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CHINESE LAW

Practical Demands to Update the Company Law

The Company Law of the PRC\(^1\) is approaching the fourth anniversary of its implementation.\(^2\) Recently, an official conference was held to celebrate its achievements in transforming state-owned enterprises into the modern business forms in the course of establishing a market economy in China.\(^3\) The practice of the past three years, however, has also exposed its shortcomings. After its adoption, certain legislative defects were almost immediately identified by some scholars.\(^4\) Currently, some academic concerns have materialised into problems of practice. Two recent high-profile cases concerning derivative actions and the fiduciary duty of corporate management vividly illustrate such situations. Interestingly, both cases involve foreign investors from Hong Kong. They reflect certain potential risks in investing in China. This article examines the facts and issues of the two cases, discusses some defects of the current legal framework through comparison with certain provisions and doctrines of the common law, and highlights future trends.

Facts and main issues of the two cases

The first case is being litigated in Shanghai and has been called an unusual case by practitioners because it took the court several months to deal with the unprecedented issues concerning the parties' standing and the applicable procedures. In October 1992, Yanzhong Industrial Stock Co Ltd of Shanghai, a listed company on the Shanghai Exchange ('Yanzhong Co'), Zhongtian International Ltd of Hong Kong ('Zhongtian Co'), and the Jinbang Second Industrial Company of Jiading District of Shanghai ('Jinbang Co') formed a joint venture to manufacture distilled water with the brand name of Bichun. The board of six directors was composed of three from the Zhongtian Co, two from Yanzhong Co, and one from Jinbang Co. The articles of association provided that the quorum for a board meeting should be five and the chairman of the board should be appointed from among the directors from Yanzhong Co.

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\(^2\) The Law was adopted on 29 December 1993 and entered into force on 1 July 1994.

\(^3\) See the report of the Symposium for the Third Anniversary of the Company Law Implementation jointly organised by the State Commission of Economic System Reform, the Ministry of Justice, the Legislative Commission of the Standing Committee of the National People's Congress, the Legal Department of the State Council, and other state departments: Fazhi Ribao (Legal Daily), 7 November 1997.

The joint venture's success, which was evidenced by the 43 per cent share of its products in the local market within three years of its establishment, apparently inspired Yanzhong Co to make more profits. In September 1995 and March 1996, Yanzhong Co established two subsidiary companies to produce and sell another brand of distilled water with the package, identity mark, and advertising materials very similar to the joint venture's products. Moreover, Mr Wang Jian, the chairman of the joint venture, also served as chairman of both Yanzhong Co's subsidiaries.

After the failure of several rounds of negotiation, Zhongtian Co called an extraordinary board meeting without the participation of any directors appointed by Yanzhong Co at which a resolution was adopted, by a 3:1 vote, to file a lawsuit on behalf of the joint venture against Yanzhong Co's subsidiaries alleging unfair competition and seeking compensation of RMB10.5 million. However, the lawsuit was withdrawn by Mr Wang Jian as the chairman of the joint venture on the ground that the resolution of the extraordinary board meeting was void. As a result, Zhongtian Co filed its independent lawsuit with the Second Intermediate People's Court of Shanghai against Yanzhong Co and its subsidiaries in September 1996. The trial was delayed for several months last year, however, due to the lack of legal provisions on derivative actions and the unclear provisions on directors' fiduciary duty within the Company Law. The two key issues litigated by the parties are whether the Hong Kong company has standing to sue as a shareholder to safeguard the lawful interests of the joint venture and to what extent the chairman may be liable for his intentional engagement in the conflict of interests situation against his own joint venture. As of the date of this writing, no final decision is available.

