carry on exchange transactions to obtain the necessary funds. In addition, it also reinforces the importance of the memorandum and articles of association in such circumstances.

50 It is also common for most overseas exchanges to have notice requirements in the event of winding up. For example, under the Listing Rules of the SEHK, a company must inform the SEHK when one of the following events occur: (i) the appointment of a receiver either by a court having jurisdiction or under the terms of a debenture or any application to any court having jurisdiction for the appointment of a receiver or manager, or equivalent action in the country of incorporation; (ii) the presentation of any winding-up petition (or equivalent application in the country of incorporation) or the making of any winding-up order or the appointment of a provisional liquidator, against or in respect of a company, its holding company, or any major subsidiary; (iii) the passing of any resolution by a company, its holding company, or any major subsidiary that it be wound up by way of members' or creditors' voluntary winding-up, or equivalent action in the country of incorporation or other establishment; (iv) the entry into possession of or the sale by any mortgagee of a portion of the issuer's assets which in aggregate value represents an amount in excess of 15 per cent of the consolidated net tangible assets of the group; or (v) the making of any final judgment, declaration, or order by any court or tribunal of competent jurisdiction whether on appeal or at first instance which is not subject to any or further appeal, which may adversely affect the company's enjoyment of any portion of its assets which in aggregate value represents an amount in excess of 15 per cent of the consolidated net tangible assets of the company.

51 Briefly, winding up is provided for in Part Eight of the Company Law, arts 189–98. There are four ways in which a company limited by shares can be wound up (i) when a company is declared insolvent because it is unable to pay its debts as they fall due (art 189); (ii) when the term of operation (which is specified in the articles of association) expires (art 190); (iii) if a meeting of shareholders resolves to dissolve the company (art 191); and (iv) where a company is ordered to be closed down by some regulatory authority for breaches of the regulations or illegal activity (art 192). In these circumstances, a liquidation committee is to be formed (in the case of insolvency by the People's Courts; for unlawful behaviour by the shareholders and relevant authorities; in other instances by the shareholders). In the event of default by the shareholders, the creditors may request that the People's Court appoint persons to perform the task. The liquidation committee has a variety of functions and powers to examine books and assets of the company as well as undertake payment of outstanding liabilities (art 193). It is only if there is property remaining after the payment of all liabilities (including taxes and wages etc) that any distribution will be made to shareholders 'in proportion to [their] shareholdings' (art 195 para 3). There is thus no statement as to the currency in which these payments might be made.

52 See discussion on the restriction on the issue of further capital without appropriate authority at pp 104–5.

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approval from a central authority.[53] The central authorities are both willing and capable to consider such issues. Moreover, the ultimate risk of undertaking a transaction which is outside the spirit (as well as wording) of the provisions, apart from confiscation,[54] is exclusion from the market-place. Such a risk could not be justified by any short-term benefit. Moreover, partly paid shares would raise the issue of conversion of the amount paid, or to be paid, in the case of foreign currency. This is a complex issue which may need to be considered further by the Chinese authorities.

The appropriate authority

Perhaps these issues focus attention on another consideration in relation to understanding Chinese securities law, that is, identifying the appropriate authority for the making of rulings or giving of information in relation to 'grey areas.' Presently, there are a variety of institutions to whom a foreigner could turn for advice. For example, the State Council, the relevant Exchanges,[55] and municipal authorities. It would be a very useful gesture if the responsibilities of the government departments could be identified. As has been discussed above, it would seem that a useful starting place would be the State Council Securities Committee or the CSRC. However, it is acknowledged that, for a variety of reasons, it may be difficult to ascertain exactly which department is responsible for particular operations or transactions. The development of the various government departments in the past two years has been quite phenomenal. In addition, any uncertainty might have been increased by the rather limited amount of legislation in certain areas which has been promulgated. It would be unfair, once again, to single out the Chinese authorities for this dilemma. For example, in Hong Kong, the Financial Secretary,[56] the Registrar of Companies,[57] the Hong Kong Monetary Authority,[58] the Securities and Futures Commission,[59] and the Stock Exchange[60] all have responsibilities in relation to Hong Kong securities law.

One would suspect that this uncertainty is an issue that the foreign exchanges should have resolved prior to allowing the Chinese company to list. Indeed, perhaps the better approach would be for the foreign exchanges and

53 See discussion below.
54 See the penalties contained in Company Law, art 210 discussed below.
55 That is, the Shanghai and Shenzhen Stock Exchanges.
56 Whose authority rests over a variety of ordinances, for example: Companies Ordinance, Securities Ordinance, Securities and Futures Commission Ordinance.
57 Through the control of matters contained in the Companies Ordinance.
58 Through control over authorised institutions contained, inter alia, in the Banking Ordinance.
59 Through the provisions of the Companies Ordinance, Securities Ordinance, Securities and Futures Commission Ordinance, Securities (Disclosure of Interests) Ordinance, and Securities (Insider Dealing) Ordinance.
60 Through the listing rules and various delegated powers from the SFC.

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regulatory authorities to advise investors.[61] However, it is these types of issues which cloud the emergence of Chinese enterprises and tend to be reflected in an element of 'risk consideration.'

Indeed, under the Listing Rules of the SEHK a great deal of additional information is required to be disclosed by a PRC company to reduce this 'risk.' First, a Chinese company which is seeking listing on the SEHK must set out a number of 'risk factors'[62] including a summary of the following:

(a) the relevant PRC laws and regulations;
(b) the political structure and economic environment of the PRC;
(c) foreign exchange controls in the PRC and the exchange rate risk of the Renminbi;
(d) the different regulatory framework for the PRC companies listing outside the mainland of the PRC;
(e) specific risk factors related to the business of the company and/or its products; and
(f) the law(s) governing the resolution of disputes arising from the company articles of association and the transfer of the company shares.

In particular, the section on risk factors requires details of the regulatory framework for Chinese companies listing on foreign or overseas exchanges. This commentary (as well as the legal opinion on PRC Law which is to be supplied) will often contain up-to-date details of the various regulatory bodies and their functions.[63]

The prospectus

Under article 12 of the Regulations, all new share issues must be accompanied by 'full and detailed information' in a prospectus.[64] Although not explicitly stated, it is likely that any prospectus will need to be approved by both Chinese authorities as well as supervisory authorities in the jurisdiction in which a company is to be listed. In the event of inconsistency between the Chinese

61 To a certain extent they do cover such issues through the summary of provisions which must be included in listing of PRC companies and it may even be possible for shareholders to seek direct assistance from the relevant exchanges. Although this service would not appear to be directly offered by the exchanges, there is no reason to suggest that they would not be helpful to shareholders.

