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Shareholders' Rights & Shareholder Activism 2021

China

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Law and Practice

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1. SHAREHOLDERS' RIGHTS

1.1 Types of Company

The two main types of companies that can be formed in China are the limited liability company (LLC) and the company limited by shares (joint-stock company). Both LLCs and joint-stock companies afford limited liability to their investors.

In general, LLCs are not subject to qualification criteria that restrict which shareholders can invest. However, joint-stock companies may not have more than 200 initial shareholders, half of whom must be domiciled in mainland China. In addition, specific industry rules may impose shareholder qualification criteria, mainly as to the nationality of the shareholders.

In 2016, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) introduced the Special Administrative Measures for Foreign Investment Access (Negative List), last revised in 2020. The Negative List sets out industries that are prohibited or restricted from foreign investment. Foreign investors investing in industries not included in the Negative List are generally treated the same as all other investors.

1.2 Types or Classes of Shares

Under Chinese law, only joint-stock companies can issue shares of stock, which are generally of two types: ordinary shares and preferred shares. Listed companies and “unlisted public companies” (unlisted joint-stock companies with more than 200 shareholders or whose shares can be publicly traded) are allowed to issue preferred shares. Certain listed companies and unlisted public companies may also issue special voting shares, which allow for more than one vote per share.

Preferred shareholders are entitled to priority over ordinary shareholders in the payment of dividends and liquidation proceeds but are restricted with respect to other rights, such as participation in the management of the company and exercising voting rights. Still, preferred shareholders can attend shareholders' general meetings and exercise voting rights on the following matters, and resolutions on such matters are required to be passed by at least two thirds of holders of preferred shares present at the meeting:

- revision of the articles of association related to preferred shares;
- reduction in registered capital of the company by more than 10% at one time or cumulatively;
- merger, division, and dissolution of the company or change of corporate form;
- issuance of preferred shares; or
- other circumstances specified by the articles of association.

Additionally, where a company has not paid the agreed dividends to holders of preferred shares for three fiscal years cumulatively or two fiscal years consecutively, preferred shareholders have the right to attend shareholders' general meetings and are entitled to voting rights as stipulated by the company's articles of association.

1.3 Primary Sources of Law and Regulation

The primary sources of law and regulation relevant to shareholders' rights include:

- the Company Law and the Securities Law, adopted by the National People's Congress and its standing committee;
- judicial interpretations issued by the Supreme People's Court; and

- administrative regulations promulgated and implemented by the State Council and its constituent departments and sub-agencies.

1.4 Main Shareholders' Rights

Main Shareholders' Rights

Under the Company Law, shareholders are mainly entitled to the following rights.

For LLC and joint-stock company shareholders, the right:

- to attend and vote at shareholders' meetings;
- to be entitled to dividend payments;
- to inspect the company's articles of association, minutes of shareholders' meetings, board resolutions, resolutions of the supervisory board, financial accounting reports, and other corporate records (LLC shareholders may make copies of these documents); and
- to share in the proceeds of any liquidation.

For LLC shareholders, the right:

- of first refusal for equity transfers to non-shareholders;
- of pre-emption for capital increases; and
- of information to inspect the company's accounting records for legitimate purposes.

Varied Shareholders' Rights

Shareholders in privately held companies may generally agree to modify, limit, or forgo certain rights. Shareholders may expressly agree to do so in provisions of the articles of association or shareholders' agreement or by resolution. However, courts may invalidate such arrangements where they are deemed to restrict statutory shareholder rights unreasonably. See **1.7 Access to Documents and Information** and **1.15 Shareholders' Rights to Grant Security over/Dispose of Shares**.

For listed companies and unlisted public companies, shareholders' rights may be varied by different types of shares, ie, ordinary shares, preferred shares, or special voting shares. These special share arrangements must be disclosed in accordance with relevant laws, regulations, and rules.

Public Disclosure Requirements

Privately held companies are not legally required to disclose publicly their articles of association or shareholders' agreements. In practice, companies must file their articles of association with the local branch of the State Administration for Market Regulation (SAMR), the companies' registry, but this filing requirement does not apply to shareholders' agreements.

