Effective since 1994, the first national corporation law of the People's Republic of China ("PRC" or "China")\(^\dagger\) pursues a distinctive mission: to meld the organizational structure of Western capitalist business into a political and
economic regime that maintains socialist principles and goals. The Eighth National People's Congress adopted the Corporation Law ("Law") in 1993, plainly modeling it on American and other Western corporation codes. The Law, however, should not be expected to produce business entities comparable to American corporations in the near future.

The Corporation Law represents a key element in the program of economic reform that China began in 1978.\textsuperscript{2} Through this program, the Chinese government aims to standardize and modernize enterprise organization and practice.\textsuperscript{3} The Corporation Law of 1993 thus supersedes provisional corporate regulations of the central government and two municipalities.\textsuperscript{4} It also constitutes one part of a general process of "legalization," the replacement of the traditional emphasis on policy and propriety\textsuperscript{5} with codified law and legal institutions.\textsuperscript{6}

The primary purposes of the law are (1) to restructure the organization and management of state-owned enterprises; (2) to address serious, chronic, and seemingly intractable problems of inefficiency; (3) to promote competition and productivity; and (4) to remove the state from detailed management of business


\textsuperscript{3} Wu Naitao, \textit{Guarantee for Modern Enterprise System}, \textit{BEIJING REV.}, Apr. 4-10, 1994, at 14.


\textsuperscript{5} The Confucian concept of "li," or standards of social conduct, was traditionally considered far superior to narrow legalistic rules, known as "fa." Codified law was seen as unnecessary and abhorrent. Since 1979, however, this view has bowed to the demands of foreign investors, and modifications of traditional ideology and a "frenzy of codification" have resulted. Barbara Campbell Potter, \textit{China's Equity Joint Venture Law: A Standing Invitation to the West for Foreign Investment?}, 14 U. PA. J. INT'L BUS. L. 1, 4-6 (1993).

\textsuperscript{6} Twenty laws were promulgated in 1993, and many of them went into effect in 1994. These include the Corporation Law, the Law on the Combatting Unfair Competition, the Law on Protecting the Rights and Interests of Consumers, and the Teachers' Law. Reports indicate that the National People's Congress is currently intensively drafting or deliberating on 152 laws, including 54 concerning economic legislation. Geng Yuxin, \textit{Reform Advance Relies on Legislation—Coverage of the NPC and CPPCC Sessions}, \textit{BEIJING REV.}, Mar. 14-20, 1994, at 4 [hereinafter Geng Yuxin, \textit{Reform Advance}]. Gaps in the statutory framework are readily apparent. For example, despite the pervasiveness of embezzlement, corruption, bribery, and other misconduct, China lacks laws to combat or deter these abuses. Huang Wei, \textit{Call to Promote Socialist Culture and Ethics}, \textit{BEIJING REV.}, Apr. 25-May 1, 1994, at 9, 13.
operations. This reform, however, should not be confused with privatization; the state will maintain ultimate control and majority ownership of the largest enterprises pursuant to a policy we term "corporatization."

A secondary function of the Corporation Law is to countenance, and even to promote, the development of small private enterprises. The Law envisions the private sector not as a substitute for state industry but rather as a necessary supplement that will be particularly useful in ameliorating current problems of unemployment and inefficiency in the national economy.

Like much of the recent legislation, the Corporation Law uses forms and conventions drawn from American and other Western law and represents an important step toward international business practices. For example, the Law provides for stock with par value and dividends; shareholders with limited liability, preemptive rights, and the power to elect directors; and directors with fiduciary duties and the power to appoint officers.

Differences from Western models bracket this general similarity at both the broad level, in ideology and overall objective, and the technical level, in details and specific rules. The melding of Western forms with the goal of promoting a "socialist market economy" has produced a Corporation Law with distinctly Chinese characteristics.

Most fundamentally, the Corporation Law focuses on state-owned enterprise rather than on entrepreneurial, capitalist business. Western corporate principles are blended with traditional concepts in Chinese law such as the "legal representative," an individual who has the authority to bind a legal entity and who is personally liable for misconduct. Other distinctive elements of the Corporation Law include an extraordinarily extensive grant of power to shareholders and provision for a "board of supervisors" to oversee the board of directors. In addition, workers play a role in determining corporate policy, and the rules governing profit allocation incorporate workers' welfare. Finally, the Law relies primarily on administrative sanctions rather than on derivative actions to deter and punish misconduct by managers.


8. Article 1 of the Corporation Law announces its purpose, "to promote the development of a socialist market economy." Similarly, Chapter 2, Section 3, which covers wholly state-owned corporations, reflects the spirit of the Chinese Constitution: "The basis of the socialist economic system of the People's Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people." *XIANFA [Constitution] art. 6 (P.R.C.).*

After briefly reviewing the historical and economic context in which the Law arises, this Article will analyze the ideological and policy underpinnings of the Corporation Law. Its core purpose was to remove government from routine, close business management without abandoning the central socialist precept that the people own the primary means of production. The Article then examines the specific provisions adopted to pursue these goals, including the rules of corporate organization and governance, liability, and stock and dividends.

