PRIVATE ENFORCEMENT OF CHINESE COMPANY LAW: SHAREHOLDER LITIGATION AND JUDICIAL DISCRETION

Lin Shaowei

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Given the short history of Chinese Company Law, it is understandable that there are certain drawbacks in it. However, with the increasing number of cases, the private enforcement of Company Law witnesses fast development, which challenges the orthodox impression of the Chinese that Confucians who are unwilling to settle disputes through litigations. It also indicates that the Chinese courts are gaining more experience in dealing with corporate cases, which contradicts with the traditional view that Chinese judges are not capable of handling high-tech cases. The case study of derivative actions also demonstrates that judges are increasingly competent in adjudicating commercial cases. Nevertheless, considering the fact that the effectiveness of Company Law depends on its implementation, judicial discretion should be restricted to certain areas and should be operated under specific principles. It is expected that the private enforcement of Chinese Company Law will remain booming with the current economic growth and that judicial discretion will become increasingly important in this field.

I. INTRODUCTION

Enforcement of law has been a topic for discussion in legal scholarship since *Roscoe Pound* identified the concepts of "law in books" and "law in action".[1] Whereas, the enforcement of *Company Law* remains underdeveloped and the widely cited "LLSV articles" provide an example for it.[2] In these studies, several famous economists concluded the ranking of shareholder protection by focusing almost entirely on "law in books" rather than "law in action".[3] Although the author acknowledges that there would be no foundation for "law in action" without "law in books", particularly in developing countries like China, where the focus of legal scholarship is on

* Associate Professor at Southwest University of Political Science and Law. This article is funded by China Postdoctoral Science Fund Supported Project and Chongqing Social Science Planning Project.

1 Roscoe Pound, *Law in Books and Law in Action*, 44 American Law Review, 12 (1910).

2 Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny ("LLSV"), *Law and Finance*, Working Paper 5661 (National Bureau of Economic Research, 1993); Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *Legal Determinants of External Finance*, Working Paper 5879 (National Bureau of Economic Research, 1997); Rafael La Porta, Florencio Lopez-de-Silanes & Andrei Shleifer, *Corporate Ownership around the World*, Working Paper 6625 (National Bureau of Economic Research, 1998).

3 Holger Spamann, *The "Antidirector Rights Index" Revisited*, 23 Review of Financial Studies, 467-486 (2010).

lawmaking rather that implementation, it is been pointed out that the inadequate enforcement of law may weaken the authority of it and undermine the efficiency of legislation. As a consequence, the enforcement of the law is an essential element in promoting the rule of law.

There are two ways of enforcing the law: private enforcement and public enforcement, each of which possesses its own strength and weakness. Public enforcement concerns criminal or administrative liability and thus has a much more severe deterrent effect on potential wrongdoers. Criminal liability cannot just lead to criminal fines but also the incarceration of wrongdoers, and incarceration for wrongdoers, while administrative liability's deterrent effect results from the significant financial losses of a wrongdoer, normally involving forfeiture, confiscation and administrative fines. However, that a strong deterrent does not necessarily bring about an optimal result as the effectiveness of legal sanctions not only depends on the severity of the penalty, but also on the probability of subjection to such a penalty.[4] If the possibility of discovering and convicting wrongdoers is low, the effectiveness of such a legal mechanism will be affected. Unfortunately, the public enforcement of law suffers from this weakness as the general standard of proof to sentence a person guilty in criminal proceedings is much higher than that in civil lawsuits. Furthermore, as *Reisberg* points out, the funding and resources of the public organizations charged with the task of enforcement are limited and thus they cannot pursue all illegal activities.[5]

On the other hand, private enforcement is not under the influence of such weakness, so it enjoys some advantages over public enforcement. For example, the gains from private enforcement generally go to individuals, creating a strong financial incentive for shareholders. An empirical study in the United States also shows that the development of capital markets is highly correlated to private law enforcement.[6] Nevertheless, it does not mean that the significance of public enforcement should be ignored, and the deterrent effect it generates is essential. Moreover, private enforcement does possess its drawbacks. For example, private enforcement is subject to collective action and is faced with free rider problems. There is no obvious a priori winner between public and private enforcement.[7] Therefore, the above discussion aims at highlighting that private enforcement is necessary, even essential by given its own advantages as well as the serious defects of public

4 Gary Becker, *Crime and Punishment: An Economic Approach*, 78 Journal of Political Economy, 169 (1968).

5 ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE: THEORY AND OPERATION, at 31 (Oxford University Press, 2007).

6 Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer & Robert W. Vishny, *What Works in Securities Laws?*, 61 Journal of Finance, 1 (2006).

7 Howell E. Jackson & Mark J. Roe, *Public and Private Enforcement of Securities Laws: Resource-based Evidence*, 93 Journal of Financial Economics, 208 (2009).

enforcement.

With regard to Chinese *Company Law*, it has been over eight years since the new *Company Law* (hereinafter *Company Law 2005*) entered into force on January 1, 2006. During the past eight years, how did *Company Law 2005* play its role in practice? Did it provide sufficient protection to minority shareholders and was it actively applied by individual shareholders? How did the courts implement this new law? Particularly, how did the courts take advantage of their judicial discretion to interpret the law when there were some defects or loopholes in some of its provisions? Though there is a vast amount of literature to evaluate this new law, the empirical analysis of private enforcement is quite rare.[8] In consequence, the examination of the private enforcement of Chinese *Company Law* will not only make an original contribution to this field, but also draw the attention of Chinese scholars to the gap between "law in books" and "law in action" in Chinese *Company Law*.

When exploring the private enforcement of Chinese *Company Law*, it is also important to examine the doctrine of judicial discretion as how the courts interpret the law that affects its implementation. It is important to inspect the doctrine of judicial discretion when exploring the private enforcement of Chinese *Company Law*, since how the courts interpret the law will affect its implementation. Therefore, the rest of the article is structured as follows: the second Chapter provides an overview of Chinese *Company Law*, underlining the reform of *Company Law 2005*; the third Chapter discusses the empirical study of the private enforcement of *Company Law*; the fourth Chapter evaluates how courts apply their discretion in interpreting the new law through the carefully chosen case study of derivative action followed by the assessment of judicial discretion; and the last Chapter is the conclusion.

II. AN OVERVIEW OF CHINESE COMPANY LAW

The current prevailing *Company Law* was first enacted in 1993 and revised in 2005. Although the first company law could date back to the Qing government (the Qing Dynasty), these old company laws were completely abolished after the Communist Party took power and established the new China (the People's Republic of China). Since the reform and opening up,

8 So far, there is no article exploring the private enforcement of Chinese Company Law in an English journal. In contrast, there is one article examining the private enforcement of corporate law in the United Kingdom and the United States. *See* John Armour, Bernard Black, Brian Cheffins and Richard Nolan, *Private Enforcement of Corporate Law: An Empirical Comparison of the United Kingdom and the United States*, 6 Journal of Empirical Legal Studies, 687-722 (2009).

many private and foreign companies have regained their vitality and gradually developed and they call for speeding up legislation. The absence of commercial law in China obviously had hindered the economic development; therefore, efforts were made to ensure trade and commercial transactions within the framework of legislation. As a consequence, the *Company Law* was adopted on December 29, 1993 and entered into force on July 1, 1994 for the first time since the foundation of People's Republic of China (hereinafter referred to as *Company Law 1993*). However, the primary purpose of the Company law 1993 was to serve the reform of SOEs, rather than to promote the various types of company in operation.[9] Many articles were enacted with the characteristics of a socialist economy, which is seemed to be absurd today.[10] Although it cannot be denied that the law played an important role in reforming SOEs,[11] the *Company Law 1993* had been criticised for becoming an obstacle to accelerating economic development. The reasons are as followed: first of all, many provisions were considered to be outdated and falling behind as private companies were rapidly emerging and the approach of SOE reform was changed.[12] Moreover, the provisions stipulated in the *Company Law 1993* barely provided protections for minority shareholders, hence the majority shareholders and directors had a strong incentive, as well as the ability, to abuse their powers. Thirdly, it was very difficult to establish and operate a company due to the restrictions of this law.[13] Finally, it is argued that factors such as insufficient experience and changeable circumstances during the transitional period also contributed to the above problem.[14]

Realizing the poor draft of provisions, people revised *Company Law* in 1999 and 2004. Nonetheless, there are few changes in these two amendments with some major issues left unresolved. In 2005, the *Company Law* was again amended, and this time its contents were significantly and substantially changed. It is generally admitted that the *Company Law 2005* has made a

9 LI XIAONING, A COMPARATIVE STUDY OF SHAREHOLDERS' DERIVATIVE ACTIONS, at 243 (Kluwer Law International, 2007).

10 For example, article 4 stipulates that "ownership of the State-owned assets in a company belongs to the state." Article 5 further stipulates that "under the state's macro regulation and control adjustment, a company organizes its production and operations autonomously according to market demand with the objective of raising economic efficiency and labour productivity and preserving and increasing the value of assets.