1.5 Shareholders' Agreements/Joint-Venture Agreements

It is common for shareholders to enter shareholders' agreements or joint-venture agreements that stipulate rights and obligations amongst them. Such agreements are generally enforceable as long as they do not violate mandatory provisions of law, such as imposing unreasonable restrictions on shareholder access to information or equity transfers. See **1.7 Access to Documents and Information** and **1.15 Shareholders' Rights to Grant Security over/Dispose of Shares**.

1.6 Rights Dependent upon Percentage of Shares

Certain rights are exercisable only by shareholders who meet shareholding threshold requirements. These rights and corresponding requirements differ between LLCs and joint-stock companies. Each of these will be addressed in turn.

LLCs

The following rights are exercisable by LLC shareholders holding at least 10% of the voting rights of the company:

- to propose to convene an interim shareholders' meeting;
- to convene and preside over a general shareholders meeting if the board of directors (or executive director) and the board of supervisors (or sole supervisor) fails to do so;
- to propose to convene an interim board meeting; and
- to request a court to dissolve the company where the company experiences serious difficulties in its business and the shareholders would suffer serious losses if the company were to continue to operate.

Joint-Stock Companies

The following rights are exercisable by shareholders in joint-stock companies that fulfil the requisite shareholding requirements. In general, these shareholding requirements are more complicated than in the case of LLCs.

Shareholders individually or collectively holding at least 10% of the shares in the company may:

- propose to convene an interim shareholders' meeting;
- convene and preside over a general shareholders' meeting if the board of directors and the board of supervisors fail to do so, provided that those shareholders have individually or collectively held their shares for at least 90 consecutive days;
- propose to convene an interim board meeting; and
- request a court to dissolve the company where the company experiences serious difficulties in its business and the shareholders would suffer serious damages if the company were to continue to operate.

Shareholders individually or collectively holding at least 3% of the shares in the company may submit an interim proposal to the board of directors, in writing, ten days before a general shareholders' meeting.

Right to Initiate Shareholder Derivative Action

Shareholders of an LLC or a joint-stock company may initiate a derivative action on behalf of the company if they, individually or collectively, have held at least 1% of the company's shares for 180 consecutive days prior to the action. See **3.6 Derivative Actions**.

1.7 Access to Documents and Information

Shareholders are entitled to access the company's documents and information. These rights differ slightly between LLCs and joint-stock companies.

LLC Shareholder Information Rights

LLC shareholders are entitled to inspect and make copies of the company's articles of association, minutes of shareholders' meetings, resolutions of the meeting of the board of directors, resolutions of the meeting of the board of supervisors, and financial reports.

LLC shareholders may also request to inspect the company's accounting books and records, provided that the requesting shareholder submits a written request to the company that states a legitimate purpose for inspection. The company is entitled to refuse a request if it reasonably believes that the request is made for an illegitimate purpose that may harm the company's interests. If the company so refuses, it is required to give the requesting shareholder a written reply within 15 days that states the grounds for refusal. Shareholders who are refused access may then petition a court to provide access to the company's accounting books.

Joint-Stock Company Shareholder Information Rights

Joint-stock company shareholders are entitled to inspect (but not to copy) the company's articles of association, register of shareholders, corporate bond receipts, minutes of general meetings of the shareholders, resolutions of the meeting of the board of directors, resolutions of the meetings of the board of supervisors, and financial reports of the company. Shareholders may also make inquiries or proposals as to the company's operations.

1.8 Shareholder Approval

In China, the shareholders' meeting is the highest decision-making body of a company, which is actively empowered to decide on major corporate matters. In particular, the Company Law expressly requires the shareholders' meeting to consider and approve the following:

- the business direction and investment plans of the company;
- the appointment and dismissal of directors and supervisors and their remuneration;
- resolutions on the increase or reduction of the the company's registered capital;
- the issuance of corporate bonds;
- any merger, division, dissolution, liquidation, or change of corporate form;
- the amendment of the company's articles of association;
- the review and approval of reports of the board of directors or supervisors, annual financial budgets, accounting plans, profit distribution plans, and loss recovery plans;
- the company's provision of any security for its shareholders or actual controller; and
- other matters as provided in the articles of association.