62 All companies seeking listing on the SEHK are required to include a section on risk factors. The matters discussed in this paper are those which are special to PRC companies.

63 See, for example, the Prospectus for Tianjin Bohai Chemical Industry (Group) Company Limited, May 1994 at p 110.

64 The basis of what constitutes 'full and detailed information' is not disclosed in the Regulations. Moreover, there are some interesting implications where the prospectus fails to provide such details. For example, who is responsible for the provision of the information and the consequences of failure? The Regulations do not, themselves, provide for any remedies or actions against the directors or other officers by officials or shareholders. In addition, is it possible to establish some shareholder or investor remedy based on the beach of this provision? Further, whether such an action could be heard by courts in a foreign jurisdiction in which a listing took place.

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regulations and the regulations of the overseas authorities, the Regulations provide that two prospectuses must be issued, each complying with particular provisions which govern issue of shares in those jurisdictions.[65]

This may be seen as an understandable attempt by the Chinese authorities to establish control over public listing of shares both on local and foreign exchanges. However, one must be conscious of the practical effect of such a decision. The obvious dilemma for investors must be the reasons why the two authorities are *not in agreement* as to information which should be disclosed. One may imagine that investors should accept the more 'rigorous' approach to vetting of a prospectus, but what if there are differences in several respects? In addition, will the existence of differences be identified?[66]

In the present climate, the major element of the exercise of control by the Chinese authorities is more likely to occur in the restructuring of a Chinese enterprise rather than at the listing stage. Moreover, on previous experience, it is more likely that the exchange on which Chinese shares are to be listed will impose more stringent standards than those adopted in China.[67]

The issue of shares

Once approval to issue shares has been received, it is the board of directors which is responsible for ensuring that all requirements are complied with.[68] Shares must be issued within fifteen months of obtaining permission to issue them.[69] It is implied within the Regulations that failure to issue shares within that period will require an applicant to make a new application. Perhaps the only reason why a Chinese enterprise would delay issuing shares is difficulties in obtaining approval from a foreign regulatory authority or listing committee for a listing, or in the event of a flat period in the stock market. However, this should not present any difficulties as fifteen months would appear to be sufficiently long to allow for completion of the listing process as well as any lull in the market.[70]

[65] As to any confusion, in the case of listings on SEHK, the provisions of rule 19A.37 state that information to be supplied by a Chinese company in a listing document or accounts (notwithstanding any obligation in the Listing Rules, the Statutory Rules, or imposed by the laws of Hong Kong) shall not be less than that required to be supplied by the PRC issuer under applicable PRC law.

[66] That is, will the prospectus include notes at the appropriate point?

[67] One particular area in which disagreements have arisen is in respect of accounting standards. In addition, it could be imagined that a number of other areas would need to be closely considered, such as other experts and legal opinions. See also note 68 above.

[68] Regulations, art 8; presumably, if the requirements are not complied with, the directors are guilty of some type of offence. This aspect raises important issues of the enforcement of provisions and generally of shareholder remedies.

[69] Regulations, art 8.

[70] Presumably, the enterprise could reapply for permission to issue the shares. This requirement contrasts with the freedom with which Western companies can choose to delay a move for listing. For example it could be imagined that the State Council will take into account a large variety of factors which might not have to be considered by Western companies: issues of state planning; the economy; the number of other enterprises already seeking listing.

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All shares must be issued at one time.[71] Special permission must be received to issue shares in separate tranches. It is implicit in these provisions that shares must be issued on the same terms.[72] Where the number of shares issued falls within the approved limit, it is also not possible for a company to issue further shares without further permission.[73] Moreover, any amendment to a proposal must be approved by shareholders.[74] In this respect, it is extremely important to understand the provisions relating to calling of shareholders' meetings which are contained in the Regulations. These provisions are quite onerous and a meeting cannot be held unless 50 per cent of shareholders attend.[75]

Private placements of shares

Under the Regulations a company may offer and issue shares to 'specific and non specific' investors outside the PRC.[76] Thus it is possible for a company to make a specific private placement of shares to an investor. This is a departure from the procedure under the *Company Law*[77] which did not allow for specific placements of shares, the only methods available being public issue or the promotion method and then public issue. The shares which are the subject of the private placement should presumably be quoted shares on the overseas exchange on which other securities of the company are listed. This, however, is not stated in the Regulations.[78]

Offerings of securities in the United States

In addition to shares, overseas depository receipts (ODRs) are also permitted under the Regulations, thus opening up the American market.[79] Whilst use of ODRs may be a better approach to the problem of winding up, the Regulations are less than clear in relation to other derivatives. For example, it is unclear whether warrants or options can be issued without the need for further

71 Regulations, art 9.

72 Perhaps implicit but not expressly stated, although there is little doubt that the foreign stock exchange would impose this requirement.

73 Regulations, art 10.

74 Ibid.

75 Clearly maintaining control within the hands of the PRC shareholders who *must* hold fifty percent: see discussion above.

76 Regulations, art 2.

77 Company Law, art ?.

78 To this extent the Regulations are somewhat ambiguous. It is clear that they will cover (i) offers of securities which lead to listings on overseas exchanges and (ii) further offers of securities made by a company which is already listed on an overseas exchange. However, what is not clear is whether it is contemplated that shares can be offered and issued for a company which is not seeking listing. If the words 'offer' and 'issue' are read conjunctively (which by the insertion of the word 'and' would appear to be the case) then it would seem that the third possibility may actually have been contemplated by the Chinese authorities. There are, of course, a number of flaws with this argument, not the least significant of which is the fact this is a matter of translation and emphasis. The difficulties with this technical approach to interpretation of Chinese law must be recognised and, to a certain extent, this represents one of the special problems of dealing with Chinese securities legislation.

79 Regulations, art 3.

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approval, and if they are issued, whether they will be allowed to be used by foreigners to obtain further capital.[80]

As discussed before and on the basis of the general approach taken by the Chinese authorities, it would seem clear that the Chinese authorities will require their approval prior to the issue of any derivatives involving capital of a company. Again, it would be unwise for foreign shareholders to accept derivatives without prior approval.

For example, the penalty for a company issuing derivatives which may be capital based without authority is set out in article 210 of the Company Law. The issue will be stopped, proceeds of the issued shares refunded (interest being paid on the amount), and a fine ranging from between one to five per cent imposed. In addition, criminal prosecution may be pursued in certain circumstances.

