Freedom or legal restriction on company chart--
current assessment and suggestion for
improvements in the PRC context

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Abstract: With the economic reform underway for nearly 30 years and Chinese company law adopted for 14 years, it is an appropriate time to review and critically examine the current company Articles of association state of running in China to determine if there is a need for reform or improvement. Legislations respecting of Articles of association always help to enhance competition circumstance for companies. And greater competition of market would help to resolve the problem of ownership confusion in China where the capital markets are still underdeveloped and market competition is weak. Though company law of China is practically new, it cannot alone guarantee good corporate governance and autonomy as Articles of association have not attained their due respect although in recent years, situation is
taking a favorable turn. This paper gives a general introduction of current situation in China and provides the reasons, then trends in the near future. Ultimately, puts forward some suggestions for improvements without seeking to design a blueprint to what would be an extremely appropriate legal framework in China notwithstanding the ambition encapsulated in the title due to the limited talent and learning of the writer.

I General Introduction:
Under UK law, corporate charter is composed with the Memorandum of association and Articles of association. While in America, certificate of incorporation and bylaws play the same roles. There is need here to clarify that term of “Articles of association” mentioned under Chinese company context enacted in 1993\(^1\) is referred to a combination of MOA and Articles of association, which is drafted before company establishment by incorporators equal to pro-incorporation contract and in most occasions, turned to be an AOA after incorporation.

As company development have not experienced a long history in China, domestic legislators prefer to be more cautious and prudent towards company law stipulation due to the immature market economy system and other considerations. The domestic businessmen’ weak law awareness has been worrying the legislators for decades. Hence, more mandatory items were required to be mentioned in AOA by the promoters for transaction security, which more or less, is an intervention of corporate internal operations with public power. This measure is not a long-term solution whereby the public power oppress company autonomous development and impact on corporate governance negatively. Especially When the domestic corporate governance is currently not optimistic vis a vis other regime of Asia such as Singapore, Japan and Hong Kong. \(^2\)

II Legislation concerning Articles of association:
1 A mandatory document for company formation:
Under PRC company law, incorporators are obliged to provide essential documents including Articles of association after initial capital contributions checked by the legal established capital verification institution during company formation. In all, there are 8 items for limited liability companies and 11 for stock joint companies required to be open to the public such as name, domicile, scope of business, names of shareholders, registered capital, amount and time of capital contributions, organizations of the company, legal representative, methods for profit distribution etc. \(^3\)

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\(^1\) Enacted at the Fifth Session of the Standing Committee of the Eighth National People’s Congress of China on 29 December 1993 and promulgated on the same day. Amended at the Eighteenth Session of the Standing Committee of the Tenth National People’s Congress of China and been in force in 1\(^{st}\) January, 2006

\(^2\) A report released by the Hong Kong-based Political and Economic Risk Consultancy, based on the findings of a survey they conducted in May 2000, makes some interesting revelations of Asia corporate governance. On a scale of zero to ten, with zero being the best grade possible and ten the worst, only three systems in Asia got a higher rating than five. Singapore was rated the highest at two points, with Hong Kong and Japan rated at 3.59 and four points respectively. Expatriate perceptions of the rest of Asia were quite negative. For example, mainland China received 8.22 points.

\(^3\) Chinese company law, article 25, article 82
2 Requirement on context of AOA:
First and foremost, provisions in the Articles of association must comply with laws, administrative regulations, articles of association or resolutions. For example: If the company’s scope of business covers any items subject to approval according to laws or administrative regulations, the approval shall be obtained beforehand. Otherwise, the conflicting part invalid. Second, it shall not injure interests of minority shareholders, the creditors and public interests. Otherwise, the directors participating in adopting the resolution modifying AOA shall make compensation to the infringed parties, unless objection of the infringers against the solutions during the voting procedures proven in the minute.

3 How Articles of association produced:
Usually, In Chinese, incorporators sign an pre-incorporation contract during the establishment process, purporting to have been made in the name or on behalf of a company at a time before company establishment. Clauses included in the contract involve company internal operation regulations and relationship with outside, such as name and address of the company, the business scope, amount of registered capital of the company, the names of the shareholders, their rights and obligations, the amount and method of capital contributions, organization, functions and powers of each segment and rules of procedure of the company, the name of the legal representative are necessary as required by the company law, to some extent , this contract play the same role as Memorandum of association under UK context, as it should be registered during application process. Since there is no material differences between MOA and AOA definition in China, most of the companies shareholders meeting, after incorporation, ratify the contract to the same effect as Articles of association if a new one is not stipulated later. Hence, the pre-incorporation contract registered in the register authority turns to be the Articles of association automatically. In the situation where a new one is required by the shareholders meeting, in most times, they just move the major items of the agreement into the new one if no controversies or different sounds arise during the meeting. Thus, in practice, rare conflicts or contradicts exit between these two documents, which is favor for judges to make a decision because no energy should be exerted to decide which bears superiority when these two documents vary, that’s exactly one of the purposes the legislators pursue.