The problems encountered in the litigation in Shanghai are not unique but arise in many cases in China. The second lawsuit touches the issues from a different angle and has been discussed by the District Court judge, Cai Huiyong, who wrote about the case in a domestic law journal published by the Supreme People's Court. Different from the issues of shareholders' right to sue against unfairly prejudicial administration of company affairs, the second case poses the question whether a shareholder, or even a third party, may block another shareholder's action on behalf of the company in violation of the

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5 The case brief and issue summary are provided by Chen Fang of East China Institution of Political Science and Law in her article entitled 'Bichun/Yanzhong Anjian Yinqi de Falu Sikao' (Legal Considerations Triggered By the Bichun/Yanzhong Case) (1997) 4 Fanli yu Jinji (Legal System and Economy) 24-5.
7 Cai Huiyong, 'Shihun Gongsi Suquan yu Guodongquan, Jingyin Guanliquan de Guanxi — You Yi Anli Yinfu de Sikao' (On the Relations Between Company's Right to Sue and Shareholders' Right as well as Management Rights — Thoughts Raised by a Case) (1997) 6 Falu Shiyong (Law Application) 28-9. The following facts are also taken from his article.
articles of association. According to the judge, since the current Company Law provides no clear answer, the case represents a new challenge to the judicial branch.

D Company of Hong Kong and E Company of Beijing formed A Company as an equity joint venture in 1986 with each party’s equal contribution of US$1.75 million as the registered capital of the venture. In 1994 A Company entered a contract with B Company to entrust it to manage a karaoke bar for a term of five years. A year later, E Company unilaterally took over the business operation and personnel arrangement of A Company without any discussion by or resolution of A Company’s board of directors. D Company objected and, by the end of 1995, an arbitral award in favor of D Company was rendered by the China International Economic and Trade Arbitration Commission, which ordered the restoration of the joint management scheme as provided in the articles of association of the joint venture.

However, before the arbitral award was executed, E Company filed a lawsuit against B Company for its default of rent payments and for termination of the management contract. Both B Company and D Company raised the issue of E Company’s standing to sue on the ground that, without any decision of the board of directors, E Company had no right to sue on behalf of A Company. The judge held that E Company’s action did not represent the true will of the joint venture and therefore dismissed the action.

As Judge Cai could find a clear answer from neither the Company Law nor the Civil Procedure Law concerning the position of D and B Companies as shareholder and third party respectively and the grounds of their claims, he stated that, as long as affirmative evidence can be shown that the company’s right to sue is exercised in a way violating the articles of association and, as a result, infringing others’ interests, the exercise should be considered void and dismissable. Thus, the arbitral award in favour of D Company in this case served as the basis for the finding that the action of A Company was not the true manifestation of its will.

Judge Cai’s discussion apparently focuses more on the legality of the company administration than on the equitable concerns of common law jurisdictions. According to him, once the evidence that rights of the company are exercised in violation of the articles of association or under control of an unlawful board is produced, the court should investigate the claims further. He believes that the rights of the company, although exercised through the board of directors, should represent the true will of the shareholders. The reasoning,

8 Ibid. p 29.
9 Judgments rendered by People’s Courts in China usually provide little legal reasoning and discussion of the issues as the courts in common law jurisdictions always do. As such, Judge Cai’s article provides very useful insights into the judicial consideration of this case.
10 Note 7 above, p 29.
on one hand, is quite impressive in finding a way without sufficient legal authority to solve the problems and proves correct in this particular case; on the other hand, it reflects the lack of sophistication of this area’s jurisprudence in its developing stage. Judge Cai’s holding may have to be subject to many qualifications in order to be applicable to company practice in general. For example, he does not address the extent of shareholders’ will that may affect the exercise of the company’s rights in terms of the separation of powers between them and the management. Also, the majority and minority shareholders’ status and their implications in forming the company’s will seem to be treated indifferently.

Having examined the two cases, the writer would like to consider the relevant issues in a larger context because the real challenges represented by the two cases are not to the judicial handling, but to the current institution of company law in China.