The Regulations also permit a company to grant an option to the underwriter of the public issue of shares to take up to fifteen per cent of the total shares to be issued by the company. This is known as a 'greenshoe' option allowing underwriters to participate in the issue where they may otherwise be excluded.[81] In the case of listings of Chinese enterprises most of these have been well subscribed[82] so that it can be imagined that this option may well be adopted by a number of Chinese companies.

Special provisions in the new regulations

The Regulations contain a number of specific restrictions on the activities of a company. These are primarily to be contained in the articles of association. Under article 13, the State Council can formulate compulsory provisions which must be included in the articles of association.[83] Such provisions cannot be amended or deleted by a company or its shareholders.[84] The Regulations do not, however, indicate the nature of any restrictions or provisions. It is this uncertainty which may present problems for a foreign investor. It is anticipated that the Supplementary Provisions will eventually be replaced by regulations which govern all listings. Indeed, the Mandatory Provisions[85] issued by the CSRC contain a number of provisions relating to a variety of different areas.

80 See discussion above at pp 104–5.
81 On the basis of some arguments, the exercise of the green shoe option is an improper use of the power to issue shares. Prima facie, shares are issued to raise capital for ascertained or determined purposes. To simply issue a further number of shares to underwriters where there was an oversubscription would appear not to have a predetermined purpose for the proceeds of the issue: see Tokley (note 15 above).
82 More particularly on the SEHK: for example, the Initial Public Offering of Denway Limited was oversubscribed some six hundred times.
83 Regulations, art 13.
84 Ibid.
85 Mandatory Articles for Companies to be Listed Abroad, issued by the State Council Securities Committee and the State Economic Reform Committee.

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One particular provision which may be considered by the Chinese authorities relates to what is known as the *golden share.*

The golden share concept is one created in the United Kingdom in relation to the privatisation of certain government industries.[86] There are a variety of reasons for introducing the golden share and these include (i) protection of a national asset against foreign ownership or control or domination by one or more major shareholders and (ii) the ability to provide a 'honeymoon' period during which the company's directors are able to adjust gradually to the disciplines of the private sector.

Under a golden share article, the government is generally issued with one share, a 'golden share' which enables it to control certain aspects[87] where the exercise of that control might be in the national interest. A golden share is not normally issued on an indefinite basis, however, and may be redeemed at any time or lapse within a fixed period of time.[88] For many of the reasons set out above, the Chinese authorities[89] are known to be interested in the application of the golden share to Chinese enterprises and it would not be surprising to find one included in the articles of association under this general provision.

Duration of a company

Article 14 repeats the requirement set out in the Company Law that a company should specify the intended duration of a company's business. This is an unusual and important provision as the Regulations allow a company to have perpetual existence. In the absence of this provision, the automatic winding up procedures under the Company Law, article 191 will take effect. The provision is unusual in the sense that it is difficult to imagine whether an exchange would find a company acceptable for listing *in the absence* of the exception provided under article 14.

86 The most famous of which is the privatisation of British Telecom in 1987.

87 One example is a takeover offer. However, this could also include a number of other matters. For example, a prohibition on foreign investors owning more than a certain percentage of the company's shares (although this would appear to be already covered by the distinction between overseas and domestic investors). Indeed this restriction on a change of control without permission of the government could be extended to a prohibition on any one person or group of persons securing voting rights over more than half of the share capital or a prohibition on any one person or group owning more than a certain percentage of the share capital (presumably this percentage is one which would give that person or group control over the company without amounting to fifty per cent — in this regard it is interesting to note that the Listing Rules of the Stock Exchange of Hong Kong set the takeover threshold for PRC companies at thirty per cent whereas the threshold for other companies on the SEHK is 35 per cent). One interesting application of the golden share could be to prohibit material disposal of assets. This would be very useful for the Chinese authorities who might be concerned as to the alienation or disposal of key industries by PRC company directors to raise funds to participate in more speculative (and certainly lucrative) markets such as property. In the same manner a restriction on winding up would ensure that the authorities could protect key industries. The right to appoint directors entitles the authorities to maintain control without the need to exercise a form of a veto. In addition, this control may extend to restriction on appointment of directors.

88 In relation to the privatisation of the Electricity Company this was five years.

89 The State Council.

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Auditors and dividends

There are also a number of significant provisions relating to the appointment and removal of auditors.[90] These are perhaps not as detailed as those which were contained in the Supplementary Provisions but again, this may have been brought about as much by a desire for flexibility as any notional drop in standards. The provisions do not specify the standard or standards by which the accounts are to be prepared but these may in any event be set by the relevant overseas exchange (as was done by the SEHK). The Regulations do require that the names of the auditors be notified to the CSRC for record purposes.

The Regulations also stipulate the manner in which dividends are to be declared and paid to foreign shareholders.[91] These are to be paid in foreign currency although they may be declared in renminbi. Once again, the Regulations are not as detailed as the Supplementary Provisions which specify that the dividends in foreign currency are to be calculated by reference to Shenzhen foreign currency swap centres. Again, this may be a matter better left to negotiation with an overseas exchange rather than to a national law.

Nominee shareholders

There are also a variety of provisions in the Regulations which relate to the registration and identification of ownership of foreign shares.[92] It is interesting that the Regulations specifically allow for the use of nominee shareholders,[93] given the disquiet in a number of other jurisdictions over the concept of nominee shareholders, and that the Chinese authorities have allowed use of nominees without additional disclosure pressure.[94] This is particularly so in the absence of disclosure provisions[95] under Chinese company and securities law.

Presumably, the Chinese authorities are less concerned about issues such as warehousing amongst foreign shareholders, as control in the short term at least will remain with Chinese investors.[96] Moreover, this apparently liberal approach may be a response to pressure from overseas investors who prefer the convenience of using nominees.

90 Regulations, art 26.
91 Regulations, art 27.
92 Regulations, art 16.
93 Ibid.
94 See, for example, the Securities (Disclosure of Interests) Ordinance in Hong Kong; the Corporations Law in Australia; the Companies Act 1989 (UK); and the Williams Act s 13 (d) in the United States; see also Tokley, 'A Comparative Analysis of Takeover Provisions' (a conference paper delivered in Beijing, 1 March 1994).
95 Although see the special provisions contained in the Supplementary Provisions, art 12, relating to disclosure of more than ten per cent of the issued shares. This provision was, however, inserted at the behest of the SEHK: see discussion below.
96 That is, as Chinese promoters must hold more than fifty per cent of the issued shares. See discussion above.

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Eventually, however, the Chinese authorities will have to deal with the issue of disclosure.[97] One of the difficulties which the Chinese authorities recognise they face is the shareholding structure of presently listed companies.[98] A review of the present structure would reveal that a considerable number of shareholders in Chinese listed companies hold small numbers of shares.[99] Moreover, the extent of over-the-counter trading make it difficult, if not impossible, for the authorities to determine ownership of shares.