4 Internal and external enforcement of Articles of association:
Subject to the provisions of this Chinese company law, the memorandum and articles shall, when registered, bear legal effect as a contract under seal-between the company and each member, and between a member and each other member, and external effect

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4 Chinese company law, article 12.
5 Chinese company law, article 20
6 In Chinese courts, problems arise where the terms of pre-incorporate contract be are partly performed, or application for establishment fails. As conducts such as acquisition, separation, liquidation, dissolution of a company are impossible to occur before the termination of promoters agreement. Sometimes the judges confront Complicated problems involving superiority.
against creditors and other outsiders. Shareholders, directors, supervisors and senior managers whose conducts shall be complying with laws, administrative regulations and the articles of association. Directors and senior managers shall not violate the fiduciary obligations and diligence duty to the company. Otherwise, according to article 153, shareholders are entitled to file a lawsuit against the violators.

5 When the document takes effect:
When do Articles of association come into force is an arguable issue stirring heated discussion in China and conclusions have not been arrived at yet. The viewpoints can be divided into three schools: 1 it goes into effect upon the establishment of company. 2 it becomes effective upon the all of the incorporators’ signatures on it, legally registered by the authority shall not be one of preconditions of enforcement. 3 The effective date should be defined in accordance with the content of AOA: Provisions regulating relationships between the investors shall be effective upon the signatures, provisions involving the directors selection, supervisors, managers appointment selections other items happen in the future shall be effective upon company formation. In my point of view, due to Chinese reality, for limited liability companies, the third view should be adopted because the comparatively closer relationship between shareholder who entrust in each other at the early stage of business cooperation. As to stock joint companies, AOA shall enter into force upon the establishment, as an examination by the register authority are helpful to prevent the agreement drafted among shareholders from infringing unspecific persons interests outside based on the unsound legal knowledge of the drafters who may violate law or administration regulations consciously or unconsciously.

6 Alteration of AOA provisions:
Conditions contained in lawful articles of association may be altered by the company by special resolution through shareholder’s meeting. Provided that, where a private company passes such a resolution, an application may be made to the court for the alteration to be cancelled if an infringement occurs.

The procedures of Articles of association modify can be divided into the following three steps in accordance with Chinese company law:

1 The proposal of alteration shall be notified to the shareholders. As for a shareholders' assembly to be held, a notice shall be given to every shareholder 20 days in advance, which shall state the time and place of the assembly as well as the matters to be deliberated at the assembly. As for a temporary shareholders' assembly, a notice shall be given to every shareholder 15 days in advance. As for the issuance of unregistered shares, the time and place of the assembly as well as the matters to be deliberated at the assembly shall be announced 30 days in advance.

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7 Chinese company law, article 11
2 The board of directors shall be responsible for convening shareholders’ meeting\(^{10}\), as BOA is familiar with operation matters of a company, in most situations, proposal of amendments to AOA are put forward by the BOA. Modifying shall be proceeded only during regular meetings as AOA alteration belongs to special solutions and may significantly affect the company future organization structure. If the board of directors or the executive director is unable or fails to fulfill the obligation of convening the shareholders’ assembly, the board of supervisors shall convene and preside over such assembly. If the board of supervisors does not convene or preside over such assembly, the shareholders separately or aggregately holding 1/10 or more of the shares may convene and preside over such assemblies on their own initiative.

3 Resolution of shareholder’ meeting. The shareholders’ meeting shall exercise revising the articles of association either in private and public companies, to modify its articles of association according to the provisions of the preceding paragraph, the consent of the shareholders who hold two thirds or more of the voting rights shall be obtained if it is a limited liability company, and the consent of two thirds or more of the voting rights the shareholders who attend the meeting of the shareholders shall be obtained if it is a joint stock limited company in according to article 182.

III Current situation:

1 Questions upon application period:
The registration bureau issued standardized Articles of association for limited liability company, stock joint company, state-owned liability companies in 2004 as implementing documents following company law. These three document provide a general structure of AOA and give a pattern for reference. The text of standardized version involved authorities of shareholders, transferring of shares, responsibilities of directors are repetition of the company law provision. For example:, Article 7, article 8, article 10, Article 12, Article 17, Article 18, Article 20, Article 23, Article 26, of the sample issued on 22\(^{nd}\) June, 2004 are the copy of those in company law stipulation.

Applicants can make alternatives when to draft the AOA. If it has been ready when applying for the company establishment in the register authority, following steps take place. However, most of the investors holding money may not hold the corresponding knowledge to draft an AOA, in view of this kind of situation, the authority will provide a standard version of AOA together with and a form with blankets where the promoters will be ordered to fill in. Sometimes applicants bearing stronger company autonomous awareness in their mind choose to fill something different from the sample according to their own companies situation. However, a large number of the applicants, including those of famous companies promoters, just do a copy from the standard version for convenience. For example: article 63 of Founder Technology Groups\(^{11}\) AOA states: special resolutions should obtain the consent of two thirds or

\(^{10}\) Chinese company law, article 47, article 109

\(^{11}\) Founded in 1986 with the investment from Peking University, Founder Group has come a long way to become a well-known IT enterprise in China and plays an important role in the development of China’s IT industry, one of the top 500 large state-owned enterprise groups and one of the 120 large
more of the voting rights, and the AOA alteration shall belong to special resolutions.”\textsuperscript{12} Whist, article 182 of company law provides: To modifying its articles of association according to the provisions of the preceding paragraph, the consent of the shareholders who hold two thirds or more of the voting rights shall be obtained if it is a limited liability company...”From this, we can see: article 63 of the ARTICLES OF ASSOCIATION is a mere repetition of article 182 of company law.