The Conclusion reflects on the importance of the Corporation Law as a milestone in the development of Chinese ideology and policy. The Law establishes an organizational blueprint that offers great promise for solving China’s chronic economic problems and, ultimately, for fully privatizing business. Success, however, will depend on the government’s resolve to enact reforms well beyond corporate law. Unless the government accepts the full rigor of the market system by withdrawing state subsidies and permitting uneconomic state enterprises to fail, the result will be a mere facade of a modernized economy. In that event, the Corporation Law is likely to join a long succession of unsuccessful past efforts to reform Chinese state enterprise.

I. Economic and Historical Context of the Current Reforms

Contemporary corporate legislation in China must be understood as the outgrowth of earlier twentieth century attempts to reform the nation’s economic policy. Such attempts have been aimed, in successive and distinct stages, at two issues — how to reform and reorganize state-owned enterprise for greater efficiency and productivity, and what place, if any, private business should occupy in China’s overall economy.

A. Persistent Problems in Managing State-Owned Enterprise

Since the country was established, the dominant feature of economic organization in the People’s Republic has been enterprise owned by the state as the representative of “the whole people.” State-owned enterprises are the principal producers of energy, transportation, telecommunications, raw and semi-finished materials, and industrial and technical equipment. In 1993, the state sector employed nearly 110 million workers, vastly more than collectives and private sector businesses combined (though vastly fewer than the agricultural sector). State-owned enterprises, which constitute only 19 percent of total enterprises, are also the main source of national revenue. The 71,600 state-owned industrial enterprises in China produced 53% of the country’s total industrial output in 1993. State-owned enterprises also provided over 67% of

10. Geng Yuxin, Reform of State Enterprises to Enter New Stage, BEIJINg REV., Nov. 21-27, 1994, at 4 [hereinafter Geng Yuxin, Reform of State Enterprises].
state revenues and financed state policies to benefit enterprises operated by collectives as well as by private, foreign, and other business owners.\(^\text{12}\)

Despite its dominance in China’s economy, the state-run system has suffered chronically from losses, inefficiency, and insufficient productivity. Chinese government statistics show that approximately one third of state-owned enterprises are losing money, largely because of poor management.\(^\text{13}\) Many state enterprises are billions of dollars in debt.\(^\text{14}\) Some, although faced with insufficient demand, rely on loans from state banks to maintain production and merely stockpile their products.\(^\text{15}\) A substantial portion of workers officially employed by state enterprises are in fact *xia gang*, or “off-post” — a euphemism for workers who are employed on paper but are not expected to report for work and thus are paid only a fraction of their previous income.\(^\text{16}\) Subsidies to keep those enterprises in operation lay a heavy burden on the government, a burden the current reforms are intended to relieve.\(^\text{17}\)

Three problems underlie the condition of state-owned enterprises: lack of autonomy (the inability of an individual enterprise to manage its own production and make other key decisions), lack of initiative, and lack of adequate incentives for efficiency and productivity. Traditionally, state ownership of the means of production meant that factory managers were responsible to the relevant ministry’s bureaucracy.\(^\text{18}\) Furthermore, China rejected two practices that amount to fundamental tenets of Western capitalist systems: paying higher wages for more or better work and discharging workers for unsatisfactory performance.\(^\text{19}\)

China adopted central planning to avoid the perceived defect of “blind competition” in a free market economy. Chinese Marxist theoreticians understood Adam Smith’s theory of the “invisible hand,” wherein individual firms, each oriented toward its own benefit, unintentionally maximized aggregate efficiency and productivity. They nonetheless deemed the byproduct of that process — periodic economic crisis, including depressions and high unemployment — to be unacceptable. Organizing enterprises to work cooperatively within an overall plan seemed more productive but in practice stripped each enterprise of the freedom and incentive to manage its operations efficiently.

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16. Governmental reluctance to admit true levels of unemployment masks the reality that as many as 20 million urban workers and 5 million government employees may be effectively unemployed. Kahn & Smith, *supra* note 11, at A8.


18. *Id.* at 101.

19. See, e.g., Potter, *supra* note 5, at 30-31, (noting, for instance, that management of foreign joint ventures could not hire and fire according to worker’s performance except in Special Economic Zones).
In addition, the government’s use of state enterprises for both production and delivery of welfare services constitutes a further structural impediment. Chinese enterprises routinely provide their workers with housing, medical care, pensions, and a host of other social services and benefits as part of the “iron rice bowl” of lifetime employment and social benefits. The work-unit system performs these welfare services that Western countries deliver not through business organizations but through government agencies. Thus, for China’s state-owned enterprises, profitability is neither the central goal nor a likely outcome.