Minority protection provisions

In addition, it is likely that minority protection clauses will be included in the articles of association. In the case of listings on the Hong Kong Stock Exchange, the Hong Kong regulatory authorities[100] have required Chinese enterprises, which list their shares on the Hong Kong stock exchange, to have special minority protection provisions.[101]

Shareholders' meetings

There are also a number of provisions which relate to calling and holding of shareholders' meetings which vary from those in common law jurisdictions. First, 45 days notice of a shareholders' meeting must be given by a company.[102]

97 Indeed, the Listing Rules of the SEHK, for example, presume they do. Under rule 19A. 16, special provisions have been inserted for 'controlling shareholders' in Chinese companies which are seeking listing on the SEHK. A 'controlling shareholder' is defined as 'any shareholder or other person or group of persons together entitled to exercise, or control the exercise of 30 per cent (or such lower amount as may from time to time be specified in applicable PRC law as being the level for triggering a mandatory general offer or for otherwise establishing legal or management control over a business enterprise) or more of the voting power at general meetings of the new applicant or who is in a position to control the composition of a majority of the board of directors of the new applicant.'

98 The difficulties were recognised by Dr Gao Xiqing, Director, CSRC, in a seminar on takeovers in Beijing, 1 March 1994.

99 Compare this to the situation in the US and UK.

100 The SFC and the SEHK. See, in addition, the special provisions for the listing of PRC incorporated companies contained in the Listing Rules of the Stock Exchange of Hong Kong, Appendix 7i.

101 Although not directly dealing with the issue of minority protection, the Listing Rules of the SEHK also have special provisions for sponsors of PRC companies. Sponsors are to be retained for three years after listing to act as the principal 'channel of communication with the Exchange.' The sponsor is to have access to directors and the SEHK places particular importance to the role of the sponsor of a PRC company. The sponsor is said to have a particular responsibility to 'satisfy himself [or herself], on all available information, that the PRC issuer is suitable to be listed and that its directors and supervisors appreciate the nature of their responsibilities and can be expected to honour their obligations under their directors' or supervisors' undertakings, the [Listing] Rules and the Listing Agreement and under applicable PRC law and regulations.' In particular, it has been said that 'the sponsor must be satisfied that the directors of the PRC issuer understand what is required of them under the Listing Rules, the Listing Agreement and applicable laws and regulations.' In particular, where securities of a PRC company are to be listed on other stock exchanges, the sponsor is required to make a written submission to the Exchange stating whether in the sponsor's opinion the PRC issuer's directors appreciate the differences as well as the similarities between H shares and the shares listed on such other stock exchanges and between the rights and obligations of holders of such shares, and the basis for such opinion. The sponsor must also explain how the PRC issuer's directors propose to coordinate and comply in a timely manner with their obligations under the requirements of the Exchange and other stock exchanges.

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This extensive period is unusual and contrasts with the period in the Company Law and also identified in earlier regulations. It is particularly curious as the provisions in the Company Law relate to the calling of meetings for holders of bearer shares. Of course, bearer shares are not permissible under the Regulations. Shareholders must give the company notice that they wish to attend the meeting not less than twenty days prior to it.[103] The form of the notice is prescribed in the articles of association.[104] It is not clear from article 20 whether shareholders who fail to respond in such fashion will be barred from attending any meeting.[105] Moreover, if a company has received notices from less than fifty per cent of the shareholders the company is not entitled to convene a shareholders' meeting.[106] The company may call the meeting again and is required to inform shareholders of this fact.[107] It is not clear what would occur if there were insufficient notices of attendance received on the delayed meeting but, on the face of article 22, it is likely that the company can simply proceed with the holding of the meeting. Curiously, the Regulations would appear to allow a meeting to be convened and held if there were sufficient numbers of shareholders who had indicated a desire to attend the meeting but then some lesser figure actually attended, as the Regulations, article 20 only applies to written acceptances.[108]

From a practical perspective this raises a number of issues. First, if the notice is sent from the office of the Chinese enterprise in an overseas jurisdiction, is the notice of attendance to be given to the company at its address in the PRC or at, for example, its New York office? Second, if the documents are sent by post from the PRC office (to be returned to the PRC office by post), what will occur if there are any disputes etc as to whether mail was received?[109]

[102] Regulations, art 20. An overseas exchange may also have its own rules as to notice. For example, in addition, under the Listing Rules, a company is to ensure that notice of every annual general meeting is published in the newspapers. The notice must not be less than eight centimetres by ten centimetres (three inches by four inches approximately) and must be published on at least one business day.

[103] Regulations, art 20.

[104] Ibid.

[105] The Regulations do not actually state this, but unless the purpose of Regulations, art 20 is to give the company notice of the fact that sufficient shareholders have consented to the holding of the meeting, this may be a conclusion which can be reached on the face of the provisions.

[106] Regulations, art 22.

[107] Ibid.

[108] One would imagine that, notwithstanding this apparent mistake, either the foreign exchange on which the shares are issued or the regulatory authorities in that overseas jurisdiction and the PRC will address this problem. It is likely that this will occur through mandatory quorum provisions in the articles of association.

[109] See, for example, the measures takes by the SEHK: the PRC issuer must appoint, and maintain throughout the period its securities are listed on the Exchange the appointment of, a person authorised to accept service of process and notices on its behalf in Hong Kong, and must notify the Exchange of his appointment and any termination of his appointment and details of:
(a) his address for service of process and notices;
(b) if different, his place of business or, if he does not maintain a place of business, his residential address;
(c) his business or residential telephone number, as the case may be;
(d) his telex and/or facsimile number; and
(e) any change in the above particulars;
See also dispute resolution, pp 123–5 below.

Interestingly, and by contrast, the *Companies Act* (UK) 1989 is also silent on the manner of giving of notice. Under Table A of the *Companies Act*, notice may be given 'either personally or by sending it by post.'[110] Moreover, under article 112 a member whose registered address is outside of the United Kingdom is not entitled to receive notices. Indeed, the Listing Rules of the Stock Exchange[111] require that shareholders shall be entitled to have a UK address for the purposes of receiving notices unless the articles allow for notices to be sent overseas. If such notices are to be sent, they are to be sent by airmail.[112] English authorities, on the same issues, establish that failure to give notice of a meeting to a member invalidates the proceedings of the meeting.[113] This rule has been mitigated somewhat by the insertion of article 39 of Table A which states that accidental omission to give notice of a meeting to, or non receipt of a notice by, a member does not invalidate the proceedings of the meeting.[114] However, it ought to be remembered that under English law a shareholder is not normally required to indicate whether the shareholder will attend. Under English law, no such requirement is on shareholders who may simply attend the meeting.