Register authority stuff treat the AOA record as a office routine. In addition to formal review, they also do substantive examination to prevent content of it beyond law permission. What promoters usually do is obey the authority order without taking much care of the features of AOA corresponding to their own companies characteristic although the standard version states at the beginning: the version is just designed for common company situations and just for reference only, drafters shall make corresponding alteration in accordance with the real company itself. The strong color of administrative instructions by the register authority causes the content of ARTICLES OF ASSOCIATION restricted in a frame if the officers are usually non-professional and prefer to take a prudent attitude to avoid any dereliction of duty or with timid psychology. In 2006, the numbe of newly registered companies in Shengzhen amounted to 50648, 80% of the companies use the standardized AOA provided by administration of commercial and industry.\textsuperscript{13}

More restrict attitude towards stock liability companies:

The government take a more serious and carefully attitude for stock liability company, especially those plan to list in Hong Kong stock exchange or overseas markets, notifications and orders issued by administrative institutions take a further step towards intervening the internal operation of companies. Chinese Securities Regulatory Commission(CSRC) issued “the Administration of the Articles of association of Companies Seeking a Listing in Hong Kong Prerequisite Clauses” in 1993, the securities Office of the State Council and the State Commission for Restructuring the Economic System together published “The Articles of association of Companies Seeking a Listing Outside the PRC Prerequisite Clauses” in 1994 and “the Guidance for the Articles of Listed Company” in 1997, the three above-mentioned documents contained comprehensive requirements of mainland company ARTICLES OF ASSOCIATION covering almost every field of company management. Although they are promulgated by the administrative branches and institutions and bear a hierarchy below People’s Congress of China-the legislation institution, they are executed even more strictly and efficiently than domestic law and tied firmly companies’ hands and foots. Companies asked to comply with the requisite clauses are only entitled to exclude seldom random provisions. And the so-called “proper

selected pilot enterprise groups. In 2006, it ranked the 10th in the Top 100 State Electronic and Information Enterprises and ranked the 9th in the Top 100 Beijing Enterprises.

\textsuperscript{12} Shen Huaqin, the Case of Founder Technology Groups: How the Judiciary Intervene “Company law review(2000)., Shanghai People’s Repulsing House ,p.339-342

\textsuperscript{13} Newspaper of Shengzhen special administrative region, 22\textsuperscript{nd}, January, 2007, A04 newspaper position
“changes” allowed by the administration is just limited to provisions order reorganization or literal expression alterations not deviating from the original intention of the prerequisites. The result of the administrative enforcement the deprivation of right of speaking from companies with public power, most of the AOA are with Chinese characteristics.

3 Authority and judges mistakes:

Cautious attitude and restrictions may not be constructive for comprehensive knowledge enhancement for officers or judges when tacking with disputes involving AOA alteration register or other matters. Sometimes it’s easy for courts and administration authority to make mistakes. A real case happened in Shanghai: On 18th, April, 2002, Company T was established in Shanghai, when the disputed happened, the shares distribution of contribution was: shareholder Chen hold 80% and shareholder Xie hold 20% of the total shares. In April, 2007, Chen applied to the S(one of the district administration of industry and commerce in Shanghai) for company articles of association modify, the alternated clauses concerning company domicile, scope of business and term of operation. S ratified the modify on 26th April, 2007. On 23rd August, 2008, Xie submitted an administrative lawsuit to the court on the ground that shareholders meeting was not convened beforehand and infringement of information right of shareholders, and asking for revoke of the approval. On 23rd, 2007, the district court rebutted the claim in the first instance, the plaintiff appealed. On 19th, February, 2008, S automatically revoked the approval during the second trial. Xie withdrawn the suit afterwards. The court allowed.

Besides company law requirements, article 3 of the “Provisions on Enterprise Registration Procedures” effective from 7th, January, 2004 provides: An enterprise registration organ shall, in accordance with the law, examine whether the application materials are complete or not, and whether they meet the statutory form or not. Under statutory conditions and procedures, if it is necessary to verify the actual content of any application material, it shall do so in pursuance of law. On the surface, the conducts of the S and the court reflect misconstrue of company law, while the deeper reason is the AOA has not received a its due respect as the mistake is some sort of naïve and absurd.

Insufficient respect for AOA embodied in another acquisition case, which once stimulating heated discussion in academy circle in ten years ago, the problem is how to define the legitimacy of “Staggered Board Provision” as an anti-acquisition measure introduced into the purchased company Articles of association. Dagang Oilfield Co. Ltd, declaring the intention of acquiring Shanghai ACE Co. Ltd, purchased party noticed the intention of acquisition at the early stage of process and the malicious acquisition suffered boycott from all of the staff of ACE, the shareholder meeting rectified the special solution of modifying the article 67 of the MOA as: “Shareholders holding 10% or more of the company’s total shares for more than 6 months shall written notify all shareholders 20 days prior to the meeting before

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promoting the representatives directors...and the number of candidates should not surpass 1/2 of the old board of directors and the supervisory board.” On 6th, November, 2006, this limitation was restricted to 3/1. On 7th, July, 1998, Dagang handled 10.0116% of ACE shares and soon request to convene a temporary shareholders meeting, while ACE company refused the request as Dagang has not achieved the precondition as it hasn’t satisfy the precondition of “ore than 6 months”. the measure Repellants” of ACE effectively block the process of acquisition.