The current legal provisions

In common law jurisdictions, derivative actions by members of a company are permitted where an action against maladministration of the company cannot be taken in the company’s name. Derivative actions may be filed either under the common law doctrine, or combined with claims based on statute. Under s 168A of Hong Kong’s Company Ordinance, for example, a member of a company may apply to the court for an order on the ground that the company’s affairs are being or have been conducted in a manner which is unfairly prejudicial to the interests of its members generally.11 The doctrine enables the court to do justice to a company controlled by miscreant directors or shareholders12 and has been supplemented by many judicial rulings that define the terms and the theories of the doctrine. However, it should be noted that derivative actions are filed on behalf of the company against certain wrong-doing; in normal situations majority rule would not allow the court to interfere with the internal management of the company acting within power.13

The Company Law of the PRC, however, includes no provision for derivative actions. According to Art 111, shareholders may have the right to sue where ‘a resolution of the shareholders’ meeting or board of directors violates the law or administrative regulations, infringes the lawful interests of the shareholders.’ However, an action filed under this provision is different from a derivative action.

11 A very similar provision can be found in s 459 (1), Company Act 1985 (UK).
12 Narcombe v Narcombe (1859) 1 WLR 370, 376 per Lawton LJ.
13 Foss v Harbottle (1843) 67 ER 189.
First, as the provision stipulates, the actionable wrong-doing is limited to violation of the law or regulations by a company resolution and infringement of shareholders' interests. However, the Law fails to recognise the different interests between different classes, including majority and minority shareholders, and to provide adequate protection accordingly. The literal reading of 'shareholders’ interests' in the Art 111 context may more naturally suggest majority interests. Moreover, the grammar of Art 111, separating the two phrases (violation and infringement) by only a comma, makes the confusion even worse because it may suggest two reasonable readings: violation and infringement are two conditions that need to exist at the same time to justify a shareholders' action; or they are two separate conditions and each may independently constitute the ground of the action. As such, minority shareholders may find it difficult to point to any specific words to support their attempted action.

Second, the Law does not spell out the elements to constitute the actionable infringement of shareholders' interests. Under Art 11, a company may only engage in activities within the scope of its articles of association. Then it is not clear at all whether conduct of the company which is ultra vires, though legal and beneficial to the majority shareholders, may be challenged by the minority as illustrated in the second case.

Third, the remedy that shareholders may seek is merely restricted to stopping the infringement, without effective compensation. Articles 63 and 118 further provide for directors' liability to the company for their violation of laws, regulations, or the articles of association in limited liability companies and joint stock companies respectively, without mentioning the remedies to the shareholders. Thus, Art 111, although it allows shareholders to file lawsuits against the management, fails to guarantee any equitable remedies to them.

Fourth, neither Art 111 nor other provisions of the Law stipulates any restrictive conditions as required in derivative actions in other jurisdictions, such as eligibility of standing, security for action, cost of litigation, and entitlement to remedies.

These differences demonstrate that the focus of Art 111 is more on safeguarding the market order of the state, rather than on effective compensation to injured individual shareholders. As a result, the current legislation fails to entitle a member of a company to petition the court on the ground that the company's affairs are being or have been conducted in an unfairly prejudicial manner against either all or part of the members' interests.

Indeed, the Supreme People’s Court, by a circular in 1994, held that an action filed by one of the joint venture parties to protect the lawful interests of the joint venture should be accepted by the People’s Court where the board of directors refused to exercise the joint venture’s right to sue because of the common interests between the controlling party of the joint venture and the
The effectiveness of the judicial remedy, however, is limited since, as stated, it may only be applicable to joint ventures, rather than companies in general; it fails to specify any necessary substantive and procedural conditions of such an action; and it addresses merely infringement of the joint venture’s interests as a whole, not violation of the lawful rights of minority shareholders.