Presumably, some of these issues will be covered in the articles of association and perhaps the important issue is that of access to, and availability of, the articles of association. Under the Regulations there is no obligation for a company to provide copies of the articles of association to shareholders.[115] Many foreign investors have little understanding of the Chinese system of registration for access to company documents.[116] It would thus appear that those overseas exchanges who offer Chinese companies listing rights ought to consider the question of the availability of a company's articles of association.[117]

110 Companies Act (UK) 1989, Table A, art 112.
111 And, also, those of SEHK.
112 Admission of Securities to Listing, s 5, ch 2, para 39.
113 See, eg, *Musselwhite v C H Musselwhite & Son Ltd* [1962] Ch 964.
114 See, eg, *Re West Canadian Collieries Ltd* [1962] Ch 370.
115 The same comment can, of course, be made of other Western companies. However, the difference is that it is generally possible for the articles to be obtained by way of a company search at some central companies registry. (Whilst this is true of the Regulations, the Mandatory Provisions which supplement the Regulations and Company Law contain provisions as to the provision of company information and documents to shareholders.)
116 In fact, the SEHK requires a *summary* of particular provisions in any prospectus which leads to listing. This, however, does not allow for changes which may subsequently be made to the provisions. In theory, of course, a company would be obliged to provide notice to shareholders of any amendments to the provisions. This would only be of benefit if the shareholders had (i) a copy of the original provisions rather than a summary and (ii) a full copy of the articles, as amendments might be made to provisions which were not summarised.
117 If, indeed, there is one. Under the listing rules of the SEHK, companies which are listed on the SEHK must make available at a place in Hong Kong for inspection by the public and shareholders free of charge, and for copying by shareholders at reasonable charges, the following:
(a) a complete duplicate register of shareholders;
(b) a report showing the state of the issued share capital of the company;
(c) the company's latest audited financial statements and the directors', auditors', and supervisors' reports thereof;
(d) special resolutions of the company;

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In addition, shareholders who constitute more than five per cent of the issued capital of a company[118] have the right to requisition a meeting. One can ask, however, whether this is really an option. For even if a foreign investor has a matter of importance which it wishes to bring to a general meeting, the period of delay is quite substantial (particularly bearing in mind the 45 day notice period). Furthermore, even if the meeting can be negotiated, the quorum requirements are quite severe,[119] and if, for example, it is the activities of the Chinese shareholders which are being questioned, is veto a possibility? This raises two issues, first as to proxies and second as to the validity of meetings where a quorum is not reached. In the first case, it is necessary to look at the Company Law to see if there are particular provisions regarding the granting of proxies.[120]

The provisions relating to proxies in the Company Law are set out in article 108. It provides simply that '[a] shareholder may commission a proxy to attend a shareholders' general meeting on his [or her] behalf.' The next line of article 108 is somewhat less clear, providing that '[t]he proxy shall submit the shareholder's power of attorney' to the company. The term 'shouquan weituo shu' is clearly stated in the Company Law and might suggest that a formal power of attorney, rather than that which is regularly used under Hong Kong company law, need be used. If that is the case, then one has to ask under the law of which jurisdiction should the power of attorney be valid?[121] For the power of attorney to be enforceable in China, if the proxy was based in China, one would expect that the power of attorney must be subject to the laws of China. For a foreign investor this may, once again, create difficulties of access to advice.

As to the second issue, neither the Regulations nor the Company Law specifically address the issue of failure to reach a quorum and it can only be presumed that such meetings are invalid. Curiously, though, the provisions relating to the holding of shareholders' meetings contained in articles 102–11 do not have any quorum provisions.

(e) reports showing the number and nominal value of securities repurchased by the company since the end of the last financial year, the aggregate amount paid for such securities, and the maximum and minimum prices paid in respect of each class of securities repurchased (with a breakdown between domestic shares and foreign shares (and, if applicable, H shares));
(f) a copy of the latest annual return filed with the Administration for Industry and Commerce or other competent PRC authority; and
(g) for shareholders only, copies of the minutes of meetings of shareholders.

118 Regulations, art 21.

119 Regulations, art 22.

120 There certainly are provisions in the Listing Rules: the issuer shall send with the notice convening a meeting of holders of securities to all persons entitled to vote at the meeting proxy forms, with provision for at least two-way voting on all resolutions intended to be proposed thereat.

121 See, for example, the provisions of the Powers of Attorney Ordinance.

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Directors and other officers

In addition to provisions contained in the Company Law, the Regulations also specifically codify certain responsibilities on directors and other officers.[122] Directors[123] and other officers are required to act honestly and diligently and in accordance with the articles of association. Moreover, they must act for the benefit of a company.[124] These responsibilities are not dissimilar to those adopted in Australia.[125] The codification of directors' responsibilities gives rise to a variety of issues including the question of who will enforce the duties, the civil liabilities of officers for breach, and the penalties involved: whether the offenders will be subject to civil or criminal penalties.

In addition, two further issues arise from the obligations contained in article 23. First, whether the obligations are similar to the fiduciary duty imposed under the common law. Second, whether there is any contradiction between these obligations and those wider obligations which are contained in the Company Law.

The obligations which are contained in the Company Law arise in relation to companies limited by shares through article 123. This provides that the provisions of articles 57–63 of the Company Law (which apply to limited liability companies) will also apply to companies limited by shares. The relevant provisions are contained in articles 59–63. These provide, inter alia, that directors must (i) abide by the articles of association;[126] (ii) faithfully perform their duties;[127] (iii) protect the interests of the company;[128] (iv) not use powers so as to seek personal gain;[129] (v) not use powers to accept bribes;[130] (vi) not misappropriate company funds;[131] (vii) not lend company funds to others;[132] (viii) not use company funds as security for others;[133] (ix) not compete

122 In addition to the responsibilities and obligations contained in the Company Law and Regulations, the Listing Rules of the SEHK also contains a Model Code for Securities Transactions by Directors of Listed Companies. The Model Code deals mostly with the dealing in securities by directors. Moreover, the Mandatory Provisions also consider these matters. In Chapter 14, the qualifications and duties of directors, supervisors, managers etc are set out. The standard of skill required is basically that of a reasonable and prudent person in the same situation (art 115). The Mandatory Provisions and directors' duties will be considered in a forthcoming article by Feng and Tokley.