11 LI XIAONING, *supra* note 9, 244.

12 For example, article 20 stipulates that a limited liability company should be established through joint investment by no fewer than 2 but no more than 50 shareholders. This provision clearly prohibited the possibility of forming a one man company while in reality many one man companies were established. Undoubtedly this gap between law and practice would increase the moral risk of nominal shareholders and thus it is detrimental to the business environment.

13 For example, if a company is established primarily to engage in production, the minimum capital should not be less than 500,000 yuan which was a substantial amount of money in the 1990s , *see* article 23(1). Shareholder may contribute their capital in the form of case, as well as in the forms of tangible goods, industrial property, non-patented technology and land use rights, however, the latter should not exceed 20 percent of the total registered capital, *see* article 24.

14 GU MINKANG, UNDERSTANDING CHINESE COMPANY LAW, at 3 (Hong Kong University Press, 2010).

certain progress in the following aspects. Firstly, *Company Law 2005* makes it much easier to set up a company as the threshold of establishing a company have been significantly lowered;[15] secondly, it provides stronger protections for minority shareholders by increasing their rights, ensuring their rights more actionable and defining directors' duties to their companies;[16] thirdly, it reduces government interventions and encourages company autonomy;[17] fourth, it stipulates for the very first time that a company should bear some social responsibility in respect of its business operations;[18] finally, the interests of creditors or third parties with whom a company signed contracts, are also strengthened and the corporate veil now can be lifted under given conditions.[19]

Although it is generally recognized that the reform of *Company Law 2005* has been a great achievement,[20] there are still many problems within this new law. Indeed, many new protective mechanisms are adopted for protecting minority shareholders' interests, but their effectiveness in practice is unpredictable owing to the lack of defined rules. For instance, the concept of piercing the corporate veil is formally enacted in *Company Law 2005* while the application of it is strongly limited on account of lacking specific guidance in practice. It leads to the problem of implementation and judicial discretion, which is the theme of this article.

III. THE EMPIRICAL RESULTS

A. Methodology

Before analysing the results of the empirical study of the private enforcement of Chinese *Company Law*, it is essential to explain how the cases that form the basis for this study were collected, because it is not a mandatory requirement for Chinese courts to publish all cases they have

15 For example, the minimum capital to set up a limited liability company has been lowered to 30,000 yuan and the amount of capital contributions in cash has also been lowered to no less than 30% of the registered capital. In addition, one person is now allowed to establish a limited liability company.

16 For the details on this, *see* Chapter 2, part 3.

17 *Company Law* 2005 confers more rights on companies and articles of association can include any provision the company wishes as long as the provisions do not violate the mandatory norm. For example, shareholders normally shall be distributed with the dividends based on the percentages of the capital that they actually contributed, but this would not be applied if shareholders have different agreements in the articles of association. *See* article 35 of Company Law 2005.

18 Article 5 stipulates that "when conducting business operations, a company shall comply with the laws and administrative regulations, social morality and business morality. It shall act in good faith, accept the supervision of the government and general public, and bear social responsibilities."

19 Article 20 stipulates that "where any of the shareholders of a company evades the payment of its debts by abusing the independent status of legal person or the shareholder's limited liabilities, if it seriously injures the interests of any creditor, it shall bear several and joint liabilities for the debts of the company".

20 Wang Baoshu & Huang Hui, *China's New Company Law and Securities Law: An Overview and Assessment*, 19 Australian Journal of Corporate Law, 1 (2006).

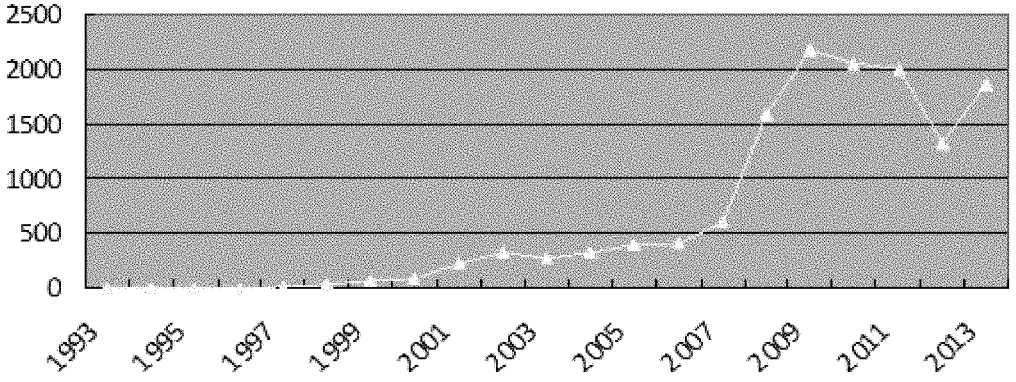
handled; however, in order to ensure accurate and uniform implementation, judges must check case summaries online or news reports. As such, a court may select and publish some of its decisions.

This research was conducted with an authoritative electronic database on Chinese law, namely Pkulaw,[21] which provides published verdicts. In order to collect all possible cases, this research also located cases on some other websites like those where corporate lawsuits not included in Pkulaw are reported. The cases that have been collected may not represent all cases that have arisen in past years. This is due to the following reasons: first, some cases are not accessible as they have never been publicly reported in newspapers or included in the database for a variety of reasons; second, although Pkulaw is the best database for conducting this empirical research, it cannot be denied that its accuracy is affected by the fact that some cases are not included or instantly updated; third, many cases may be settled privately without going to the court and thus unknown to others.

B. Results

1. General Results. — The first *Company Law* was implemented on January 1, 1993 and cases were collected from this date to the end of 2013. Figure 1 below shows the results of this research.

Figure 1: The Number of Litigations Concerning Private Enforcement of Chinese Company Law



As seen from Figure 1, there were only two cases in the first year since the implementation of the *Company Law 1993*. The number rose

21 PKULAW, at http://www.pkulaw.cn/.

continuously, peaking in 2010 with 2,176 cases. Although it began to fall after 2010, there was an average of 1,791 cases per year. This enhanced utilisation suggests that Chinese *Company Law* was becoming increasingly acquainted and used by Chinese people. This raises doubts over the general assumption that Chinese people are unwilling to resolve disputes by bringing lawsuits due to the Confucian ethics which are strongly rooted in Chinese culture. It is argued that culture can deeply affect the means of resolving disputes in a society.[22] However, the increasing number of cases demonstrates that the culture of avoiding go to courts does not have a significant impact on Chinese people, at least in the area of company law. Two factors are at play for this phenomenon.

First of all, while Confucian culture is widely known in traditional China, another school of Chinese thoughts, the Legalists, has been intentionally or unintentionally neglected in the debate. This school of thought believes that a nation's cohesion can be secured by the application of strict legislation as well as harsh and draconian punishment.[23] The application of this school of thought was exemplified by the first Emperor of China, Qin Shi Huang, who organised the construction of the Great Wall and who also emphasized the necessity of using cruel punishment for those daring to show even the slightest resistance. Throughout the history of China, the Legalist school has been accompanied by the Confucian school. Its main belief of adopting strict laws to secure social stability has undoubtedly had an influence on Chinese dispute resolution. Consequently, Confucianism is not the only traditional culture to affect methods for resolving disputes; another traditional counter-culture has encouraged people to use law to resolve disputes.

Second, unlike China's ancient society, the country is now experiencing an economic miracle, leading to a transformation in almost every aspect of the nation's being. This results in the emergence of a commercial culture. One of the core principles embodied in commercial culture is that everyone should be held accountable for his or her behaviours. For example, anyone who fails to perform obligations under a contract should be held responsible for that failure and thus be prepared to be sued if he does not redress the damage caused by his non-compliance. Therefore, in commercial culture it is normal, or at least not unusual, to resolve disputes by litigation.