Article 111 of Chinese company law provides: ...The shareholders representing 1/10 or more of the voting rights, or 1/3 of the directors, or the board of supervisors may bring forward a proposal on holding a temporary meeting of the board of directors...While the another precondition in ACE to request a shareholder meeting is: holding the shares more than 6 months. Which should enjoy a superiority? As reselection of board of directors belongs to company internal operation and management structure matters, the stipulation is a random article, Means the law shall tolerate adjustment made by ACE.

Eventually the problems was solved by the CSRC through administrative mediation rather than litigation: the CSRC sent a “letter” emphasizing on the inappropriate an-acquisition measures of ACE without denial of legal enforcement of the new ARTICLES OF ASSOCIATION, then prompted these two parties to reach a compromise allowing Dagang to add directors to the board directly instead of re-selection.

4 Deficiency in logic and feasibility during formulating Article of Association:
Sometimes shareholders draft ARTICLES OF ASSOCIATION without thoughtful consideration, or reluctant to appoint a lawyer, which resulting in Corporate Deadlock, the CCTV channel once reported a company dispute in program: Economy and Law: Company W in Xian, no board of directors because of the small scale of the company, three shareholder, A, B and C constitute the shareholder meeting and A is the general manager. Later B and C request a shareholder meeting promoting B as the general manager and dismissed A from the post. The distribution of capital n: A contributed 25.8 million yuan, each of B and C contributed 17.1 yuan. The company ARTICLES OF ASSOCIATION stipulated: 10 million equal to one voting right. Dismissing of the general manger should obtain two thirds or more votes in the shareholder meeting as a special resolution. Hence, A hold two voting rights, each of B and C holds one, then the corporate deadlock took place because the voting result will never surpass 2/3 though C transferred his shares to B later after meeting. Considerable calculation before hand, in most situations, will avoid the deadlock. This case revealed the lack of realization of the importance of ARTICLES OF ASSOCIATION.15

IV Trends in near future:
Common law countries like America, England and Singapore require less items in

15 CCTV, Economy and Law, visite time:2006.2.16.
http://www.cctv.com/program/jjyf/20040927/102300.shtml
Articles of association, in America, the AOA must or may set forth 4 items including name, number of shares, address of the corporation’s initial registered office, name and address of each incorporator and 6 irregular establishment requirements which may be set forth. In England, although an OECD study establishes that the UK already has low barriers to entrepreneurship in comparison to other countries surveyed, The package of measures put forward by the CLRSG for of goal of “create in Britain a true enterprise culture where the chance to start and succeed in business is genuinely open to all” announced in 2001 includes proposals to reduce the amount and complexity of the incorporation documentation (such as replacing the memorandum and articles with a single constitution and giving companies unlimited capacity thereby obviating the need for an objects clause). Singapore Companies Act requires 7 items, name, amount of share, division of the share capital.

16 Model Business Corporation Act (3rd Edition), section 2.02

17 The forerunner of OECD was the Organization for European Economic Co-operation (OEEC). OEEC was formed in 1947 to administer American and Canadian aid under the Marshall Plan for the reconstruction of Europe after World War II. Its headquarters were established at the Château de la Muette in Paris in 1949. OECD took over from OEEC in 1961. Since then, its mission has been to help its member countries to achieve sustainable economic growth and employment and to raise the standard of living in member countries while maintaining financial stability – all this in order to contribute to the development of the world economy.


19 The UK government announced the establishment of an independent fundamental review of company law in March 1998. It established a review body, the Company Law Review Steering Group (CLRSG) to manage the review.

20 51 Modern Company Law for a Competitive Economy. Company Formation and Capital Maintenance (October 1999), ch 2; Final Report, ch 9. An instrument of incorporation is required for EC directives purposes thus precluding the option of having no constitution at all which is now allowed under Australian law: Corporations Law s 117 (though a constitution is still required for listed companies under ASX rule 15.11). Use of electronic communications in the incorporation processes is already provided for in the UK by the Companies Act 1985 (Electronic Communications) Order SI No 3373. There are now proposals to extend the use of electronic communications by making mandatory for quoted companies website posting and electronic notification of certain information: Final Report, ch 8.

21 Article 22 of Singapore Companies Act.
Continental Law including Japan, and Singapore also have simplified requirements on AOA. As to Macao commercial code, 5 items must be included, they are type, object, address of registered office, company capital, composition of the administration. The 1985 Companies Act of England states: the Memorandum of Association shall defines the 6 points: name, statement of type, signature of one or more subscribes, objects of the company.\(^{22}\)

Japan is also striving to achieve a market of maximum openness, and independence. In Japan: article 166 of original Japanese commercial code requires 10 items in AOA, by now, item(4), item(5) and item(7) have been deleted, with only 7 items left, also the irregular establishment matters including: the type and number of shares, the issuing price of the shares, the amount of the share issue price which shall not be included in paid up capital.\(^{23}\)have been deleted.