In an LLC, at least a two-thirds affirmative vote is required to approve an amendment of the company's articles of association, increase or reduce

registered capital, effect a merger, division, or dissolution of the company, or effect a change of corporate form.

In a listed company, at least a two-thirds affirmative vote of the shareholders present at the shareholders' meeting is required where the company, within one year, purchases or sells major assets or provides guarantees for any amount that exceeds 30% of the company's total assets.

1.9 Calling Shareholders' Meetings Right to Call Shareholders' Meetings

Shareholders in LLCs and joint-stock companies have the right to call shareholders' meetings, provided that they meet the requisite shareholding thresholds (see **1.6 Rights Dependent upon Percentage of Shares**).

Meeting Notice and Information Entitlements LLCs

Shareholders must be informed of a shareholders' meeting at least 15 days in advance, unless otherwise provided in the articles of association of the company or agreed by all shareholders in writing.

Joint-stock companies

Shareholders must be informed at least 20 days in advance of the time and place of a general meeting and the matters to be considered at the meeting, and at least 15 days in advance for an interim general meeting. Holders of bearer shares must be notified by a public announcement, including the above-mentioned items, at least 30 days in advance.

Meetings May Be Held in Person or Remotely

The Company Law allows shareholders to formulate their own rules on holding shareholders' meetings in the company's articles of association, including whether to hold meetings remotely via telephone or other means. In practice,

meetings may be held remotely if the company's articles of association so provide or no shareholder otherwise objects.

1.10 Voting Requirements and Proposal of Resolutions

Voting Requirements at Shareholders' Meetings

The Company Law generally allows shareholders to agree on voting requirements for shareholders' meetings. In practice, the articles of association provide rules as to quorum, voting method, and voting requirements over specified matters. The Company Law requires certain corporate matters to be approved by at least two thirds of shares in the company, see **1.8 Shareholder Approval**.

Right to Make Proposals

LLCs

Shareholders may agree as to the rules and requirements for making shareholder proposals in the shareholders' agreement or the articles of association. The Company Law is silent on this point.

Joint-stock companies

The Company Law stipulates that only shareholders who, individually or collectively, hold at least 3% of shares in the company may submit an interim proposal to the board of directors, in writing, at least ten days before a general shareholders' meeting.

1.11 Shareholder Participation in Company Management

Under the Company Law, shareholders in a company are entitled to participate in important decision-making and to select management. Shareholders elect directors to the board of directors. In practice, shareholders often agree on the allocation of director nomination rights, either in the shareholders' agreement or the company's articles of association, to make sure

the board is not under the sole control of a particular majority shareholder.

Shareholders may directly participate in managing the company, by attending and exercising their voting rights at the shareholders' meeting, or indirectly via the directors and senior management whom they appoint.

1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors

Shareholders have the power to appoint or remove directors by adopting shareholders' resolutions or decisions, subject to the company's articles of association.

Shareholders can request a court to revoke a board resolution within 60 days following the date on which the board resolution was passed, if either (i) the convening procedure or the voting method of the board meeting was in violation of any law, regulation, or the company's articles of association, or (ii) the content of the resolution violates the company's articles of association.

Additionally, if the content of a board resolution is invalid where it violates any law or regulations, shareholders can request a court to confirm that a resolution is invalid due to a violation of the law or regulations.

1.13 Shareholders' Right to Appoint/Remove Auditors

The shareholders maintain the ultimate authority in appointing or removing the company's auditor. The shareholders may either exercise this authority themselves or further delegate it to the board, subject to the company's articles of association. In the case of removal, Chinese law allows the auditor to be present and to make a statement when a removal decision is being deliberated.

1.14 Disclosure of Shareholders' Interests in the Company

The SAMR requires companies to indicate, among others, each shareholder's name, subscribed capital contribution, and shareholding ratio. This information is also made publicly available on the SAMR's online database platform.