123 Regulations, art 23.

124 Ibid. art 23 sets out two duties: first, the German concept of '*Treu und Glauben*' — in truth and good faith — and second, diligence. The Mandatory Provisions, art 116 also repeats 'Treu und Glauben' in respect of the duty to avoid conflicts. This is an important development as it is the first time that PRC law has specified a standard of diligence, truth, and good faith in terms of what Western lawyers would call a fiduciary duty. This issue will be discussed more fully in the forthcoming article by Feng and Tokley.

125 Corporations Law (Cth, Aust), ch 3, Pt 3.2.

126 Company Law, art 59.

127 Ibid.

128 Ibid.

129 Ibid.

130 Ibid at para 2.

131 Company Law, art 60.

132 Ibid at para 3.

133 Company Law, art 61.

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with the company;[134] (x) not engage in activities which are harmful to the company;[135] (xi) not conclude contracts with the company except as provided in the articles of association or as approved by shareholders;[136] and (xii) not disclose company secrets.[137]

By contrast, the obligations imposed by the common law are far more generally put (although they may ultimately encompass the same broad categories of activities); for example, directors are said to owe three types[138] of fiduciary duties: (i) to act in good faith for the benefit of the company; (ii) exercise the powers only for proper purposes; and (iii) avoid possible conflicts between personal interests and interests of the company.[139] In relation to fiduciary duties generally and by way of comparison, two aspects should be noted. First, directors owe their duty individually notwithstanding that they may have acted as a body. Second, the duty is owed to the company only. Moreover, it is argued that the fiduciary duty (except where expressly limited under the statute) is not limited to directors and applies to all officers of a company who are authorised to act on its behalf, particularly managers. The duties commence when a director takes office but do not cease when he or she is no longer a director but may continue in certain circumstances such as confidential information.

The obligations in the Company Law, whilst not operating on precisely the same basis,[140] are certainly similar in effect to fiduciary duties. The obligations require the directors (and others) to protect the company's assets and interests and to place them at a level higher than the directors' own interests. The nature of this obligation to shield and guard the assets of the company for both the company's best interests and ultimately the shareholders, is very similar to that of a fiduciary duty. Moreover, it would be wrong to presume that Chinese courts or authorities would be any less vigilant in the imposition or enforcement of these obligations than English courts of the late nineteenth or early twentieth

[134] Ibid.
[135] Ibid.
[136] Ibid at para 2.
[137] Company Law, art 62.
[138] Indeed, it has even been argued that the are four aspects to fiduciary duties: see Gower, *Principles of Modern* Company Law (London: Sweet & Maxwell, 5th ed, 1993), p ??.By comparison, Gower argues that this is also a head which bears discussion in terms of directors' duties. It is said that directors cannot fetter their future discretion of powers given to them by the company. This 'duty' arises out of the fact that it is implicit in the previous two heads of duty that to fetter a power would not be to use it for its proper purpose and also would not, accordingly, be to act in the best interests of the company. There is little doubt that Gower is correct to say that it is wrong for directors to fetter their future discretion but it is also arguable that categories of breach in this respect would more properly fall into one of the other two headings. By reference, Gower mentions the following as examples: *Clark v Workman* [1920] 1 Ir R 107; *Cartmells Case* (1874) LR 9 Ch App 691. These matters are similar to those raised in Mandatory Provisions, art 116. This issue will be discussed further in the forthcoming article by Feng and Tokley.
[139] See, eg, *Percival v Wright* [1902] 2 Ch 421; *Allen v Hyatt* (1914) 30 TLR 444.
[140] For example, there are no similar equivalents to the taking of bribes although one may suggest that such activity would not be in the best interests of the company if the directors require some additional personal benefit to convince them of the value of the transaction to the company.

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century. Indeed, given that China is embarking on a socialist market economy, it is likely that the relevant bodies will be more vigilant than the laissez faire approach taken by the courts which shaped the common law principles.

Indeed, in general terms the most significant difference appears to be the extension of the duty to a period after the director ceases to hold office. The Chinese authorities would be well advised to consider adopting such an extension.

As the rule that directors must act honestly and in good faith is one for which it is difficult to give a clear definitive test, it may encompass a number of the principles which are covered in articles 59–63. Indeed, under the common law the courts have had to rely on a so called 'common-sense' approach to identify what conduct falls short of the criteria. It will be interesting to see whether Chinese judicial authorities[141] adopt similar standards to those adopted by English courts of the mid twentieth century. For example, that directors are to be judged by their standards and not what a court thinks is appropriate.[142]

In addition, it is interesting to compare the nature of the duty owed by directors. For example, despite the fact that a company has a separate legal personality, under the common law it is clear that the directors are not expected to disregard the interests of members. If that were so, then it would not be possible for directors to declare dividends as it is arguable that it is in the company's best interests to keep any profit to further its business interests. Moreover, if a director is a shareholder then it has also been held to be acceptable for the director to have *some* regard to his own interests as a shareholder and not to have fallen short of this duty.[143] A corporation is also a legal person under the Company Law and it is equally clear that many of the obligations owed by directors are owed to the company alone. As to whether the exclusions which operate under the common law also exist, it is likely that some do, given that directors are also entitled (and expected) to distribute profits by way of dividends.[144]

Another issue which arises under the Regulations or Company Law is whether directors are to have any regard for any other group of persons other than the company. In common law jurisdictions, there are certainly statutory obligations in respect of dealings with creditors and employees and, in complying with these, it is arguable that the director is only acting in the company's

[141] This reference is intended to include the arbitration bodies which may also need to consider the provisions; see discussion below at pp 123–5.

[142] See, eg, the leading case of *Re Smith & Fawcett* [1942] Ch 304, where the court said that directors are required to act 'bona fide in what they consider — and not what a court may consider — is in the best interests of the company.' Directors, however, may also be found wanting if they fail to turn their minds to whether or not a transaction was in the best interests of the company. See also *Re W & M Roith Ltd* [1967] 1 WLR 432. Indeed, from a quick review of the Mandatory Provisions, the standard is likely to be an objective one (art 115).

[143] See, eg, *Greenhalgh v Arderne Cinemas* [1951] Ch 286; *Mills v Mills* (1938) 60 CLR 150.

[144] Company Law, art 177; Regulations, art 27.

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best interests. However, these obligations fall short of the creation of a specific duty.[145] The same could possibly said under the terms of the Company Law although the position of the supervisors may be somewhat less clear. Under Company Law, article 15 (which applies to limited liability companies) it is stipulated that companies must protect 'the lawful rights of their staff and workers' and strive to achieve worker safety.