China conform to the history tendency, the older company law, article 22, required items mentioned in AOA of limited liability companies, the new company law amended in 2006 deleted three of them, namely: item 5: the rights and obligations of the shareholders, item 7: the conditions for transfer of capital contributions by shareholders 10: the reasons for dissolution of the company and method of liquidation. For stock joint companies, item 6: the rights and obligations of the shareholders was deleted in article 79.

Although still rare AOA with characteristics according to company features, with the developing company law theory and deepen awareness of company autonomy in China, more domestic companies began to use AOA as a tool to organize company operation structure. And government become reluctant to proceed a mediation between companies and put forward a paradox proposal. In 2001, a similar case to Dagang acquisition mentioned-above-Peking Yuxing Co.ltd acquisition: the purchased party, Founder technology groups MOA conferred the right of examination of the eligibility of directors to BOD, the acquirer: Peking Yuxing Electronics Technology Co. Ltd, requesting a temporary shareholder meeting to introduce new candidates into the board of directors, Fangzheng BOA refused the request as it violated the company chart, the anti-acquisition measure succeeded. This time the CSRC was not invited to mediate the dispute, the acquisition failed for granted. The deal failed based on modified AOA. Unlike the earlier case, it has been nationwide admitted that the shareholders, through the general meeting, have the final right of speaking to special solutions such as AOA alteration.

V The reasons of current situation:
Reasons of companies:
1 deficient judgments on the hierarchy of article of association:

\(^{22}\) Article 22 of Companies act of UK
\(^{23}\) Article 168, Article 168-2. of Japanese commercial code.
Some shareholders, practitioner, even law educators sometimes underscore or overestimate the legal hierarchy of Articles of association which is the constituent document regulating internal affairs within companies while also functioned to regulate the relationship with outside. Problems often arise where they can not tell the differences between mandatory provisions, authorized provisions and random provision. A real case: A, a shareholder of a company meant to transfer shares, and no one else of the shareholder intended to purchase, hence, A has to transfer to an outsider, which cause the arguments among the other shareholders against A, claiming the transferring should be invalid. A claimed the legitimate of this deal according to article 72 providing the transferability of interests: that Capital contributions in the limited company may be transferred freely by the shareholders among themselves. Actual procedures for transfer should be set out in the articles of association of the company. Where a shareholder wishes to transfer its interest to a third party, the consent of more than half the shareholders is necessary for such transfer and the remaining shareholders have a right of first refusal to purchase the capital contribution of the selling shareholder on the same items and conditions as those offered to the third party. If the remaining shareholders do not purchase such capital contribution, they will be deemed to have consented to the transfer. Any transfers of investment must be recorded in the share register of the company.

Any provisions of Articles of association depriving legal rights from shareholders shall be invalided denying transferability of shares is no difference from infringement against shareholders. The hierarchy of an AOA shall never surpass that of law.

Meanwhile, the new company law has increased the proportion of random clauses to give more extensive choices to elevating corporate governance and enhancing company autonomy. However, most of the companies turn a blind eye to this change.

2 Culture of family groups control:
It’s a quite common phenomenon in Asia that in most cases, listed companies are still dominated by family owners that often disregard the views and interests of non-family shareholders like Hong Kong. In other countries like China, major listed companies are either partially owned by the government directly, or by friends and relatives of people holding political power who then use their relationships to their own advantage. Concentrated corporate ownership of Asian companies has given family-based owners and their affiliated companies excessive power to pursue their own interests to the detriment of minority shareholders, creditors and other stakeholders. It has also reduced the effectiveness of important mechanisms of shareholder protection such as the system of a Board of Directors, shareholder participation through voting, and transparency and disclosure. The dominance in so many Asian companies by strong family groups or by the state have tended to limit the development of good corporate governance.

25 George Shenoy and Pearlie Koh: Corporate governance in Asia Asia Business Law Review No 31
Corporations have their own running rules distinct from families. Running of the companies establish mainly on rational business judgments and functional management, while the latter one depends on family seniority and emotion, which may easy to be effected by subjective, personal feelings. Dominance of families has its merits at the establishment procedures of company for less contradicts and conflict. However, with the growing-up of the company, excessive concentration will show an obvious negative impact. Family-centric sense damages a reasonable shares structure, senior managers arrangement and other of internal management routines. Because confidence is only limited in the small scope of families, the strong color of personal doctrine make the Articles of association a mere figurehead.

3 Insufficiency economic democracy consciousness and company autonomy sense:

Good corporate governance system can not be formed without economic democracy culture. Soil of company autonomy couldn’t be nurtured by the long-lasting planned economic system. Chinese business man mechanically obey the instructions relevant to Articles of association, accepting the imitating western model blindly without considering their own enterprises. In other words, some of them even don’t know why AOA exist.

Economic democracy ensure the economic freedom, minimizing the public power intervention under the premise of not injuring lawful rights of others. Economic democracy optimize the company internal governance activities through requiring equal selection, effective participation and the ultimate control power of the public upon discussing and voting procedures which are theoretical basis of foundation of shareholders voting, management participation, decision procedures, and reasonable power distribution.