Foreign-invested companies are also required to disclose to the MOFCOM their ultimate beneficial owner, not merely their direct shareholder. However, information regarding ultimate beneficial owners is not publicly disclosed.

Naturally, public companies are subject to more stringent disclosure requirements.

1.15 Shareholders' Rights to Grant Security over/Dispose of Shares Grant Security Interests over Equity Interests/Shares

Shareholders in an LLC or a joint-stock company are generally entitled to grant security interests over their shares, unless the company's articles of association provide otherwise. Public companies are subject to special rules formulated by the relevant securities exchange.

Disposal of Equity interests/Shares

- Shareholders in an LLC may freely transfer all or part of their equity interests to existing shareholders, unless the company's articles of association provide otherwise. In the case of a transfer to new shareholders, the transferor must respect the existing shareholders' statutory right of first refusal.

Additionally, the Company Law provides redemption rights to dissenting minority shareholders who vote against a shareholders' resolution with respect to certain major matters concerning the company, including:

- (a) no profit distribution for five consecutive years, though the company has been profitable;
- (b) merger, spin-off, and transfer of principal assets; and
- (c) extending the term of the company.

Shares in a joint-stock company are generally freely transferable, but should be transferred through a stock exchange or other means, as provided by the State Council.

Restrictions on Right of Disposal

- Although the shareholders in an LLC are generally entitled to dispose of their equity interests, restrictions may be imposed in the company's articles of association or shareholders agreement, eg, put/call option, lock-up period, drag-along, co-sale, etc. These restrictions are generally enforceable as long as they are properly documented.
- The shares of a joint-stock company held by promoters, directors, supervisors, and senior management are subject to statutory lock-up periods. Public companies are subject to additional restrictions/rules formulated by the relevant stock exchange.

1.16 Shareholders' Rights in the Event of Liquidation/Insolvency Shareholders' Rights in the Event of Insolvency

In the event that a company becomes insolvent, the shareholders may adopt a resolution to apply to a people's court for bankruptcy protection (including reorganisation, settlement, or bankruptcy liquidation). Where creditors apply to a people's court for bankruptcy liquidation, shareholders individually or collectively holding no less than 10% of the company's registered capital may apply to the people's court for reorganisation of the company, to prevent the company from directly entering bankruptcy liquidation.

During the reorganisation process, shareholders may appoint a representative to attend the creditors' meetings and discuss the reorganisation plan. Shareholders have the right to vote on matters during the creditors' meetings, to the extent the reorganisation plan involves the adjustment of the shareholders' interests.

Shareholders' Rights to Require the Company to Be Put into Liquidation

Shareholders may adopt a resolution to dissolve and liquidate the company. In addition, shareholders individually or collectively holding no less than 10% of the company's voting rights may apply to a people's court to dissolve and liquidate the company, provided that the company experiences serious difficulties in its business and the shareholders will suffer serious damages if the company continues to operate.

Shareholders in an LLC will form a liquidation committee, which will exercise duties and powers on behalf of the company during the liquidation process, which includes clearing company assets, preparing the balance sheet and list of assets, handling outstanding business, disposal of remaining assets, etc. In a joint-stock company, the liquidation committee will comprise members appointed by the board of directors or shareholders, depending on the company's articles of association.

COVID-19 Impact

Since the COVID-19 outbreak, many companies, especially mid- and small-sized firms, have suffered from serious business difficulties, or in some cases have become insolvent. Although Chinese law with respect to shareholders' rights has not changed as a result of the COVID-19 pandemic, in judicial practice, people's courts have tended to rule in favour of the company in dissolution and bankruptcy cases that arise primarily due to the impact of COVID-19, striving to ease the company's business difficulties or

debt burden and to help the company to survive the pandemic.