The lack of provisions dealing with derivative actions and the limited scope of Art 111 inevitably pose difficulties to both practitioners and local People’s Courts which, under the Constitution, have no right to interpret, but merely apply the law. Thus, with little discretion and judicial guidance, a local People’s Court is in an unenviable position in deciding cases. On one hand it may not refuse to take the case; on the other hand, to ask a judge to decide a case without legal authority is to require him to rely on guesswork. Therefore the lack of legal rules, rather than treatment in the courts, should bear more blame for any mistakes in the proceedings. In this regard, the two cases have shown the considerable gap between a sound legal system and the current stage in China.

The second issue illustrated by the two cases concerns the scope of directors’ fiduciary duty. Although the concept of directors’ fiduciary duty is generally recognised in both common law jurisdictions and China, its practical implications may not be the same in the two. In common law jurisdictions, directors’ fiduciary duty is fundamentally based on trust and agency. The concept proves so important in common law countries that large numbers of cases have tried to elaborate its meaning and dimension. Interestingly, the extensive and comprehensive judicial efforts have made it impossible to codify the duty precisely with terse expressions. As such, the fiduciary duty of directors today still largely depends on the articulation of case law.

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15 According to Art 67 of the Constitution, the power to interpret laws belongs to the Standing Committee of the National People’s Congress.

16 A recently published Supreme People’s Court reversal may serve as a good illustration where, without any legislative guidance, the High Court of Hebei Province ruled that, in a finance lease, a guarantor’s liability was exempted after the lessee and the lessor revised the lease contract without the consent of the guarantor. The Supreme Court held that the guarantor could be exempted only from the liability lately created by the new contract, but still be answerable for the old contract: The Leasing Ltd Co of China v Man-made Plank Plant of Baoding City and Mancheng County Branch of the Industrial and Commercial Bank of China, printed in Zuigao Renmin Feyuan Shenli de Ershen Zaishen Jiujin and Xuanbian (Selected Economic Cases of Second Instance Heard by the Supreme People’s Court), vol 2, pp 410-15 (compiled by the Economic Trial Division of the Supreme People’s Court and published by the Press of China University of Political Science and Law in 1997).

17 In 1978 an attempt to codify the duty in the 1978 Company Bill in UK was finally given up after the drafters found it was impossible for the legal profession to reach an agreement on any suggested expressions of the duty.
Despite certain minor divergences, the fiduciary duty of company directors is generally agreed to include at least the duty to act in good faith for the company,\(^{18}\) the duty to exercise the powers conferred upon them for their proper purpose,\(^{19}\) the duty to avoid conflicts of interest,\(^{20}\) the duty not to fetter their discretionary powers,\(^{21}\) and the duty to exercise care, diligence, and skill.\(^{22}\)

As compared with the complexity of directors' fiduciary duty in common law jurisdictions, the provisions of the Company Law of the PRC appear to be oversimplified. Article 59 of the Law provides that 'directors, supervisors and managers shall comply with the articles of association of the company, faithfully perform their duties, uphold the interests of the company, and shall not take advantage of their positions and powers for their own personal gains.' Article 61 further stipulates that directors and supervisors shall not engage personally in the same business as the company they are serving or any activities for themselves or other parties harming their company. These provisions, at the most, merely indicate part of fiduciary duty in a descriptive way, rather than clearly specify the nature of the duty. In other words, compliance with these rules may not necessarily guarantee the same result as ensured by the case laws of common law jurisdictions. For example, in the second case discussed above, arguably at least E Company's action on behalf of the joint venture to terminate the lease contract, when the lessee defaulted, was made for the interests of the joint venture. However, the more precise issue of the case is whether the action was filed for the best interests of the joint venture where the other shareholder with half of the investment interests did not consent.