Reasons of the legislators and governance:

1 Regulations serving for government policies:

(1) laws for the purpose of cleaning-up “Guandao” enterprises:

Since opening and reform policy, China has witness several typical transition stage. Most of the Chinese domestic law are drafted based on policies or suggestions of government. To a large extent, the law serves to quicken economic transitions speed. In 1988, the 7th National People’s Congress adopted an Enterprise Law. China, from 1987 to 1996, witnessed a major transformation in the operating mechanisms of enterprises. Corporate structures began to evolve into modern company systems. Regulations against “Guandao” enterprises in 80th during last century. Chinese major legislation relating to companies matters began from the 80th of last century, the initial aim was to reorganizing and transforming the existing ones rather than new ones. Those described as “Guandao” companies, in their nature, are intermediary transferring administrative power into cash, which is a nationwide weird
phenomena and existed in a large number. One piece of paper approving importing picture tube of TV, an order of adjustment within the scope of original planned prices, a contract transferring the state-owned land using rights enabled to transfer a government into an real “enterprises”. “Guandao” companies is the result of legal absence and political distortion. In order to anti-corruption and prevent loss of state assets

Notices relevant to company law was issued, one of the most important purposes of the law is to reorganize and normalize these weird companies which are tools of pursuing private interests at the expense of public interests. In 1985, the state council public document named “notice of further re-organizing companies” which state:“steady residence of company and capital corresponding to the scale of production and business is two essential preconditions of the legal companies establishment., Companies falsely stating the capital should be ordered to close and certificate of corporation should be revoked. If registered capital is not paid in full, the margin shall be filled or the registered capital shall be adjusted, and loan from banks shall not be included in the capital….It is clear that registered capital adequacy decided the destiny of corporations. Under the huge pressure of governance order, Articles of association was forgot and put aside and has no room to display its functions relating to registered capital, steady domicile, scope of business and so on.

(2) Law aimed at restructuring of State-owned Enterprises.

The problem of SOEs State-owned enterprises (SOEs) have a crucial position in the Chinese economy.28 They are the key drivers of China’s industrial sector. In early 1999, SOEs accounted for one-third of national production, more than one-half of total assets, two-thirds of urban employment and almost three-fourths of investment. However the fact remains that many of the SOEs are inefficient and cannot compete against growing domestic and international competition. Therefore, there is consensus in China on the pressing need for reform: the preparatory documents for the Ninth Five Year Plan have assigned this task a high priority. The Third Plenum of the Central Committee also considered these reforms indispensable for creating a “modern enterprise system”. To this end, a two-pronged reform strategy was adopted. It calls for efforts to change the external operating environment for the SOEs, reducing their subsidies through fiscal and banking systems, and promoting competition through increased trade, foreign investment and low entry barriers. It also calls for attempts to change SOE internal environment by making management more autonomous and accountable, restructuring operations, diversifying ownership, and streamlining and reforming corporate governance. The central authorities have made sweeping endeavors to diversify ownership and assign greater autonomy to SOE managers. In March 1996, the central government announced plans to concentrate on the reform and development of 1,000 large SOEs – the so-called high priority group- to reinvigorate them. They are expected to be the core of China’s modern enterprise system. Despite these earnest endeavors, reforms have failed to address some of the fundamental problems, particularly of the larger SOEs. he old Company law was

aimed at state-owned enterprises restructure. The restructuring of State-owned Enterprises emphasize on the Controllability of the restructuring process and results while neglecting leaving room for the corporate autonomy. The reform did not breakthrough the authority of , instead, was led by the “state ownership”. The old company was issued to adapt the restructuring of State-owned Enterprises, helping state-owned enterprises to get rid of the non-performing assets, or a policy to build modern corporate system. In other words, the company law, again became a tool to save the state-owned enterprise. However, up till now, we can see obvious effect, To make matters worse, the company law, to large extent, oppressing the private enterprises development. The reason is the over force law, narrowing the room for corporate autonomy.

(3) Foreign law system aimed for capital attraction:
The early legal framework for absorbing foreign capital was established by a series of specialized laws beginning with the Sino-Foreign Equity Joint Venture Law (EJV Law) in 1979 followed by the Wholly Foreign-owned Enterprises Law (WFOE Law) in 1986 and the Co-operative Joint Venture Law (CJV Law) in 1988. Those specialized laws constitute a discrete system of law governing the setting up of sino-foreign joint ventures in the PRC especially in Greenfield projects. The system has matured over the last 20 years or so and posed little difficulty to foreign investors. It’s more proper to say that this series of law is produced to meet the need of government policy rather than a result of economic marketing adjustment. The feature of quick success and instant benefits in the series was showed in this serious and developing of company autonomy especially for private enterprises was ignored one more time.