2. SHAREHOLDER ACTIVISM

2.1 Legal and Regulatory Provisions Defining Shareholder Activism

Chinese corporate law does not articulate what defines shareholder activism, nor are there many relevant precedents in this area in China. It can be understood to refer to non-founder shareholders who use their equity stakes to influence the operation and management of the company to achieve desired outcomes. Companies involved in shareholder activism are usually joint-stock companies where there are a number of shareholders who hold divergent interests. By contrast, LLCs are typically closely held and, in most cases, outside investors cannot become shareholders without the approval of existing shareholders.

Governing Laws and Regulations

Shareholder activism is principally governed by the Company Law and the Securities Law, as both contain provisions that apply to shareholder's rights and corporate governance. China's securities authority, the China Securities Regulatory Commission (CSRC) is empowered to promulgate administrative rules to implement these provisions. Notable among these rules are the Code of Corporate Governance of Listed Companies, the Rules on the Shareholders' General Meetings of Listed Companies, and the Guidelines for the Articles of Association of Listed Companies.

Recent Developments

Shareholder activism has been addressed to an extent in recent years through legislative changes, which have mostly applied to joint-stock companies. The Securities Law was revised

2019 and now contains a chapter that provides investor protections for shareholders' proposals, voting, and other rights. The Code of Corporate Governance of Listed Companies was revised in 2018 to encourage shareholder participation and to specify minority-shareholder protections and more transparent dividend policies, among others.

Recently, in June 2021, the CSRC revised its Standards No 2 on the content of annual reports, which increased recommended and required environmental, social and governance (ESG) reporting for listed companies. This increased disclosure serves two primary purposes:

- it gives regulators greater visibility into the achievement of government policy objectives (such as environmental pollution standards); and
- it enhances shareholder participation by disclosing ESG issues that may be of interest. ESG-related activism is discussed further in **2.2 Level of Shareholder Activism** and **2.4 Targeted Industries/Sectors/Sizes of Companies**.

2.2 Level of Shareholder Activism

Shareholder Activism Remains Uncommon

Shareholder activism is not as prevalent in China relative to other economies, such as the United States or the European Union. This is primarily due to the following reasons.

- Shareholders have ultimate decision-making authority: the shareholders' meeting is the highest decision-making body of a company, which is empowered actively to decide on major corporate matters, including the selection of directors and officers and the approval of major transactions. Requiring majority-shareholder approval for these matters reduces the likelihood of shareholder activism.

- Strong presence of controlling shareholders: the State has majority ownership or control over a significant proportion of Chinese-listed companies. In addition, many other listed enterprises are controlled by founder-managers and their families. Highly concentrated ownership with strongly positioned majority shareholders presents a natural obstacle to any would-be shareholder activist.
- Large proportion of retail investors: the proportion of retail investors in China's stock market is one of the highest in the world. Diffuse equity ownership and unsophisticated investors mean these shareholders are more focused on short-term trading profits than evaluating the long-term performance of managements. In addition, it is more costly and time-consuming for a group of individuals to take action collectively.

Shareholder Engagement Shows a Modest Increase

In general, shareholder engagement in China has shown a modest increase, according to recent joint research published by Fidelity International and ZD Proxy, two consultancies, in Fidelity International China Stewardship Report 2020. The report observes that:

- shareholders' voting participation rose to 26.2% of non-controlling shares in 2019, versus 25.5% in 2017;
- investors engaged more with listed companies on ESG issues; and
- listed companies and managements are making it easier to take part in voting and to initiate ESG engagement.

The reasons for such changes could be due to legislative changes, as mentioned in **2.1 Legal and Regulatory Provisions**, which provide more statutory flexibility for active shareholders as well as the establishment of the China Securities Investor Services Centre (ISC), which

advocates for the rights and interests of small- and mid-sized individual investors.

Activism in Action: Baoneng v Vanke

The most prominent case of shareholder activism in China has been Baoneng Group's 2015 hostile takeover bid for Vanke, a top real estate developer in China. Baoneng Group, a financial services conglomerate, initiated its takeover bid by acquiring open-market A-shares of Vanke through its life insurance unit. Baoneng was later joined by other potential suitors. Vanke's management resisted the takeover by announcing a major restructuring and suspending trade of both its A- and H-shares. During this time, Vanke also sought to introduce Shenzhen Metro, a state-owned entity, as a white knight. The takeover bid ended, however, primarily due to regulatory enforcement intended to end highly leveraged transactions. Among other consequences, the chairman of Baoneng, Mr Zhenhua Yao, was removed from his post and barred from engaging in the insurance industry for ten years.