The growth in cases also suggests that the judiciary should have gained more experiences in dealing with corporate cases which provide a rich area

22 Carlos Vera & Arbitrating Harmony, "Med-Arb" and the Confluence of Culture and Rule of Law in the Resolution of International Commercial Disputes in China, 18 Columbia Journal of Asian Law, 149-194 (2004).

23 REN XIN, TRADITION OF THE LAW AND LAW OF THE TRADITION: LAW, STATE, AND SOCIAL CONTROL IN CHINA, at 21 (Praeger Publisher, 1997).

for the exercise of judicial discretion. It is argued that China's current judiciary may not be able to deal with the increasing volume of litigation, especially corporate litigation that needs commercial specialist and securities knowledge. This is true to some extent as the competence of Chinese judges has been criticised for a long time owing to an earlier policy permitting retired military officers to work as judicial officials. As a direct result of this policy, many judges lacked legal knowledge as they had little or no legal training. However, the situation has been improved in recent years as Chinese judges are becoming increasingly competent owing to the enactment of the *Judges Law*.[24] The vast number of corporate cases also adds weight to the argument that Chinese judges are becoming more competent as they are gaining more experience in dealing with such cases. On the other hand, although *Company Law 2005* has made significant progress in many aspects as noted above, it cannot be denied that it still has many defects. As such, it is important to see how these defects are tackled by the judges. In other words, how have the judges used their discretion to overcome these defects? The large number of cases undoubtedly provides some answers to this question. The next part of this article will explore this by examining the carefully selected case study of derivative actions.

2. The Types of the Cases. — Cases involving the private enforcement of company law are varied and thus it is necessary to classify them. Based on the nature of lawsuit, they can be categorized into two types: horizontal disputes, as well as between equal shareholders and vertical disputes, and which arise between shareholders and controllers (managers/majority shareholders). The former type does not normally involve oppression and as such can be initiated by either minority shareholders or majority shareholders. In this type of cases, the defendants are not normally the managers. Concerns regarding the recognition of shareholders' qualifications are typical on this type of dispute. This kind of suit does not involve the exploration of the interests of minority shareholders. Conversely, vertical disputes are concerned with the oppression of minority shareholders and this group of dispute is recognized as a core issue in modern company law.[25] The figures below show the number of these two different categories of disputes in the implementation of Chinese *Company Law*.

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24 The Judges Law of the People's Republic of China (hereafter Judges Law) was first enacted in 1995 and then revised in 2001. The new Judges Law has replaced the previous policy and stipulates the need for qualifications for becoming a judge. For example, it requires an academic degree and work experience. Furthermore, entry-level judges are to be selected from individuals who not only meet the basic requirements, but have also passed a National Judicial Examination. The bar exam in China is known to be "the most difficult exam in the world" because of its low pass rate. With these strict requirements, it is believed that Chinese judges will become increasingly competent. *See* article 12 of the Judges Law.

25 REINIER KRAAKMAN, ET AL, THE ANATOMY OF CORPORATE LAW, at 35 (Oxford University Press, 2009) .

Figure 2: The Percentage of Two Types of Cases

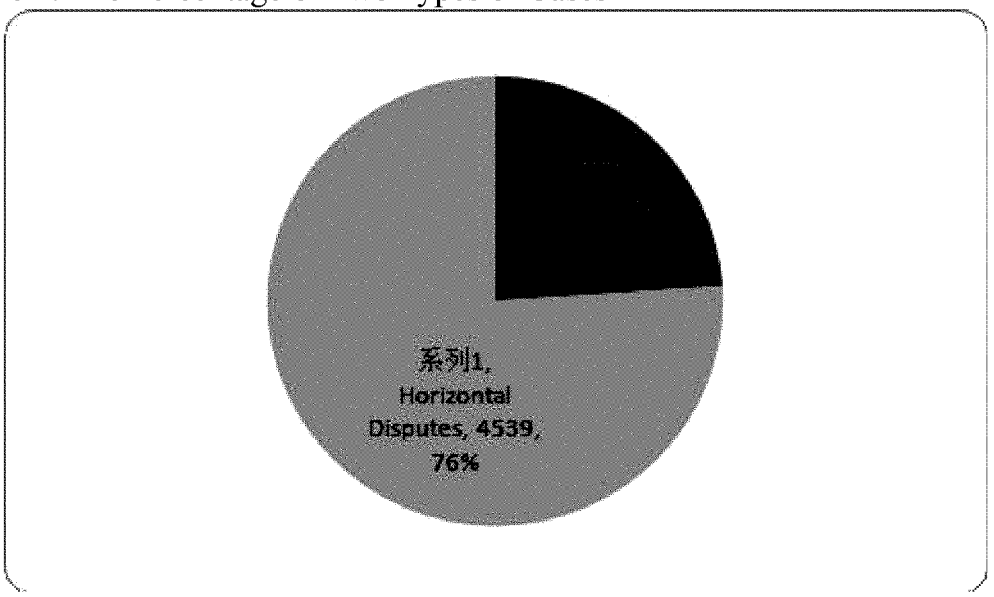

Figure 3: The Horizontal Cases

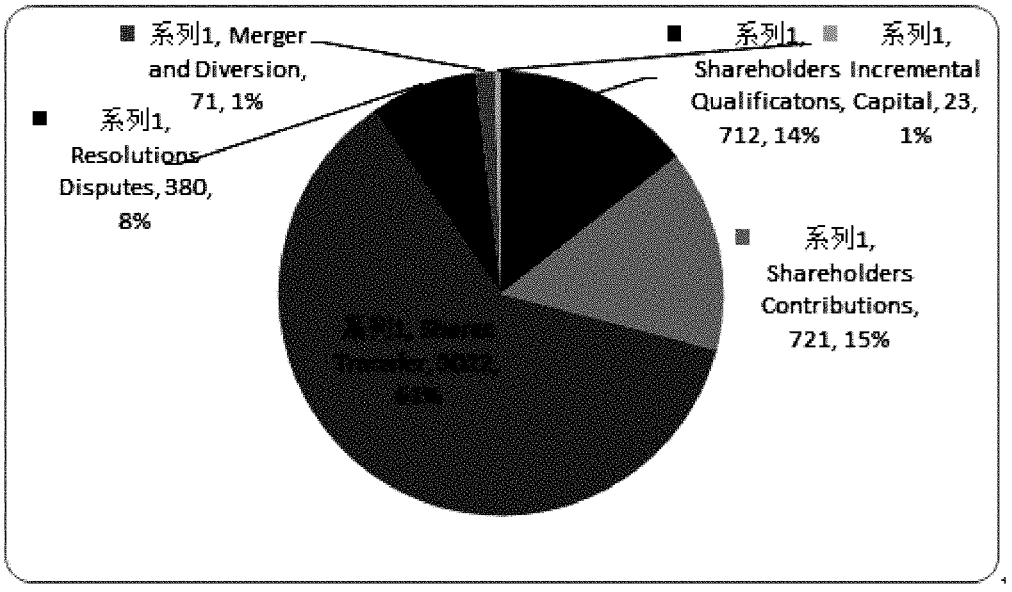

Figure 4: The Vertical Cases

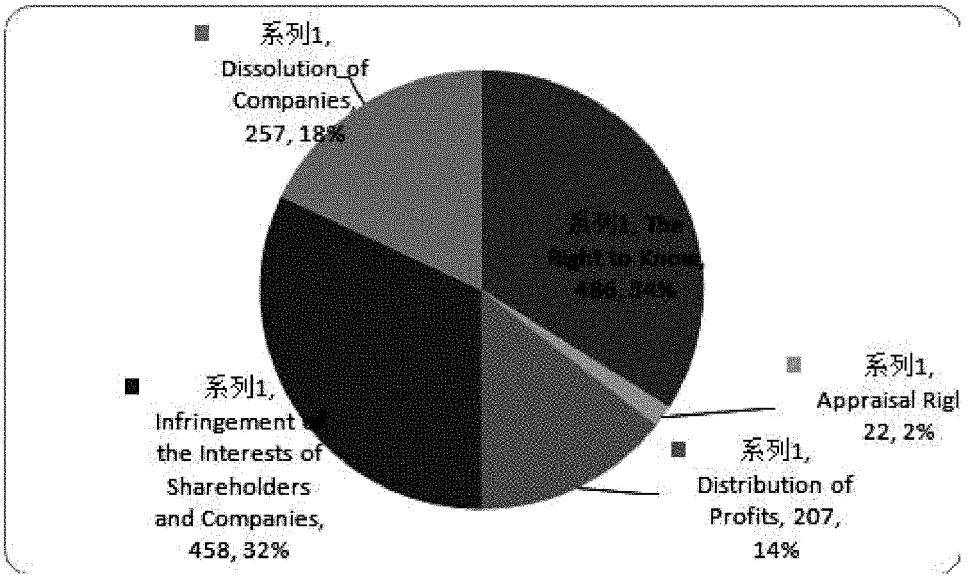

Figure 2 shows that over two thirds of the cases are horizontal disputes while vertical disputes constitute less than one third. At first glance, this may appear to refute the assertion that the agency problem is severe in China.[26] However, a close examination would reveal that the number suggested in Figure 2 does not counter the general assumption of the serious agency costs in China.