2 The inertia of the planned economy system

This may be explained by the fact that China’s foreign trade system was historically modeled on that of the Soviet Union. it is too open to administrative interference and essentially gives veto power to government units at various levels. Nowadays, this phenomenon is still apparent although have been alleviated to some degree. The government perform its duty by orders instead of service. Requirement of Standardization, formalization upon Articles of association is favor to easy regulation. The stubborn custom is probably attributable to the fact that, traditionally the conception of “promote agriculture and oppressing commerce” has been rooted in the Chinese society for over thousand year. Government used to take a hostile attitude and supervising the commercial activities, because commercial activities are adverse to their feudalism dominance and help to promote Capitalist society formation. Governing peasants and exploiting cereal and food from them, keeping them ignorant or fatuous consolidate the governance. After the built of new China, although the government began to realize the importance of “developing productivity vigorously”, however, the mode of “ the government regulating enterprises was enhanced instead of changed. This mode denying the independent status of enterprises, which totally become a kind of “accessories” of the government and operated under the order and coordination of the government. The Market-oriented reforms was been introduced for several years, even so, the government hasn’t been released from this kind of
3 Overestimating the function of Laws in the construction of the perfect corporate governance

The new legislation is sometime believed too comprehensive in scope, covering every type of matters including company internal operations. Article 123 of company law stipulated: “A listed company shall have independent directors. And the concrete measures shall be formulated by the State Council.” Hence, the establishment of independent directors become the fourth essential organ following the shareholder’ meeting, board of directors and board of supervisors. In fact, choosing the board the supervisors or the independent directors to supervise the management is right of a company, the company can choose either or them as it belongs to internal operation.

Articles of association can be modified from time to time while the law shall be keep steady, the regulations upon the companies is equal to intervention into organization structure with public power, in long run, the legislation will drive itself into dilemma. Function of laws shall be limited in commercial activities. This kind of limitation has be proven by the American Enron Corporation bankruptcy event. Before the scandal, America utilized her strong economic position to import domestic corporate governance mode into the countries accepting the economic support through world bank and other organs. Changes is difficult to take place when the mode has been consolidated by laws. After the Enron scandal, the defects of independent directors were revealed, and its effectiveness was questioned widely in the word. Allowing the choice of establishment of independent directors may avoid the  bankruptcy.

I hold the view that’s unwise for law to imposes independent directors establishment obligation to shareholders as statutory requirement. Before Enron bankruptcy, it was still a middle whether independent non-executive directors eminently suitable to play a crucial role in a company’s internal governance and in creating an optimistic effect on professional board. Unfortunately, direct empirical studies have been mixed. A study by Baysinger and Butler indicated that the proportion of independent nonexecutive directors in 1970 was positively correlated with return on equity in 1980. In contrast a study by Bhagat and Black found no solid evidence that independent directors affected firm performance. Other US studies have also looked for indirect evidence on the effectiveness of independent director, by looking at the likelihood of boards with independent nonexecutive directors of disciplining or removing the CEO of an underperforming firm. In one study it was found that a board comprising of at least 60% independent directors was more likely than a board

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comprising less than 60% independent directors to dismiss the CEO.\textsuperscript{31} However it was also shown that independent directors who have less detailed knowledge of a firm are too cautious in replacing a bad CEO while the company’s share price remain respectable. The first impediment is that independent non-executive directors are simply outnumbered by the executive and affiliated non-executive directors, such that it is difficult for them to have a measurable impact on the voting decisions of the board. Second is that some independent non-executive directors like many non-executives, are allied to management to such a degree that detached monitoring may be difficult.\textsuperscript{32}

Stoke joint companies independent directors design was introduced in the new company law, article 123 provides: A listed company shall have independent directors. And the concrete measures shall be formulated by the State Council.\textsuperscript{33}

VI Suggestion for Improvement:
Whether or not the institution relevant to public power willing to take concrete steps to reduce corruption and improve corporate governance is the key for better competition market creation. I concentrate on those areas that I consider to be particularly relevant to the question.

1 Getting ride of the bureaucratic styling of acting:
The old Chinese legislation mode usually under strong political instructions, policies such as economy market or state-owned enterprises reform guide the direction of People’s Congress legislation. Decades ago, the PRC Government emphasized the need to seize opportunities to further expand and develop its economy, and even more measures were introduced to create a climate conducive to foreign investment. The imperative of attracting direct foreign investment became a matter of national priority, and a number of attractive and preferential schemes were introduced to induce foreign investors. The legal system of attracting foreign capital was born. The promulgation of Chinese company law is of a strong political color. Legislation work was often started as a tool to stimulating some respect of Chinese society such as foreign investment attraction or domestic enterprises reorganizing. In the usual case, administrative regulations draft by state council can turn into mandatory laws though legal procedures upon approval of People’s congress. Which strengthen the power of government during law execution. This logic deviating the original function of commercial law, which should be adjusted according to the market rules. Maybe the old mode of legislation make some contribution of economy market acceleration, dramatic and sustained economic growth in China.

\begin{thebibliography}{9}


\bibitem{Independent} The measure is referred to <Independent Directors of Listed Companies Ordinance> which is being propelled to be published by state council this year.

\end{thebibliography}
In long run, it will be improper to reality needs. Chinese companies growing this kind of circumstance will at a disadvantage in the worldwide competition.

In the modern framework, the function of government should be clarified, the government should provide service to enterprises, supporting the hearth growing of enterprises y formulating measures and policies. Chinese government’s function should be deviated from controlling the economic resource to providing services.\textsuperscript{34}

2 Helping companies to build autonomous management.

Received wisdom would say that a favorable corporate legal environment should offer:
1) easy access to the corporate form;
2) minimum interference with management; and
3) appropriate investor protection.