2.3 Shareholder Activist Strategies

Activist Strategies

The following are strategies that activist shareholders in China could potentially use to exert influence over decision-making in a company.

- Increase shareholdings – activist shareholders can increase their shareholdings either to secure board representation or to put forward shareholder proposals, to exert more influence in decision-making at board meetings and shareholders' meetings.
- Launch proxy contests – while uncommon, activist shareholders who have yet to secure board representation can launch proxy contests to replace members of the company's board of directors.
- Engage with shareholder advocacy groups – smaller investors are encouraged to engage with an investor advocacy group, namely,

the ISC, on shareholder proposals, dispute mediation, and other matters.

- Litigation – any shareholder or a group of shareholders can technically file suit under the Company Law, including against directors or management (i) whose violations of laws and the company's by-laws have caused a loss to the company, and (ii) who have directly damaged their interests (see **3.3 Legal Remedies against the Company's Directors**). In practice, however, activist shareholder litigation is uncommon in China because of stringent legal requirements and because the risk-reward ratio does not favour initiating such actions.

Shareholder Activist Agendas

While it remains uncommon, shareholder activism is encouraged where it aligns with prevailing government policy goals, such as ESG issues.

COVID-19

These strategies and agendas with respect to listed companies have not noticeably changed in China due to the COVID-19 pandemic.

2.4 Targeted Industries/Sectors/Sizes of Companies

Shareholder activism in China is not as common as in other jurisdictions, for the reasons discussed in **2.2 Level of Shareholder Activism**. No particular industries or sectors are especially known to be the typical targets of activist shareholders in China.

With respect to overall trends, two developments are being seen as having an impact on shareholder participation, particularly with regard to ESG issues:

- the expansion of recommended and mandatory ESG disclosures under CSRC Standard No 2 (See **2.1 Legal and Regulatory Provisions**); and

- greater participation of global institutional investors in China. In this respect, the belief is that there will be greater shareholder focus on ESG issues and for larger institutional shareholders to play a guiding role.
- providing mediation and settlement services on behalf of individual investors;
- investigating and monitoring investors' needs and demands, and carrying out strategic research and planning; and
- advocating on behalf of investors with government and regulatory authorities.

2.5 Most Active Shareholder Groups

Going forward, global institutional investors are expected to play a greater role in shareholder engagement, stewardship, and activism in China. The ISC is also expected to continue to play an important role in advocating for smaller shareholders.

Global Institutional Investors

China reduced foreign investor restrictions in the fund management industry in 2020. In response, many global institutional investors have moved forward with business expansion plans in China. For example, BlackRock has plans to expand into China's capital markets, having recently obtained approval to set up a fund management company. In its proxy voting guidelines for China, BlackRock emphasises its intent, among others, to support ESG initiatives and to vote at all general and interim shareholders' meetings where it is authorised to do so. In this regard, greater institutional shareholding in China may result in an increase in shareholder engagement, stewardship, and activism.

ISC Advocacy

The ISC plays an important role in the development of shareholder activism. The ISC was founded on 5 December 2014 and is a non-profit financial institution directly administered by the CSRC. The ISC primarily functions as an advocate for individual shareholders in the following ways:

- non-profit education and promotional activities on behalf of individual shareholders;
- non-profit holding of securities to exercise shareholder rights;

The ISC has been active in exercising these responsibilities. According to media reports, by the end of April 2021, the ISC had exercised shareholder rights 3,687 times, including proposal rights, voting rights, and others. The response rate by managements to questions raised by the ISC was 71.17%, and companies' adoption rate for ISC-initiated proposals was 65.47%.