First of all, a low percentage of vertical disputes does not necessarily mean that the number of cases is small. There were 1,430 cases from 1993 to 2013 involving the interests of minority shareholders and this figure is steadily increasing. Given the fact that there were very few cases when Chinese *Company Law* was first implemented, it is fair to say that the awareness of the ability to protect minority shareholders is increasing.

Second, among the horizontal disputes, there were 3,022 cases concerning the transfer of shares. These cases account for 61 percent of the horizontal disputes (see Figure 3). This is understandable as that Chinese *Company Law* sets some restrictions on transfer of shares in respect of

26 Lin Shaowei, *Double Agency Costs in China: A Legal Perspective*, 9 The Asian Business Lawyer, 116-136 (2012).

limited liability companies.[27] Without this type of lawsuit, the gap between horizontal and vertical disputes would be significantly narrowed.

Third, the courts have been traditionally ill-disposed to private class actions involving companies, particularly public companies. As early as 1996, shareholders repeatedly attempted to file suits with the courts, without one case being accepted.[28] This position continued even after the enactment of China's *Securities Law* in 1998. In light of this situation, the Supreme People's Court (SPC) surprisingly issued a report in 2001 stating that all lower courts should refuse to hear private securities litigation cases. Whereas, this prohibition was suddenly changed in 2002 as the SPC lifted the restriction on accepting cases, though the only available cause of action was limited to false disclosure. After specific rules for handling private securities cases were issued by the SPC, the lower courts started to accept such litigations. Although the limited availability of civil remedies continues to be criticised, it is apparent that the attitude of courts towards shareholder litigation has changed in a direction that is increasingly sympathetic towards shareholders. With the increasing awareness of the need to protect investors, Chinese courts can be expected to be more open to shareholder litigation in the future.

Finally, among the 1,430 cases concerning vertical disputes, the infringement of shareholders' and companies' interests and the violation of the right to know constituted over 60 percent of the cases (see Figure 4). The right to know provides fundamental protection for minority shareholders by allowing access to information such as whether the interests of the company, especially interests of minority shareholders, have been damaged. The increasing number of this type of lawsuits implies that the basic right for minority shareholders to protect their own interests are still relatively weak. Therefore, this provides further confirmation that the agency problem is still severe despite the relatively small percentage of vertical disputes in total cases.

3. Location of the Cases. — This section aims to reveal the locations where the cases were heard. There are thirty-one provinces and municipalities

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27 According to the article 72 of the *Company Law*, shareholders are free to transfer their shares to other shareholders in a limited liability company. However, if a shareholder wants to transfer his shares to a person other than a shareholder, he must obtain the consent of more than half of all shareholders. The shareholder who intends to transfer his shares shall notify the other shareholders in writing and seeking their approval. If those shareholders fail to make any response within thirty days of receipt of the written notice, then they are deemed to consent to such transfer. Where more than half of the other shareholders do not consent to the transfer, such shareholders should purchase the shares to be transferred. The failure to do so would be deemed to be consent to such a transfer. Where the shareholders consent to the share transfer, other shareholders shall have the pre-emptive right to purchase the shares on equal terms and conditions. However, Chinese *Company Law* also stipulates that these above rules could be changed if the articles of association have some contrary rules regarding shares transfers. Considering the nature of limited liability companies, it is reasonable to believe that a transfer would have greate restrictions if the articles of association stipulate otherwise.

28 Walter Hutchens, *Private Securities in China: Material Disclosure about China's Legal System?*, 24 University of Pennsylvania Journal of International Economic, 599-689 (2003).

in China. Figure 5 lists the top ten locations where these cases were heard. These ten locations account for over 70 percent of the total cases. In addition, in order to examine the relation between economic development and the private enforcement of *Company Law*, this section also lists the top 10 developed provinces and municipalities.

Figure 5: Top 10 Locations of the Cases

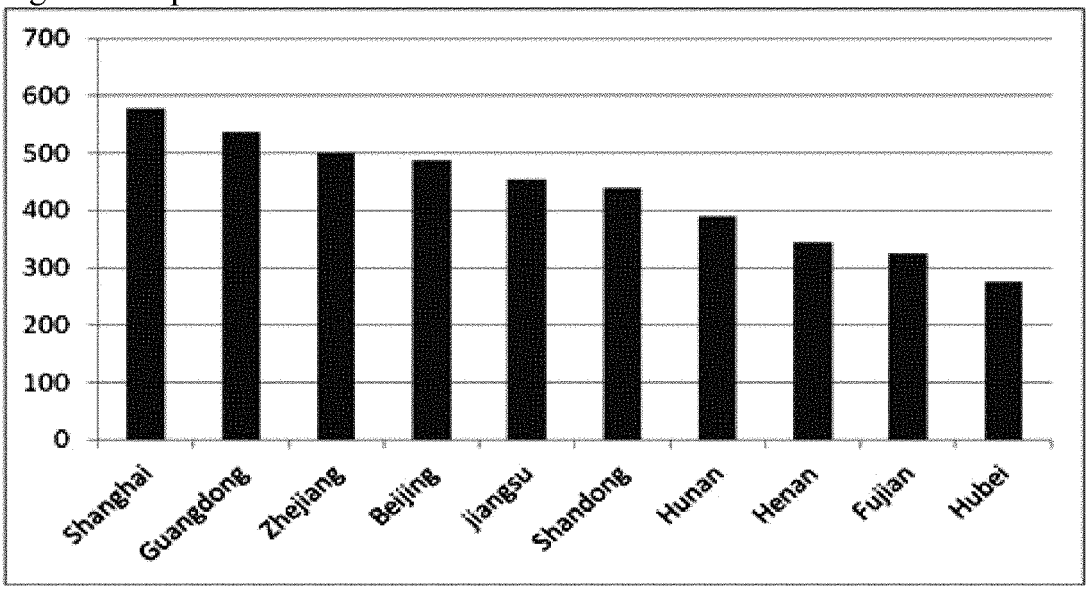


Figure 6: Top 10 Provinces and Municipalities in GDP (Billion Yuan)