Articles of association shows characteristics continue to be rare, board composition and structures with features promoting independence, usually cannot be seen in common company articles of association. Specific board composition and structures may assist in Board composition in this context refers to the make-up of the board in items of executive and non-executive directors, independent and affiliated non-executive directors.\textsuperscript{35}

Corporation autonomy can not exist independently on company system structure. Companies making their own decisions is one of the basic requirement of corporation autonomy, company law leave enough room for the shareholder to make decisions to realizing their wills. Hegemonic, uniform law restrict company autonomy, making company losing its due competiveness and be eliminated by the market. The important task of company law is to emerge autonomy Marxism into law to a largest extent. its alternative disputes solutions provide foreign partners with flexible options and more negotiation space.

On one hand, weak legal conscious worry the legislators, one another hand, utilizing the legislation power impose negative impact on strengthening the awareness of law. The above-mentioned dilemma may be resolved by losing the criteria gratudally, amend, remove of the superfluous requirements shall be conducted shall be underway catering for the realities.

Few legislations of countries in the world provided in details into the internal operations of companies aside from mandatory protections clauses for interests of minorities, creditors and public. which can be resolved by the articles of association,

\textsuperscript{34} Wei Jie, Zhao Junchao: “ the relationship between government and enterprises after entering WTO”, < Forefront of theoretical>,2002,1 page 151
\textsuperscript{35} Stapledon & Lawrence, supra, n 14 at 151. Singapore Journal oSf inIngtaerpnartieo nJaol u&rn Calo mopf arfanttievren Laatiwonal & Comparative Law (2001) 5 pp 516 . 568 Eilis Ferran
for example, China company law provided detailed regulations relevant to corporate internal running in the following 3 categories:

1 Detail Method and procedures of convening of shareholder’s meeting: Article 41
2 The responsibilities of directors and senior managers: article 47
3 limitation on transfer of shares: article 72, article 73, article 74

Operations affairs regulated in an ARTICLES OF ASSOCIATION can be divided into two aspects: First, relationship between promoters and shareholders. Usually, the pre-emptive right of shares, competition prohibition, The same right to vote, Physical capital, limitation on transfer of shares, Share Repurchase etc. These kind of clauses is equal to a contract and shall be amended depend on parties intention without surpass legal boundary. Chinese company law open these rights at least to limited liabilities companies as shareholders are acquaintances of each other. Second, organization structure of the company which shows what the ARTICLES OF ASSOCIATION is special contract-a constituent document of an organization. The number of directors, appointment and dismissal of directors and directors, responsibilities of BOD shareholder’s meeting, procedures of shareholder’s meeting, number of supervisors board, appointment and dismissal of supervisors. These clauses are adopted for an outsider third party.

3 Encouraging companies to arrange operations affairs through Articles of association

At the apex of a company’s internal control system, the board of directors is a pivotal factor in achieving effective governance. Shareholders look to the board as their primary means of protection. The board of directors is elected by shareholders to monitor management at a closer level than shareholders can achieve. Through monitoring management, boards can guard against fraud, waste of assets, underperformance and more generally the agency problem. However what is of a greater concern for all shareholders, is that the company prospers and earns a good return for them. In this respect the board lays a key role in providing leadership in corporate strategy and active oversight of the management, which besides monitoring, extends to include supervising, motivating and evaluating management. The importance of the board’s role is increased in today’s modern companies because of the ‘strategic intricacies of management matters, the need for confidentiality and the difficulty of evaluating management achievements and performance in adverse economic circumstances’. 36

Government shall encourage the shareholder to take a good care about the internal operation instead of turn a blind eye on it. In realities, the legal representative share a supreme status, under most situations the biggest shareholder is appointed to be the legal representative, he may confer management right the chief director, then what he only cares about is the profit and dividend each year.

4 Law enforcement improvement:
Issues like corruption and the adequacy of the law enforcement mechanisms in a legal system have a bearing on investor confidence and corporate governance. Many countries in Asia have company legislation that is practically new. The company law in Vietnam came into effect in 1990; that of the People’s Republic of China 1994; and that of Indonesia in 1996. However, legislation, though a good starting point, cannot alone guarantee good corporate governance. It is something that has to be worked out over time.

In China the basic elements of a corporate legal and regulatory framework are more or less in place, but what is lacking is the compliance and legal enforcement.

VII Conclusion:
China must do a lot more to prepare its local enterprises for increased foreign competition that will come with the entry into the World Trade Organization (WTO). Government interference in mergers and acquisitions should be minimized to allow more scope for market forces and economic considerations to determine industry consolidations. Most mainland companies were without proper corporate governance and that it was very important for mainland companies to upgrade their corporate governance to meet international standards. Or else, it will be very difficult for us to compete with foreign competitors. However, the Chinese government has made unremitting efforts to plant good corporate governance into Chinese enterprises in its SOE restructuring drive aimed at enhancing their competitiveness, business management and government business relationship.37

There is an interaction between managerial freedom and investor protection. Managers can be expected to accept interventionist rules designed to protect investors so long as the loss of autonomy is outweighed by the greater availability of capital or reduction of its cost that results from the boost to investor confidence attributable to those rules. The task for those charged with the task of drawing up a competitive corporate regulatory product for an individual state is thus to strike the right balance between managerial freedom and investor protection. So a key question is how well are the China authorities doing in setting this balance in the immature situation.

37 Refer to the President of the Bank of China, Mr. Liu Mingkang, gives some interesting insights speeches at the World Economic Forum China Business Summit 2000.