2.6 Proportion of Activist Demands Met in Full/Part

Due to limited shareholder activism in China, there are no publicly available statistics on the proportion of activist shareholder demands that have been met in full or in part. However, minority shareholder involvement in making proposals is exceedingly rare. According to Fidelity International's 2017-19 survey data, only 1.4% of all shareholders in the study submitted proposals, and only 5% of the proposals were from minority shareholders.

2.7 Company Response to Activist Shareholders

Shareholder activism in China tends to be quite limited, for the reasons discussed in **2.2 Level of Shareholder Activism**. Based on limited anecdotal observations, managements have been seen to respond to activist shareholder demands in the following ways.

Acceding to Activist Demands

There have been instances where managements have recently acceded to minority shareholder demands with respect to:

- increasing dividend pay-outs;
- downsizing management incentive packages; and
- increasing ESG disclosure.

Compromising: Sweetening the Deal for Minority Shareholders

Managements may offer better deal terms in response to minority-shareholder complaints. For example, in one instance, the management offered revised deal terms to minority shareholders in a preferential share issuance to the controlling shareholder. To compensate the minority shareholders, the revised deal terms offered to increase dividend pay-outs and to take steps to increase the company's profitability.

Resisting Activist Demands

In extreme cases, managements have taken measures to resist activist demands. These measures have included:

- cancelling interim shareholders' meetings to avoid consideration of shareholders' proposals;
- seeking out a deal with a white knight investor (see **2.2 Level of Shareholder Activism**, Baoneng v Vanke); and
- suspending trading of shares (see **2.2 Level of Shareholder Activism**, Baoneng v Vanke).

3. REMEDIES AVAILABLE TO SHAREHOLDERS

3.1 Separate Legal Personality of a Company

Chinese law recognises companies as having legal personalities separate from their shareholders. Shareholders are generally not held liable for the debts of their companies beyond their subscribed and contributed capital.

However, the principle of "piercing the corporate veil" may apply where a shareholder has abused its limited liability status at the expense of creditors in violation of provisions of law, administrative regulations, or the company's articles of association.

3.2 Legal Remedies against the Company

Shareholders in a company are entitled to legal remedies against the company. In particular, minority shareholders often seek legal remedies to protect their interests and statutory rights.

Shareholders typically pursue remedies against the company in disputes over:

- shareholders' right to access information (see **1.7 Access to Documents and Information**);
- adoption of shareholders' resolutions (see **1.12 Shareholders' Rights to Appoint/Remove/Challenge Directors**);
- requests to redeem shares (see **1.15 Shareholders' Rights to Grant Security over/Dispose of Shares**);
- dissolution of the company (see **1.16 Shareholders' Rights in the Event of Liquidation/Insolvency**); and
- payment of dividends.

In less common instances, shareholders may pursue legal remedies against the company over administrative matters, such as to be registered with the SAMR as a shareholder in the company. These causes of action include:

- determination of shareholders' qualifications;
- records of shareholders' registers; and
- requests to change the company's registration.

3.3 Legal Remedies against the Company's Directors

Shareholders may be entitled to pursue legal remedies against the company's directors and senior management, through either direct or derivative action.

Shareholder Direct Action

Any shareholder in an LLC or a joint-stock company can file suit directly against directors and senior management who, in undertaking their duties, harm the interests of the shareholders in violation of any law, regulation, or the company's by-laws.

Shareholder Derivative Action

Shareholders may be entitled to file derivative actions against directors and senior management, including where they cause harm to the company while undertaking their duties, in violation of any law, regulation, or the company's by-laws. For more details on shareholder derivative actions, see **3.6 Derivative Actions**.

3.4 Legal Remedies against Other Shareholders

Shareholders in an LLC or a joint-stock company may pursue legal remedies against the company's other shareholders through derivative action. For details on shareholder derivative actions, see **3.6 Derivative Actions**.

Shareholder Derivative Action

Abuse of related-party transactions

Shareholders are expressly entitled to take action against controlling shareholders and ultimate controllers who infringe the company's interests through abuse of related-party transactions. For this purpose, "control" may arise from direct or indirect majority shareholding or where it is otherwise demonstrated that the party exercises significant influence over the resolutions of the board of shareholders or the shareholders' general meeting.