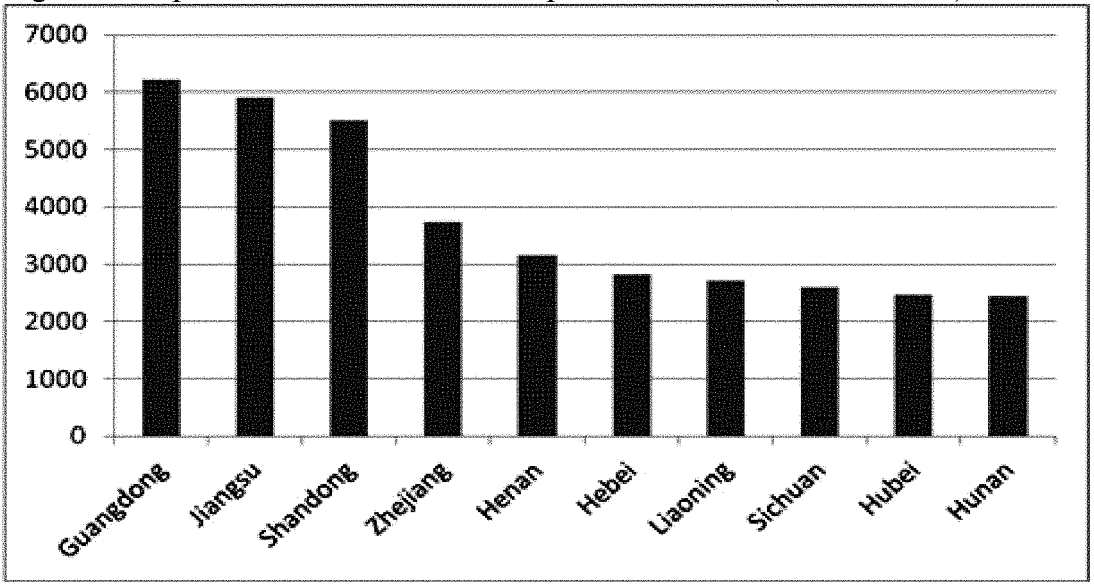
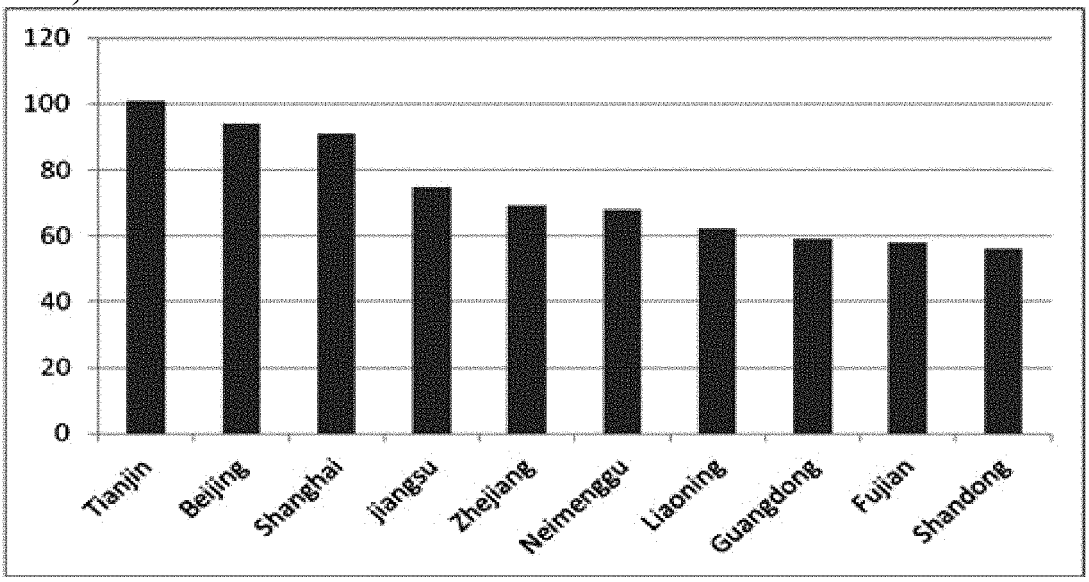


Figure 7: Top 10 Provinces and Municipalities in Per Capita GDP (Thousand Yuan)



From the above figures, it is clear to see that all the top 10 provinces/ municipalities, which constituted over 70 percent of the total cases, are either in the list of top 10 GDP or the list of top 10 Per Capita GDP. This means a vast amount of cases occurred in economically advanced areas, which is unsurprising, since a developed region normally has more business disputes. With the continuously growing economy in China, it can be expected that private enforcement of *Company Law* will be strengthened and that judges are likely to become more competent in adjudicating these lawsuits.

IV. CASE STUDY: DERIVATIVE ACTIONS

In addition to the general results of the private enforcement of *Company Law*, this research aims to examine the exercise of judicial discretion during this process. Namely, how the judges interpreted the rules in practice, particularly those that are ambiguous or unclear. It is important to explore this area for the following reasons. First, unlike common law jurisdictions, Chinese judges do not have a wide discretion to interpret the law when adjudicating cases. They have to make their decisions strictly according to the relevant legislation. Nevertheless, this does not mean the judges have no role to play in interpreting the law. In fact, judicial activism is now being

promoted in legal scholarship and within the court system.[29] The development of judicial activism reveals that courts have increasingly become a public policy maker and an implementing agency. Second, it is generally recognized that the current legal system in China is incomplete, which results in many loopholes in the legislation. Without exercising judicial discretion, courts may find difficulties in dealing with these types of cases. Third, Chinese *Company Law* has a binding effect across the country and thus it is argued that there is no role for the so-called "regulatory competition"[30] to operate in China. However, judicial discretion in local courts can be treated as similar to "regulatory competition", because various interpretations of the rules can occur and result in one area being clearly distinct from others. In view of the above, judicial discretion is not only important but also necessary in the enforcement of Chinese *Company Law*.

In order to assess how the courts exercise their judicial discretion in interpreting rules in Chinese *Company Law*, cases of derivative actions have been selected as a sample for studying. There are a number of reasons for choosing this type of lawsuits. First of all, they are vertical disputes and an examination of them may be helpful in understanding the protection of minority shareholders. Secondly, although derivative actions were formally adopted in the *Company Law 2005*, in practice they were recognised prior to its implementation. As such, it would be interesting to explore the reasons behind this acceptance. Finally, the statutory derivative action was adopted after much consideration and public consultation, but problems still exist. This means that judicial discretion has to be in place in order to make the new statutory rule workable.

A. Derivative Actions Cases Prior to Company Law 2005

Prior to *Company Law 2005*, there was a dispute over whether derivative action had already been adopted in article 111 of *Company Law 1993*.[31] However, the majority of scholars disapproved the view that article 111 provided the basis for derivative action to individual shareholders as the article only directed litigants to discontinue the execution of illegitimate

29 Hou Shuwen, *Judicial Art of Equity and Judicial Activism*, 1 Chinese Journal of Law, 7 (2007); Gu Peidong, *A Study on Several Issues of Active Justice*, 4 China Legal Science, 3 (2010); Yang Jianjun, The Development of "Judicial Activism" in China, 1 Science of Law (Journal of Northwest University of Political Science and Law), 8 (2010).

30 Roberta Romano, *Is Regulatory Competition a Problem or Irrelevant for Corporate Governance?*, 21 Oxford Review of Economic Policy, 212-231 (2005); Ehud Kamar, *A Regulatory Competition Theory of Indeterminacy in Corporate Law*, 8 Columbia Law Review, 1908-1959 (1998); Simon Deakin, *Legal Diversity and Regulatory Competition: Which Model for Europe?*, 4 European Law Journal, 440-454 (2006).

31 Article 111 of *Company Law* 1993. For further details on this, please refer to: Lin Shaowei, *Derivative Actions in China: One Step Forward, Two Steps Back?*, 23 International Company and Commercial Law Review, 197 (2012).

resolutions rather than affording shareholder's standing to bring a derivative action.[32] Despite of the absence of a clear statutory basis for derivative actions, such cases were nevertheless heard in courts from time to time before the entry into force of the *Company Law 2005*. After a comprehensive search of the available websites on which cases and news reports of derivative actions are published, 23 cases were collected. In these cases, four were not accepted by the courts for the reason that the plaintiff shareholders were not eligible to bring an action against the wrongdoers on behalf of the companies; sixteen cases were accepted for various reasons; two cases were finally settled; and at the time of writing, it is unclear whether one case will be accepted or rejected as the result has not yet been published.[33]

Table 1:

Derivative Action Cases Prior to Company Law 2005		
Results	Number	Percentage
Refused	4	17%
Accepted	16	70%
Settled	2	9%
Unknown	1	4%

All four unsuccessful cases were rejected for essentially the same reason: the plaintiff shareholders were not eligible or entitled to bring a derivative action. The Yue Qin case was rejected because the Haile Company itself was able to bring an action against the wrongdoers, and thus the plaintiff shareholder, *Yue Qin*, lacked the standing to bring such litigation.[34] In the Honguang Shiye case, the judge ruled that "there is no necessary causal relationship between the losses of the plaintiff shareholder and the misbehaviours of the defendants", and that the suit should be rejected.[35] In the Chengdu Lida case, the plaintiff shareholder was found ineligible for derivative action as part of his complaint sought to claim for his own losses.[36] The court went further in pointing out in the Sanjiu case that derivative actions would not be accepted unless plaintiff shareholders are authorized by all the shareholders to bring the suit.

Although many cases have been accepted by courts, the reasoning

32 LI XIAONING, *supra* note 9, 244.

33 The result of this case has not yet been published online. This is not unusual as the publication of court judgments is not compulsory in China.