In general terms, the Company Law appears to have adopted the concept of the use of a power for its proper purpose and it is clear that, where directors have used a power to gain advantage for themselves, they have done so for an improper purpose. It is equally clear in respect of both jurisdictions that, where directors have acted honestly in what they believe to be the best interests of the company, they may nevertheless be liable if they have exercised their powers for a purpose different from that for which the powers were conferred on them.[146]

Under the Regulations, a director must not compete[147] or conclude contracts with a company.[148] Under the common law, as the position of a director vis-à-vis the company is that of a fiduciary. Accordingly, directors must not place themselves in a position where there is or may be a conflict between their interests and duties to themselves or others and their duty to the company and the company's interests. However, whilst one would have expected that an application of the general principle would preclude a director from acting as a director of a rival company under the common law there is authority that this is not the case.[149]

The strict principle laid down by Lord Cranworth in *Aberdeen Rly v Blaikie*[150] does not appear to apply to the Company Law, although under the common law, the principle has also been slightly altered where the articles of association permit some transactions to take place. It has been held that, in the absence of express provision in a company's articles, the only effective step is to make full

[145] See, eg, *Lonrho Ltd v Shell Petroleum* [1980] 1 WLR 627; and *Walker v Wimborne* (1976) 50 ALJR 446.

[146] *Howard Smith v Ampol* [1974] AC 821; *Piercy v Mills* [1920] 1 Ch 77; *Hogg v Cramphorn* [1967] Ch 254.

[147] Company Law, art 61.

[148] Ibid at para 2.

[149] This rule has been strongly criticised both by textwriters and in a number of cases. It has been said that, whilst it is conceivable that a director may be able to satisfy the law requirements as to both directorships, it is a very fine line and it would not take a great deal for the director to cross that line. See generally *London & Mashonaland v New Mashonaland Exploration* [1891] WN 165; *Bell v Lever Bros* [1932] AC 161; *Scottish Co-op v Meyer* [1959] AC 324; and *Thomas Marshall v Guinle* [1978] 3 WLR 116.

[150] (1854) 1 Macq HL 461, 471–2:

> 'A corporate body can only act by its agents, and it is, of course, the duty of those agents so to act as best to promote the interests of the corporation whose affairs they are conducting. Such agents have duties to discharge of a fiduciary nature towards their principal. And it is a rule of universal application that no one, having such duties to discharge shall be allowed to enter into engagements in which he has , or can have, a personal interest conflicting, or which possibly may conflict, with the interests those whom he is bound to protect ... so strictly is this principle adhered to that no question is allowed to be raised as to the fairness or unfairness of a contract so entered into ... '

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disclosure to the members and have the contract ratified by the company in general meeting.[151] Similar exceptions are also provided in the Company Law.[152]

The statutory duty to declare interests which exists in most common law jurisdictions[153] does not appear to have been adopted in the Regulations.[154]

Under the Company Law, directors must not disclose company secrets.[155] This contrasts with the provisions under the common law where directors must not without the consent of the company use corporate property or information *for their own profit.* It has been held that the directors were liable to account for any profit made once it was established:

(i) that what the directors did was so related to the affairs of the company that it can properly be said to have been done in the course of their management and in utilisation of their opportunities and special knowledge as directors; and

(ii) that what they did resulted in a profit for themselves.[156]

It is also clear that a director is liable who resigns from the board of directors so as to be able to take an opportunity which arose whilst the director was still a director of the company and in which the company was interested.[157]

In addition, under the common law there is a duty to exercise care and skill.[158] This general obligation would appear to be encompassed in the other obligations on directors contained in the Company Law and Regulations.[159] Another important contrast between the common law approach and that taken under the Company Law and Regulations is that, as the provisions under

151 See, eg, *Transvaal Lands v New Belgium* [1914] 2 Ch 488; and *Benson v Heathorn* (1842) 1 Y & CCC 326.

152 Company Law, art 61, para 2.

153 See, eg, the provisions of s 162 of the Companies Ordinance, and also *Hely-Hutchison v Brayhead* [1968] 1 QB 549; and *Guinness v Saunders* [1990] 2 AC 663.

154 The duty has, however, been adopted in the Mandatory Provisions, arts 120–1.

155 Company Law, art 62.

156 *Regal (Hastings) v Guiliver* [1967] 2 AC 134 per Lord MacMillan at p 153; *Boardman v Phipps* [1967] 2 AC 46; *Industrial Development Consultants v Cooley* [1972] 1 WLR 443; *Queensland Mines v Hudson* (1978) 52 ALJR 379.

157 *Canadian Aero Service v O'Malley* (1973) 40 DLR (3d) 371.

158 The precise meaning of these terms has been discussed at some length. Does this duty refer to some subjective or objective view of a director — is the level as high as that required of some professions or is it lower? It is sometimes difficult to distinguish between the limits and obligations imposed under this head of duties and those under the other areas mentioned above. It has been said that the case of *Re City Equitable Fire Insurance Co* sets out three propositions which reflect the common law position:

1 A director need not exhibit in the performance of his duties a greater degree of skill than may reasonably be expected from a person of his knowledge and experience.
2 A director is not bound to give continuous attention to the affairs of his company. His duties are of an intermittent nature to be performed at periodical board meetings even though the director is not bound to attend all meetings.
3 A director is entitled to delegate some of his activities to officials and to rely on experts where, having regard to the articles and the nature of the circumstances, these may properly be delegated.

See *Re City Equitable Fire Insurance Co* [1925] Ch 407; *Re Denham & Co* (1883) 25 Ch D 752; *Selangor*

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the common law are not codified, the enforcement of the duties is left to the shareholders.[160] However, under the Company Law, these are provided for in articles 214 and 216.

Shareholder disputes

Shareholder disputes under the Regulations may be dealt with either by the Chinese courts of law or through arbitration. The Regulations stipulate that the appropriate forum for dispute resolution will be specified in the Articles of Association.[161] By way of introduction, it is perhaps useful to undertake a brief comparison of the systems which are available. The Chinese court system is essentially comprised of four levels of courts. These are the Supreme People's Court, the Higher People's Court, the Intermediate People's Court, and the Basic People's Court. Each of these levels has separate divisions to deal with economic, civil, criminal, and administrative disputes. Supervision of a People's Court is generally carried out by the level which is higher. The Supreme People's Court is the highest judicial authority and exercises a range of powers and supervision over the judicial system in China.

The system has a two-tier appeal process. This operates such that appeals are heard by courts which are at the higher level in the system. There is no appeal from an appeal although it is possible in certain circumstances to seek a retrial by application to the original court.