Other causes of action

Shareholders are generally entitled to file derivative actions against any party that infringes the legal rights and interests of the company, which includes other shareholders and their controllers.

3.5 Legal Remedies against Auditors

Shareholders, including minority shareholders, are entitled to pursue legal remedies against the company's auditors and advisers, either directly or derivatively.

Shareholder Direct Action

Any shareholder in an LLC or a joint-stock company may directly file suit against auditors and advisers whose work product causes actual harm to the shareholder. These shareholder direct actions are brought principally under the Securities Law or in tort.

- Securities Law – auditors and advisers must show affirmatively that they were not at fault in instances where their work product has harmed a third party, which includes company shareholders.
- Tort – based on judicial interpretation, auditors and accountants are rebuttably presumed liable in tort where they issue a false report that harms a third party, which includes the company's shareholders.

Shareholder Derivative Action

Shareholders may also pursue legal remedies against auditors, advisers, and other third parties in a derivative action, the requirements for which are discussed in **3.6 Derivative Actions**.

3.6 Derivative Actions

Shareholders in an LLC or joint-stock company may file derivative actions on behalf of the company under causes of action that include those discussed in **3.3 Legal Remedies against the Company's Directors**, **3.4 Legal Remedies**

against Other Shareholders, and 3.5 Legal Remedies against Auditors.

Shareholder Eligibility

To file a derivative action, shareholders to the action must have held, individually or collectively, at least 1% of the company's shares for at least 180 consecutive days prior to the action.

Commencing the Derivative Action

The shareholders to the action should make a request in writing to the company's supervisor(s) or board of supervisors. Shareholders themselves can initiate the action on behalf of the company under certain circumstances. This includes exigent circumstances and where the company's supervisor(s) or board of supervisors refuses to initiate the action or fails to do so within 30 days of receiving the shareholders' request.

Remedies and Costs

Any remedies shareholders obtain in a derivative action belong to the company. Thus, shareholders can only realise remedies indirectly through their shareholdings. For this reason, larger shareholders tend to be more active in derivative actions.

Shareholders' costs of litigating the action are borne by the company only to the extent that they are reasonable. Shareholders must therefore be mindful of whether their litigation costs are indeed reasonable, in order to be reimbursable by the company.

3.7 Strategic Factors in Shareholder Litigation

Shareholders are entitled to pursue legal remedies under various causes of action against the company, directors and officers, other shareholders, and third parties such as auditors, as discussed in **3.2 Legal Remedies against the Company**, **3.3 Legal Remedies against the Company's Directors**, **3.4 Legal Remedies against Other Shareholders**, **3.5 Legal Remedies against Auditors**, and **3.6 Derivative Actions**. When considering legal action in China, shareholders typically consider:

- selecting primary causes of action that are most achievable and relevant to their objectives;
- determining whether to act as joint claimants in the same action, which will depend upon whether their interests are fully aligned;
- undertaking strategic moves necessary to support their primary causes of action, such as gaining access to company files through an interlocutory measure or independent suit; and
- potential remedies and assumption of costs, including whether it is more advantageous to initiate a direct or derivative action (see **3.6 Derivative Actions** for recovery and costs in derivative actions).

Han Kun Law Offices is a leading full-service law firm in China with over 600 professionals located in four offices in Beijing, Shanghai, Shenzhen, and Hong Kong. The firm's main practice areas include private equity, mergers and acquisitions, international and domestic capital markets, investment funds, asset management, antitrust/competition, banking and finance, aviation finance, foreign direct investment, compliance, private client/wealth management, intel-

lectual property, and dispute resolution. Han Kun provides a full range of legal services and business advice to Chinese companies and multinationals doing business in China. Over the years, Han Kun has been widely recognised as a leader in complex cross-border and domestic transactions that cover foreign investment access, industry compliance, labour and national security review, taxation, foreign exchange, and intellectual property.

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