34 *Yue Qin v. Rajesh Prabhakar* (Shanghai Municipal Intermediate People's Court, 2003)

35 The detail of Honguang Shiye case is available at http://finance.sina.com.cn/t/20010906/104276.html (Last visited on August 10, 2013).

36 *Chengdu Lida Ltd., Co. v. Zhou Chunsheng, Zhou Wenzhang, et al.*(2006). More details of this case is available at http://old.chinacourt.org/public/detail.php?id=186427 (Last visited on August 10, 2013).

behind such acceptances is unsystematic and chaotic. In exploring these published cases, five aspects can be found to justify the acceptance of derivative actions.

The first aspect is that the court should support the derivative action on the basis of a fundamental principle of company law. In the Dalian Shengdao case, Xiangzhou District Court ruled that the application of the plaintiff shareholder should be supported, because "he brought an action to protect his legitimate rights and interests in accordance with the relevant fundamental principles of protecting shareholders' rights and interests in *Company Law*."[37] This reasoning was reaffirmed in another case, *Zhang Baorong v. Yu Gang and Rongma Company*. Here, the court said:

Yu Gang's behaviour constitutes a tort against the Rongma Company. After the infringement upon the Company, *Zhang Baorong*, as a shareholder of the Rongma Company, tried every available way to seek remedies for the Company, but failed. In order to prevent further infringement to the Company, he filed a lawsuit to this court and its claims should be accepted as it is in line with the legal principles of *Company Law*.[38]

Zhang Jianhua v. Huang Jiawei, the court ruled that the lawsuit brought by the plaintiff shareholders was proper to safeguard the interests of the corporation and shareholders and was thus not against the law.[39] In *Shunde Guoxin Corporation v. Shunde Maocu Corporation Case*, the court stated that Guoxin Corporation was a qualified plaintiff because its interests as a shareholder were infringed by the defendant and thus Guoxin was entitled to bring a lawsuit.[40]

The third aspect for the courts to accept derivative actions was based on the right of subrogation. Lawsuits based on the right of subrogation generally applied to contract cases, where creditors have rights to recover their debts by bringing an action.[41] However, there are some differences between lawsuits based on the right of subrogation and those on derivative actions. For example, the purpose of derivative actions is to safeguard the interests of the company rather than the plaintiff shareholders themselves; by contrast, the purpose of the lawsuits based on subrogation is to recover the plaintiff creditors' debts.[42] Nevertheless, the principle of subrogation applies to derivative actions in some cases. For example, in the Dalian Shengdao case,

37 *Dalian Shengdao Group v. Zhuhai Huafeng Group* (Zhuhai Municipal Xiangzhou District People's Court, 2000).

38 *Zhang Baorong v. Yugang and Rongma Company* (Beijing Municipal Zhaoyang Distric People's Court, 2004) .

39 *Zhang Jianhua v. Huang Jiawei* (Shanghai Municipal Jingan District people's Court, 2002).

40 *Shunde Guoxin Corporation v. Shunde Maocu Corporation* (Shunde District people's Court, 2002).

41 The right of subrogation is stipulated in article 73 of *Contract Law of the People's Republic of China* in which it states "where the obligor is remiss in exercising its due creditor's right, thereby harming the obligee's interests, the obligee may petition the People's Court for subrogation in its own name, except that the creditor's right exclusively belongs to the obligor."

42 LIU JUN, STUDY ON SHAREHOLDERS' DERIVATIVE ACTIONS, at 26 (PhD Thesis, Chinese University of Political Science and Law, 2007).

the court found that the plaintiff shareholders were eligible for bring an action by exercising the right of subrogation in order to protect their legitimate rights and interests.[43] In *Shanghai Zhanwang Corporation and Shanghai Baiyulan Research Institution v. Shanghai Jinshan Liangyou Company*, the court ruled that the plaintiff, as a shareholder of the company who suffered a lot because of the defendants, was entitled to bring a lawsuit of subrogation on behalf of the company.[44]

Fourth, the reason for allowing individual shareholders to bring a derivative action was the abuse of corporation's legal personality. In *Shanghai Zilaishui Company v. Shanghai Huihuang Company*, the court stated that:

As the defendant controls the management and property of the company, the company, as a factual legal entity, is not able to exercise its right to bring an action. In this situation, the corporate veil should be lifted as the defendant was abusing its legal personality and the interests of the plaintiff shareholders were thus damaged indirectly. Therefore, the claims of these two plaintiff shareholders should be accepted.[45]

Finally, although there is no basis for derivative actions to be enacted in *Company Law 1993*, it was clearly expressed and adopted in several cases. In *Linyi Foreign Trade Company v. Shandong Import and Export Company*, the court simply stated that:

Although derivative action is not adopted currently in *Company Law*, it is accepted in practice. It is worthwhile to emphasize that a derivative action should be commenced under certain circumstances and shareholders cannot abuse this right. Here, when Linyi Company was prevented from bringing a lawsuit, Linyi Foreign Trade Company was entitled to bring a derivative action on behalf of Linyi Company.[46]

This view was subsequently reaffirmed in *Hong Kong Limited Company v. Guangzhou Suihang Company* where the court ruled that when the company itself was not able to bring an action, the plaintiff shareholder was entitled to claim rights against the defendant. Therefore, "this litigation is in accordance with the conditions of derivative actions".[47] In *Shanghai Yaoguo Company v. Gaobaoquan*, the Court plainly held that shareholder derivative action is an important judicial tool for protecting the legitimate rights and interests of shareholders, and thus individual shareholders are allowed to bring derivative actions when a company is prevented from bringing such litigation.

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43 *Dalian Shengdao Group v. Zhuhai Huafeng Group*, *supra* note 37.

44 *Zhanwang Corporation v. Shanghai Jinshan Liangyou Company* (Shanghai Municipal First Intermediate People's Court, 2002).

45 *Shanghai Water Supply Company & Shanghai Baiyulan International Tourism Culture Research Institute v. Shanghai International Rowing Club Company* (Shanghai Municipal Intermediate People's Court, 1999).

46 *Linyi Foreign Trade Company v. Shandong Import and Export Company* (Shandong Provincial Higher People's Court, 1999).

47 *Guangzhou Suihang Company v. Hong Kong Youxiang Company* (Guangdong Provincial Higher People's Court, 2003).

The court had started to use the terminology of derivative actions although it had not been formally adopted in *Company Law 1993*. It is surprising that according to the courts, derivative actions should only be brought under certain circumstances or conditions, among which only one condition seems practical, when the company is not able to bring an action against wrongdoers itself. However, one case did not use the terminology of derivative actions, nor did it cite any regulation relevant to derivative actions.[48] Here, the court seems to deliberately avoid the topic of derivative actions, and its decision is directly based on the facts of the case. This approach was favoured by some lawyers as it was considered to be a "wise way" of dealing with derivative actions.[49]

B. Derivative Actions Cases after Company Law 2005

Derivative action is now enacted in article 152 of the *Company Law 2005*, which enables an eligible shareholder[50] to bring a derivative action when a director or senior manger has committed a violation as specified in article 150 of *Company Law 2005*. Before initiating a derivative action, a plaintiff shareholder has to make a request in writing to an appropriate body. Specifically, a request should be made to the board of supervisors, or the supervisors of a limited liability company without a board of supervisors, where a lawsuit is to be brought against the directors or senior managers. On the other hand, in an action against the supervisors, the demand should be made to the board of directors or to the executive directors of limited liability companies without a board of directors. Only when the relevant body refuses this demand or fails to response within 30 days of receiving such a demand, can the shareholders commence a derivative action.

This research collected all the available derivative actions cases since the implementation of *Company Law 2005*, covering the dates from January 1, 2006 to August 30, 2013. One hundred and three cases were identified as the table below shows.

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48 ZHAO JIN & WU GUO, DERIVATIVE ACTIONS, at 274 (Law Press, 2007).

49 *Id.*

50 There is no special requirement for the shareholders of limited liability companies, while an eligible plaintiff in a joint stock company (JSC) is required to hold one percent or more of the total shares separately or aggregately for at least 180 consecutive days.