Moreover, the duties specified in Arts 59 and 61 seem too narrow. Good faith, declaration of interests, enforcement of fair dealing, and ethical use of the company's business opportunity and information are not stated and cannot be inferred from the current provisions. As compared with the established case law in common law jurisdictions in this regard, the Company Law of the PRC apparently falls short of meeting the generally accepted standards. According to the former, directors in exercising their powers must act bona fide in what they consider to be the best interests of the company,\(^{23}\) rather than the interests in general under the latter. As Megarry J observed in Gaiman v National Association for Mental Health, as a company is an artificial legal entity, it is not easy to determine what is in its best interests without paying due regard to its

\(^{18}\) Re Smith & Fawcett Ltd [1942] 1 All ER 542.
\(^{19}\) Howard Smith Ltd v Ampol Petroleum Ltd [1974] AC 821.
\(^{20}\) Aberdeen Railway Co v Blaikie Bros (1854) 1 Macq 461.
\(^{21}\) Thorpy v Doldberg (1964) 112 CLR 597 (Aust Hct).
\(^{22}\) Re City Equitable Fire Insurance Co Ltd [1925] Ch 407.
\(^{23}\) Teck Corporation Ltd v Miller (1972) 33 DLR (3d) 288.
present and future members as a whole. Also in Mills v Mills, Latham CJ held that the test for a director's acting in good faith would be different where the company's shares were divided into different classes. Therefore, without the support of equity principles and precedents, the current phrase of 'interests of company' in Art 59 may leave courts and judges in China with more questions than answers.

Furthermore, the vagueness of the provisions may further prevent the rules from being effectively implemented. In the first case above, for example, Art 59 may not effectively restrict directors appointed by Yanzhong Co from harming the joint venture, since the prohibition of seeking personal interests may not be readily applied to the case where the unfair competition may not necessarily benefit Yanzhong's directors personally, but the company they represented. Indeed, the Article mentions 'upholding the interests of the company.' However, the rule fails to provide any test of the interests, particularly, in the situation where the company as a business entity and the interests of certain shareholders do not coincide. With respect to Art 61, the questions of what constitutes 'engagement' and how 'same business' should be defined are not answered by either legislation or judicial interpretation. Also it fails to articulate the duty of directors to disclose their interests in a deal with the company.

Finally, different judicial approaches of the common law and civil law jurisdictions make the legislative differences discussed above more distinctive in practice. The common law takes an inclusive approach so that the directors' fiduciary duty may include both expressed provisions and implied principles and both established doctrines and newly discovered or developed rules. In contrast, China, as a country following the civil law tradition for decades, takes an exclusive approach, namely that the courts (other than the Supreme Court) cannot be allowed to interpret laws and people may do whatever they want to as long as they are not prohibited by laws, which in most cases mean written codes. As such, although the first glance at these two articles might suggest that they are much more restrictive than those rules in common law countries where directors' disclosure and shareholders' ratification may be allowed, the same result of the practice may not be guaranteed.

The government has clearly realised the problems and tried to remedy them by certain recent subordinate enactments. For example, the Special Provisions Concerning Extraterritorial Issuing and Listing by Domestic Joint Stock Companies, promulgated by the State Council on 4 August 1994, provides

25 (1938) 60 CLR 150.
26 See s 162, Company Ordinance, and Bamford v Bamford [1970] Ch 212.
27 Printed in Zhonghua Renmin Gonghe Guo Zhengquan Qiwo Fagu Huibian (The Collections of Laws and Regulations of the PRC on Securities and Futures) (Legal Publishing House, 1997), vol 1994, pp 34-7 (compiled by the CSRC).
that the company and its shareholders, directors, supervisors, managers, and other high level officers all may claim their rights in accordance with the articles of association by filing arbitral proceedings or lawsuits. Also the concepts of fiduciary duty and due diligence were officially introduced when the State Council promulgated the Provisions Concerning Foreign Capital Shares of Listed Joint Stock Companies within the Territory of China on 25 December 1995. Article 6 of the Provisions states that directors, supervisors, managers, and other senior management personnel shall bear fiduciary and diligence duties to the company. On one hand, the provision represents a general recognition of the rule of Foss v Harbottle; on the other hand, it fails to detail the two duties.