As the system of law used in China is based on statutes, the doctrine of stare decisis does not apply. It is common for the National People's Congress, the NPC Standing Committee, the Supreme People's Court, as well as the State Council to give opinions on the interpretation of laws and regulations. Any interpretations which are given by these legislative bodies carry legal effect.[162] Interpretations given by the Supreme People's Court may be limited to specific cases if the Supreme People's Court so designates. Opinions given by the State Council carry general legal effect but these are generally limited to administrative rules and regulations.

Where a party fails to comply with a legally binding judgment, the successful party may apply to the same court to enforce the judgment. There are, however, time limits within which the application must be made.[163] Generally speaking,

[160] It should also be recognised that it is possible for shareholders to take action against the directors et al by way of the dispute resolution method which is discussed below. The SEHK has taken a number of unusual steps to ensure that these rights are retained (for example, through the requirement that directors enter into contracts which, inter alia, bind them to the dispute resolution method). Given the restriction imposed on the rights of shareholders of companies incorporated under the common law, the obligations on the PRC companies would appear to be well advanced (in terms of minority protection) as there is no need to rely on exceptions such as the exception to the rule in *Foss v Harbottle* (1843) 2 Hare 461.

[161] Regulations, art 29. See also the Mandatory Provisions, art 163.

[162] See discussion in note 9 above.

[163] Where one of the parties is an individual, the period is twelve months; where both parties are legal persons, the period is six months.

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foreign judgments and decisions will be recognised and enforced by courts in the PRC only if there is an enforceable treaty or other reciprocal arrangement between the PRC and the relevant country and the foreign judgment does not contradict or violate some principle of PRC law or policy.

The Regulations also permit shareholder disputes to be referred to arbitration.[164] However, the Regulations fall short of the specific arbitration provisions which have been required by the SEHK ('the Hong Kong Provisions').[165] In the Regulations, it is open for a company to specify in its articles of association which form of dispute resolution will be adopted for disputes involving directors etc and shareholders. The Regulations have been criticised on the basis that there is an element of uncertainty in the provisions as to dispute resolution (there being no certainty as to which forum will deal with a dispute). However, to be fair to the PRC authorities, any uncertainty arises through the need for flexibility and it is open for the respective overseas exchanges to implement more specific requirements, as has been done by the SEHK.

Like the Hong Kong Provisions, the arbitration provisions contained in the Regulations are to be included in the articles of association, although the Regulations do not go so far as to require them to be inserted in a service contract between a company and each director. The effect of the clauses is that (i) all disputes between any shareholder and a company, its directors or supervisors and (ii) all claims of shareholders arising from the affairs of the company (as stipulated in the articles of association, Company Law, or the

[164] Regulations, art 29.

[165] These provisions require the insertion of an arbitration clause which states, inter alia,

(a) Whenever any disputes or claims arise from this contract, the company's articles of association or any rights or obligations conferred or imposed by the Company Law or other relevant laws and administrative regulations concerning the affairs of the company between (i) the company and its directors or officers; and (ii) a holder of overseas-listed foreign shares and a director or officer of the company, the parties concerned shall resolve such disputes and claims through arbitration.

Where a dispute or claim described above is referred to arbitration, the entire dispute or claim shall be resolved through arbitration; all persons who have a cause of action based on the same facts giving rise to the dispute or claim or whose participation is necessary for the resolution of such dispute or claim, if they are shareholders, directors, supervisors, manager, or other officers of the company or the company, shall submit to arbitration.

Disputes over who is a shareholder and over the share register do not have to be resolved through arbitration.

(b) The party seeking arbitration may elect to have the dispute or claim arbitrated either by the China International Economic and Trade Arbitration Commission in accordance with its arbitration rules or by the Hong Kong International Arbitration Centre in accordance with its securities arbitration rules. Once the party seeking arbitration submits a dispute or claim to arbitration, the other party must submit to the arbitral body selected by the party seeking the arbitration.

If the party seeking arbitration elects to arbitrate the dispute or claim at the Hong Kong International Arbitration Centre, then either party may apply to have such arbitration conducted in Shenzhen according to the securities arbitration rules of the Hong Kong International Arbitration Centre.

(c) The laws of the People's Republic of China shall govern the arbitration of disputes or claims described in clause (a) above, unless otherwise provided by law or administrative regulations.

(d) The award of the arbitral body is final and shall be binding on the parties thereto.

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Regulations themselves) must be referred to arbitration. Under the Hong Kong Provisions, the disputes were to be referred to either the China International Economic and Trade Arbitration Commission ('CIETAC') or the Hong Kong International Arbitration Centre for arbitration. The arbitral award is to be final.

CIETAC is one of two domestic PRC arbitration organisations for the resolution of disputes involving foreign parties. It has a wide-ranging jurisdiction. Although an award made by CIETAC is said to be final and binding it can, of course, only be enforced through the People's Courts. Under the Civil Procedure Law, the People's Court will enforce awards 'unless certain errors or regularities' are proved and, perhaps more importantly, 'the execution of the award would be contrary to public interests at large.' The form of dispute resolution is extremely important to the confidence of foreign investors investing in Chinese companies.[166] The effectiveness of the provisions to encourage foreign investment in the PRC through listing of companies on foreign exchanges will depend very much on the resolution of disputes to be in a fair and efficient manner. Confidence is likely to be enhanced by the referral to independent bodies, and thus the Hong Kong Provisions are considered to have been particularly effective.

Conclusion

The Regulations represent another step in the move towards full regulation of corporate activity in the People's Republic of China. Given that the first moves towards a market economy came so recently, the Regulations are surprisingly sophisticated. In many ways, the Regulations, like the Company Law, are more advanced than similar legislation in many other jurisdictions. This is particularly so in terms of minority protection. The problem facing the PRC authorities is, as always, whether the rapid pace of development in this area can be matched by other institutions and laws within the legal system. The protection of shareholder and minority rights and enforcement of directors' duties are, for the most part, in the hands of the judicial or quasi-judicial bodies and the real effectiveness of the Regulations may only be demonstrated after these bodies have had the opportunity to consider the legislation.

I A Tokley[*]

[166] See the comments of the head of an American business delegation to the PRC in 'Court System Fundamental to Investor Confidence,' South China Morning Post, Business Post, 10 October 1994.

[*] Lecturer, Department of Professional Legal Education, University of Hong Kong. I wish to thank my friend and colleague Dr Peter Feng Xiang for his assistance. In addition, I am grateful to Trevor Turtle, for his advice on the use of golden shares by the United Kingdom government, and the officers of the China Securities Regulatory Commission and the State Council for Restructuring the Economy who, in many hours of interesting discussion, provided great insight into the legislative process in the PRC.

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