Table 2:

Number of Derivative Actions in China from 2006 to 2013								
Year	2006	2007	2008	2009	2010	2011	2012	2013
Number	13	6	17	22	22	14	8	1
Percentage	12.6%	5.8%	16.5%	21.4%	21.4%	13.6%	7.8%	0.9%

It seems that derivative actions have been effectively utilized in China, as 103 in terms of cases is a good take-up figure in comparison with the number of other countries. For example, when Japan adopted derivative actions in 1950, this mechanism lay dormant for the first 35 years. Not a single derivative action was taken in the five years following its enactment and there was less than one case per year on average from 1950 to 1985.[51] By the end of 1992, there were only 31 derivative actions pending before Japanese courts.[52] In the UK, where derivative action was enshrined into the *Companies Act 2006*, there were less than 20 cases brought before courts after its implementation.[53] From this perspective, it appears that derivative action has made a noticeable impact in China.[54]

However, beyond merely the number of cases, an analysis gives a more nuanced insight into how China differs from other nations with respect to derivative action. Closer examination reveals that China's derivative action system is less of a success than the absolute figures imply: first, although there were very few cases in the first 40 years after derivative action was enacted in Japan, the number skyrocketed from the early 1990s onward. In 1993, there were 86 cases pending before Japanese courts. This number continued to rise, peaking in 1999 with 95 new cases filed and a total of 222 cases pending.[55] By comparing this figure to the 103 cases brought before the courts over an eight-year period in China, the latter seems less impressive. Second, one of the main reasons why few derivative actions have been

51 MASAFUMI NAKAHIGASHI & DAN W. PUCHNIAK, LAND OF THE RISING DERIVATIVE ACTION: REVISITING IRRATIONALITY TO UNDERSTAND JAPAN' S UNRELUCTANT SHAREHOLDER LITIGANT, IN DAN W. PUCHNIAK, HARALD BAUM & MICHAEL, THE DERIVATIVE ACTION IN ASIA, at 133 (Ewing-Chow ed., Cambridge University Press, 2012).

52 Mark West, *The Pricing of Shareholder Derivative Actions in Japan and the United States*, 88 Northwestern University Law Review, 1439-1440 (1994).

53 *Singh Brothers Contractors (North West) Ltd*, Re (2013) EWHC 2138 (Ch); *Fort Gilkicker Ltd*, Re (2013) EWHC 348 (Ch); *Hughes v. Weiss* (2012) EWHC 2363 (Ch); *Phillips v. Fryer* (2013) B.C.C. 176 (Ch D); *Certain Limited Partners in Henderson PFI Secondary Fund II LLP v. Henderson PFI Secondary Fund II LP* (2013) 3 All R.R. 887; *Bamford v. Harvey* (2012) EWHC 2858 (Ch); *Kleanthous v. Paphitis* (2011) EWHC 2287 (Ch); *Seven Holdings Ltd.*, Re (2011) EWHC 1893 (Ch); *Parry v. Bartlett* (2011) EWHC 3146 (Ch); *Ritchie v. Union Of Construction, Allied Trades and Technicians* (2011) EWHC 3613 (Ch); *Stainer v. Lee* (2011) 1 B.C.L.C. 537 (Ch D); *Kiani v. Cooper* (2011) 2 B.C.L.C. (Ch D); *Cinematic Finance Ltd. v. Ryder* (2012) B.C.C. 797 (Ch D); *Wishart, Petitioner* (2010) B.C.C. 162; *Stimpson v. Southern Landlords Association* (2010) B.C.C. 387 (Ch D); *Iesini v. Westrip Holdings Ltd.* (2009) EWHC 2526 (Ch); *Franbar Holdings Ltd. v. Patel* (2008) EWHC 1534 (Ch); *Fanmailuk.com Ltd. v. Cooper* (2008) EWHC 2198 (Ch); *Mission Capital Plc v. Sinclair* (2008) EWHC 1339 (Ch).

54 Huang Hui, *Shareholder Derivative Litigation in China: Empirical Findings and Comparative Analysis*, 27 Banking and Finance Law Review, 628 (2012).

55 Mark West, *Why Shareholders Sue: the Evidence from Japan,* 30 Journal of Legal Studies, 351-372 (2001).

brought in the UK is that other stronger remedies are available for minority shareholders to protect themselves. For example, unfair prejudice has proved to be a very popular mechanism in protecting minority shareholders owing to the wide range of conduct covered by this rule and the flexibility of relief it offers.[56] The dominant role of this remedy means that derivative action plays an insignificant role in disciplining corporate management in the UK. However, no mechanism like unfair prejudice exists in China and derivative actions therefore ought to play a key role in corporate governance. Third, there are severe double agency costs[57] in China and the interests of minority shareholders have often been exploited over the last 20 years. Cases involving derivative actions that could have been at least doubled had it been used effectively. Last but not least, considering the huge number of companies in China, 103 is not a large figure and thus the effectiveness of derivative actions remains doubtful.

In addition to the above results, the empirical study shows that there are several loopholes in both procedural and substantive aspects, and the courts have different ways of dealing with these problems. These legislative drawbacks undoubtedly create unsystematic and problematic application of law in practice. Some courts may use these shortcomings to avoid the implementation of derivative lawsuits, while others have taken bold action to welcome these lawsuits regardless of the lack of procedural clarity.

For example, according to article 152 of the *Company Law 2005*, plaintiff shareholders must make a request to the appropriate department in the company before initiating litigation. However, problems arise when there is a dispute on which department of the company is the "appropriate one".

In Shunde Zhaoyu Electronic Hardware, the complaining shareholder, who was also the legal representative for the company, brought a derivative lawsuit without making any request to the appropriate department, believing that he or she had the power to act for the company. The application was permitted at first-instance, but was later rejected by the intermediate level court on appeal for the reason that it did not strictly follow the strict requirement of making a request.[58] In Beijing Dingyu Cable, the court refused a claim owing to the failure in making a proper demand even though there

56 ARAD REISBERG, DERIVATIVE ACTIONS AND CORPORATE GOVERNANCE: THEORY AND OPERATION, at 277 (Oxford University Press, 2007).

57 Unlike other countries that have only one principle agency cost incurred by the separation of ownership from management, there are currently two forms of agency costs prevalent in China: vertical agency cost between shareholders and managers, and horizontal agency cost between majority shareholders and minority shareholders. The former agency problem originated from SOE reform started in 1978 which led to insider control problems and owner absence. Conversely, the concentrated ownership structure makes minority shareholders vulnerable to exploitation from block-shareholders and thus creates the latter agency cost. For the details on this, *see* Lin Shaowei, *Double Agency Costs in China: A Legal Perspective*, 9 The Asian Business Lawyer, 115 (2012).

58 *Zhao Yu v. Zhou Yuchao* re: *Shunde Municipal Zhaoyu Electronic Hardware Company Limited* (Foshan Municipal Shunde District People's Court, 2006); on appeal Guangdong Province Foshan Intermediate People's Court (2007).

was no corporate organ or actor in existence at that time that could have received such a request.[59] This adjudication has been criticised by some scholars for its unforgiving reading of the request requirement.[60]

Despite of the above cases in which the courts have tried to avoid the application of derivative actions by using loopholes in the law, some other courts have taken a positive attitude towards this new system. For example, in the Beijing Aeronautical case, the company had already entered into liquidation. Here, the court accepted the derivative action even though a request was not made by the plaintiff shareholder, as there was no appropriate sector that could have received the request at that time.[61] This decision, which obviously contrasts with the case of Beijing Dingyu Cable, has been followed by other cases.[62]

The last issue concerning the request requirement is whether a request should be made when a plaintiff shareholder is at the same time a supervisor. In *Wang Peng v. Cao Qing and others*, the court ruled that the plaintiff shareholder, Wang, did not need to make a request as he was concurrently serving as a supervisor of the company, even though he failed in giving the reason of exemption.[63] In *Zhang X v. Wang X*, the court shared this view and further pointed out that it was lawful for the plaintiff shareholder to bring an action without making a request as he was fulfilling his duty as a supervisor.[64] In *Dong Yemin v. Wang Chenghai and others*, the precedent had been followed, but for a different reason. In this case, the judge held that a plaintiff shareholder could not make a request upon himself as a supervisor and therefore the request could be waived.[65] However, this reasoning was not followed in *Li Wei v. Li Yongjian and others*. In this case, the court held that the plaintiff shareholder should strictly comply with the request requirement even when he is a supervisor in the company.[66] In light of above cases, it seems that the courts are more willing to excuse the request requirement when a plaintiff shareholder serves as a supervisor. However, this needs to be further clarified in the future.