The Detailed Implementing Rules of the Provisions issued by the China Securities Regulatory Commission ('the CSRC') on 3 March 1996 included no further definition or explanation. However, Art 45 of the Rules provides that the disputes between foreign capital shareholders and the domestic listed company, its management as well as domestic capital shareholders concerning the articles of association and other affairs of the company shall be governed by the laws of China. Both the Provision and the Rules, as subordinate regulations, do not constitute any revision of, but supplement, the Company Law. As a result, the gap between the domestic standards and the generally accepted ones in international practice are narrowed in listed companies with foreign investment: because the addition of the commonly used concepts in other jurisdictions to the confusing descriptive provisions of Art 59 of the Company Law will definitely promote foreign investors' understanding of and confidence in the legal environment in China. It also represents China's efforts to modernise its current legal system in the course of its economic reform. Nevertheless, it should be noted that, as the discussion above suggests, the current legal rules and practice concerning fiduciary duty and due diligence are still developing, and thus the same or familiar wording in legislation may not be able to secure the same test and results as under common law jurisdictions. Moreover, these rules may not apply to domestic joint stock companies without B shares or foreign listing or limited liability.

The trend of future developments

In the long run, an overhaul of the Company Law is inevitable. However, the future reform cannot ease the current tension between the defects of the Law and the present demands of practice because technically, given the complexity of the Law and the broad issues to be addressed, such a revision may well take

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28 Art 15 (ibid, p 35).
30 (1843) 2 Hare 461, 67 ER 189.
years. Thus, some alternatives have been worked out. For instance, the State Council has kept inserting new rules in past years as mentioned above by issuing its national regulations on certain spots.

More frequently, the detailed rules concerning company operations have been promulgated by the CSRC, the watchdog under the State Council in the securities sector. One good example in this regard is the controversy that arose after directors and supervisors of more than twenty listed companies were found to have sold out all their share-holdings of their own companies in their office. A subsequent CSRC’s Notice in 1996 established prohibitive rules against any such transfers.

The latest efforts from the CSRC to improve the company legislation on derivative actions and directors’ fiduciary duty is embodied in the Guidance on Articles of Association of Listed Companies promulgated on 16 December 1997. The Guidance, with twelve chapters and 194 articles, provides model articles with limited room left to the companies themselves to insert their own drafts. To some extent, the provisions of the Company Law are virtually rewritten. Although the title of the document may not readily indicate its mandatory nature, the CSRC has made it clear that any change or deletion of the necessary contents of the Guidance without acceptable justification will cause CSRC’s refusal to process any applications from the companies concerned for their listing matters. Indeed, the Guidance is applicable to listed companies. But it will definitely lead the course of reform and thus has significant impacts on future company practice in China.

Several articles in the Guidance concern the issues raised by the two cases. Article 37 repeats Art 59 of the Company Law. However, Art 40 provides that the controlling shareholder, while exercising his power, shall not harm the lawful rights and interests of the company and other shareholders. As a result, the concepts of minority shareholders and their protection have been clearly recognised. By the same token, if Arts 37 and 40 are read together, the minority shareholders will be entitled to protect their lawful rights and interests through legal action. Article 72 further stipulates that the interested shareholder shall
not participate in voting for the transaction concerned and his voting shares shall not be counted as effective votes. If this rule can be stretched to limited liability companies, then the resolution to sue Yanzhong Co and its subsidiaries adopted by the other shareholders may not have been blocked by Yanzhong Co as the interested party.

With regard to directors’ fiduciary duty, Art 59 of the Guidance states that the board of directors, while reviewing shareholders’ proposals, shall take the best interests of the company and shareholders as the applicable criterion. Article 80 further articulates the standard by providing that, inter alia, they shall not act ultra vires, shall not operate or engage in other business to the detriment of the interests of their own company, and shall not take advantage to seize business opportunities of their own company. Article 82 states that, without due authorisation, no director shall act in his name on behalf of the company or the board. Where he acts on his own behalf but the third party may reasonably believe he is acting for the company or the board, it is the duty of such director to declare his position and status before the dealing. The imposition of the disclosure duty seems to have introduced the indoor management rule of common law jurisdictions into China.

All these provisions clearly reflect the trend of increasingly improving the current legal framework of company law by introducing more familiar common law rules and doctrines. With the support of other provisions against ultra vires, conflicts of interest, and seizing business opportunities of the company, the best interests test becomes more concrete and operational. However, the progress in at least three aspects is still limited. First, provisions do not emphasise the interests of the company as a whole, which means that the directors have to faithfully balance the present and future interests and interests of shareholders of different sectors. Second, they have not paid attention to the new trend regarding directors’ duties. As Lord Diplock pointed out in Lonrho Ltd v Shell Petroleum: ‘so long as the company remains a going concern the company’s best interests may well be served by having regard to other interests,’ such as creditors’ and employees’ interests. Third, in contrast with the trend of abolition in common law jurisdictions, the ultra vires doctrine is still strictly enforced in China.

The so-called indoor management rule is developed from Turquand. The rule states that a bona fide outsider, while dealing with the company without notice of the company’s internal management requirements, is not under a duty to conduct any inquiry regarding internal compliance. He is entitled to

36 Greenhalgh v Arden Cinemas Ltd [1951] Ch 286.
38 Hong Kong, as the latest example, abolished the doctrine in 1997 by the enactment of the Companies (Amendment) Ordinance 1997.
39 Royal British Bank v Turquand (1856) 6 E & B 327.
assume that all internal procedures have been followed where no irregularity requires him to do any further investigation. However, the constructive notice doctrine may hold him aware of the provisions of the company’s public documents. Apparently, Art 82 of the Guidance is borrowed from the common law rule. Nevertheless, it is interesting to note that the Chinese version seems to have a focus different from the sole purpose of protecting the innocent outsider under the common law rule, regardless of the cause of the internal procedural defects. The Chinese version apparently puts more emphasis on preventing directors’ wrong-doing. As such, a practical implication appears to be that the application of the rule may always connect with certain directors’ personal liability to the company. However, Art 82 fails to specify in such a case who should first be held liable for the outsider: the company or the directors? Moreover, the constructive notice doctrine seems not a part of the Chinese version.

In addition to tightening up and clarifying the standards, the Guidance also rationalises certain rules in the Company Law. The absolute ban on the deals involving directors’ personal interests, for instance, is relaxed. Article 83 requires the interested director to disclose the nature and degree of his involvement at the earliest board meeting. The company may cancel the contracts, deals, or arrangements concerned unless the disclosure is properly made and the board grants its approval without the participation of the interested director in voting. However, this rule may not be applied against a bona fide outsider. This provision may sound familiar to practitioners in common law countries where a self-dealing transaction is always voidable at the company’s option, whereas a deal with an outsider may be avoidable upon the company’s proof of the outsider’s knowledge of the directors’ conflict of interests.

Based on this discussion, it can be concluded that the Guidance has established some legal basis for shareholders, especially minority shareholders, to protect their lawful interests and to better monitor the performance of directors. The connection of the CSRC’s regulation with the articles of association of companies provides certain remedies for the defects of the current company legislation. The progress should be particularly welcome by foreign investment firms in forms of both companies or joint ventures if it represents the trend of future developments in company practice in China. In the past, as the two cases have illustrated, their status as Chinese legal persons may result in them enjoying less legal protection as compared with foreign issuing and listed companies.

40 Hely-Hutchinson v Brayhead Ltd [1968] 1 QB 549. Also per Vinelott J in Movietex Ltd v Bulfield (1986) 2 BCC 99.
On the other hand, a close watch is needed in order to assess the effectiveness of the practical implementation of the Guidance and to see to what extent the new rules may apply to the operation of limited liability companies. Moreover, it should be noted that despite the progress which has been made, certain issues are still not solved, such as the relevant procedures, definitions of many key terms, and the applicable tests in practice.

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