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59 *Zhang Ke v. Zhang Chen re: Beijing Dingyu Special Type Electric Cable Company Limited* (Beijing Haidian District People's Court, 2008).

60 DONALD CLARKE & NICHOLAS CALCINA HOWSON, PATHWAY TO MINORITY SHAREHOLDER PROTECTION: DERIVATIVE ACTIONS IN THE PEOPLE' S REPUBLIC OF CHINA, THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH, at 254 (Dan W. Puchniak et al. ed., Cambridge University Press, 2012).

61 *Lin Yu v. Aeronautical New Concept Science and Technology re: Beijing Aeronautical City Tongzhi Nengka Engineering Company Limited* (Beijing Haidian District People's Court, 2006.

62 *See* the cases of Shanghai Ninghui 2008, Liaoning Baotong Materials 2006, and Huangshan Fenghua Real Estate 2009.

63 *Wang Peng v. Cao Qing and others* (Qingdao Intermediate People's Court, 2009).

64 *Zhang X v. Wang X* (Shanghai First Intermediate People's Court, 2010).

65 *Dong Yemin v. Wang Chenghai and others* (Shanghai First Intermediate People's Court, 2009).

66 *Li Wei v. Li Yongjian and others* (Hunan Province Rucheng People's Court, 2009).

V. JUDICIAL DISCRETION: REFLECTIONS FROM THE CASE STUDY

This section focuses on some of the conclusions that can be drawn from the case study of derivative actions. In addition to this, some important principles of the enforcement of *Company Law* will also be highlighted.

First of all, Chinese courts are now more willing to exercise judicial discretion. Traditionally, Chinese courts were regarded as "law-applying" institutions. The current legal system in China implies that judges are not law-makers. Nevertheless, this has been changing for the past decade as the courts have become increasingly autonomous. The traditional view of "law applying" has been fading while the role served as "law-making" is emerging. Despite of the fact that the rule of law had been advocated for many years, many Chinese legal schools recognised that the rule of law needed to be reconciled with the rule by man basically because the need for discretion in law could not be denied.[67] The increase in the exercise of judicial discretion reflects that the courts will have a vital role in the private enforcement of *Company Law*.

Second, the courts are increasingly capable of exercising their judicial discretion. Despite of this, it is argued that Chinese judges are incapable of tackling commercial cases due to their highly technical nature as well as the inexperience of judges themselves. Indeed, this might be true at the earlier stages of the enforcement of *Company Law 1993*. After decades of practice, the judges have become rather competent in this area. As the cases of derivative actions show, judges have even managed to accept derivative actions without the existence of a clear statutory basis for them in order to provide protection to minority shareholders. Without sufficient skills and confidence, the courts would have simply rejected those claims.

Third, the courts cannot exercise judicial discretion free from restrictions. Indeed, judicial discretion is a double-edged sword. It can be used to fill the gap between the "law in books" and "law in action" and thus promote the applicability and feasibility of Chinese *Company Law*. Nonetheless, it can also hinder commercial activities if inappropriately used. As such, given the reasons stated above, judicial discretion should be encouraged albeit with the judicious application of restrictions. It is therefore proposed that the following principles should be adopted in order to make judicial discretion more workable: (1) the principle of prohibiting violation. This means that the judges cannot deny the effect of existing legislation. Judicial discretion can only be exercised within the area where there are no

67 Margaret Woo, *Law and Discretion in the Contemporary Chinese Courts*, 8 Pacific Rim Law & Policy Journal, 581-615 (1998).

clear stipulations. Otherwise, the court system would become a law-making institution and the current legal system could, in effect, be compromised. (2) The principle of encouraging complementarity. The inevitable limitations of the legislators and the drawbacks of legislation indicate that judicial discretion should be strongly encouraged and thus the gap between "law in books" and "law in action" could be filled. (3) The principle of limited creation. Where there is no statutory rule, the judges may have to "create" rules in order to deal with new situations. However, the "creation" itself does not mean the judges are free to make whatever decisions they want. They should be made on specified aspects and their creation should be subject to limitations. (4) The principle of appropriate interference. Cases involving companies and business have their own distinctive features and thus they cannot be treated in the same way as other types of lawsuits in terms of the exercise of judicial discretion. It is traditionally recognised that the internal affairs of companies should not be interfered with by courts, as too much intervention in this area may hinder the development of companies. In fact, by examining the cases of derivative actions, it seems that Chinese courts embrace this principle in practice as one of the criteria to refuse an application.[68] (5) The principle of protecting minority shareholders. Nowadays minority shareholders in China do not only face the problem of being oppressed by the majority of shareholders because of the ownership structure, they are also at risk of being exploited by managers owing to the severe vertical agency problem. Recognising these double agency costs, sustainable development of the capital market calls for sufficient protection for minority shareholders. As such, the judges should be inclined to be sympathetic towards vulnerable shareholders when exercising their judicial discretion.

VI. CONCLUSION

Given the short history of Chinese *Company Law*, it is understandable that this legislation has many drawbacks. In spite of this, the private

68 In the *Weihai Yinghai* case, an action was allowed to proceed while it was later rejected for the reason that the dispute "belonged to the issues of the company's internal administration". This decision was upheld in another case of Huangshan Fenghua Real Estate where an application was permitted at the first-stance, but was then dismissed by the Anhui provincial-level court, which supported the argument of the defendant that the issues "merely pertain to internal shareholder disputes". *See Qingdao Municipal Chemical Petroleum Supply Company Limited v. Zhang Chun re: Weihai Yinghai Zhiye Development Company Limited* (Weihai Municipal Intermediate People's Court, 2007); on appeal Shandong Provincial Higher People's Court (2008); *Shi Jianjun v. Qian Guoli and others re: Huangshang Municipal Fenghua Real Estate Development Company Limited* (Huangshan Municipal Intermediate People's Court, 2004); on appeal Anhui Provincial Higher People's Court (2009). For further details on this, *see* DONALD CLARKE & NICHOLAS HOWSON, PATHWAY TO MINORITY SHAREHOLDER PROTECTION: DERIVATIVE ACTIONS IN THE PEOPLE'S REPUBLIC OF CHINA, *in* THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH, at 243 (Dan W. Puchniak et al. ed., Cambridge University Press, 2012).

enforcement of *Company Law* appears quite robust, as the number of cases has increased significantly from 2 to 1,791 since its inception. This growing number challenges the widespread impression of the Chinese as Confucians unwilling to resolve their disputes through litigation. It also means the courts are gaining more experience in dealing with corporate cases, which refutes another traditional view, namely, Chinese judges are not capable of dealing with such highly technical cases. Furthermore, the empirical results also show that cases involving vertical disputes are much fewer in number than horizontal cases. However, this does not imply that the agency costs are not severe as the number of such cases is relatively large. Last but not least, a vast majority of cases occurred in economically advanced areas, which is unsurprising as most business disputes occurred in affluent regions. With the continuously growing economy in China, it is to be expected that private enforcement of *Company Law* will continue to be strengthened.

The case study of derivative actions also showed that judges are increasingly competent in adjudicating commercial cases. In addition, many judges are inclined to decide in favor of minority shareholders when exercising judicial discretion. Nevertheless, judicial discretion cannot be exercised without restrictions. Indeed, considering the fact that the effectiveness of *Company Law* depends on its implementation, judicial discretion should be restricted to certain areas and should follow the principles detailed above. It is expected that the private enforcement of Chinese *Company Law* will remain robust with the current economic growth and that judicial discretion will become increasingly important in this area.

(Revised by Andrew G. R. Whyte)

中国公司法的私人执行：股东诉讼与司法裁量权

内容提要 中国2005年公司法颁布实施至今已有十年，从私人执行的视角观察公司法可发现，认为中国法官难以裁判技术性较强的商事案件的传统观点值得商榷，中国公司法私人执行纠纷数量的逐年增加也在很大程度上体现出公司法在实践中的活力，派生诉讼案件的日益上升不仅表明即便存在诸多缺陷的公司法制度也具有广泛的需求，更凸显了中国股东积极运用法定诉权保障自身权益的意识与行为自觉。而在公司法制度存有漏洞与公司法规则广泛运用之间，容易出现法官滥用裁量权的现实性与可能性的，为此应当通过对法律的严格解释、公司法原则的确立等限制法官对司法裁量权的可能滥用，以期让公司法得到更好的适用。