To reform the system, the Chinese government has tried a succession of approaches with little success. For instance, in 1961, the government designated state industrial enterprises “companies,” but these operations remained essentially administrative units of the government. The government next experimented with economic organizations called “trusts” that integrated manufacturing and distribution functions in the industrial and communication sectors. In 1985 and 1986, State Council regulations authorized “economic unions” with a similar purpose.

Concurrently with these later reforms, the government worked towards a new company law, drafting seven versions over a ten-year period. A significant ideological development occurred during the drafting process at the Plenary Session of the Communist Party Central Committee in 1984. As part

21. State enterprises’ services to employees encompass housing, medical care, public security, local police stations, nurseries, schools, savings banks, and tax offices. Geng Yuxin, Reform of State Enterprises, supra note 10, at 4. The state, through work units, also provides extensive benefits to seventy percent of China’s 147 million nonfarm workers. These benefits include housing, medical care, schools, and entertainment, such as the free use of skating rinks and amusement parks. Jesse Wong, In China, the Welfare State Hangs On, Burdening Already-Stressed Companies, WALL ST. J., Aug. 23, 1994, at A9.
22. Wang, supra note 14, at 93, 131; Geng Yuxin, Reform of State Enterprises, supra note 10, at 4; Wu, supra note 12, at 7.
24. The Chinese government established two kinds of trusts: the national unified trust (such as the Automobile Industrial Company) and the local trust (such as the Yangzhi River Shipping Company). The term “trust” denotes something similar to the form of business structure that American “antitrust” laws target, but without the negative connotations. Id. at 19.

The Council intended to consolidate particular industries from the manufacturing stage through the product distribution stages into a single entity. Economic unions would be formed voluntarily, not by administrative order. The form would not be restricted to certain occupations, districts, or types of property; economic unions could be group enterprises, enterprise blocs, integrated complexes, etc. Either existing enterprises or new investment initiatives could create new economic unions. Id.
of a call for comprehensive economic reform, including greater autonomy for enterprises, the central committee indicated that ownership and management of state-owned enterprises "may be appropriately separated."  

The People's Congress codified this ideological shift in 1988 when it enacted the Law on Industrial Enterprises Owned by the Whole People. The law assigned responsibility for management to enterprise managers but preserved the roles of the Communist Party and of government agencies in controlling business operations. Enterprise managers received "operating rights" designed to permit greater autonomy in the use of state-owned assets, but these rights were vague and poorly designed. That same year, the government adopted the "responsibility contract system," in which state enterprises and their supervising governmental agencies agreed on the means of management and distribution of profits. Because the government retained the authority to appoint managers, specify profits, and dictate the terms of the agreement, however, this reform effected little improvement.

The reforms of this progression shared a common failure to provide meaningful enterprise autonomy or incentives for enterprise efficiency. As a result, none succeeded in adequately improving productivity or profitability.

In the mid- to late 1980s, Chinese economists began developing new theories on stock companies. Building on a reference by Karl Marx, scholars explored the stock company as a possible form of capital ownership by the organized working people. They argued that the corporate form and advanced business management skills developed in capitalist countries could benefit a socialist system as well.

This approach was analogous to China's decision to abandon its commitment to "austere self-reliance" and to encourage the importation of foreign technology. That policy reversal claimed to "make foreign things

29. Wang, supra note 14, at 98-99. Communist Party representatives within each enterprise remained responsible for promoting Party principles, and government agencies continued to enforce extensive rules. Directors wielded some discretionary power, subject to approval by a workers representative assembly and various government departments.
30. "Operating rights" seemed to provide the rights to possess, use, and dispose of state-owned property. Significant regulatory restrictions circumscribed each of these rights, however. The rights also could not be asserted against the state. Thus, for example, the state could reassign operating rights to a different enterprise without incurring liability and could regulate the use of the property. Moreover, operating rights did not include the right to benefit from the rights of possession, use, and disposition. Id. at 102-12. Overall, the statute provided enterprise managers little opportunity for independent decisionmaking and did not improve efficiency. Id. at 98-100.
31. Id. at 119. A more positive interpretation of the course of reform from 1978 to the current Corporation Law comes from the Minister of the State Commission for Restructuring the Economy. See Li Tieying, supra note 12, at 15.
34. Wang, supra note 14, at 119-21; Zheng, supra note 4, at 604-05 (citing Tong Dalin, Gufenhua Shi Shehut Zhuyi Qixe De Yige Xinjidian [Stock Company Being a New Starting Point of Socialist Enterprises], PEOPLE'S DAILY, Aug. 8, 1986, at 2).
serve China and achieve greater, faster, better, and more economical results in building socialism. In the same vein, the government opened the path to reform by recasting Western corporate law not as wedded to laissez-faire capitalism, but rather as a foreign construction readily adaptable to serving China in accordance with socialist principles.

Finally, on December 29, 1993, the Fifth Session of the Standing Committee of the Eighth National People's Congress adopted the first Corporation Law for China. This legislation is expected to play a major role in the standardization of business organizational structure and business practice for large sectors of the socialist market economy. It is also seen as an important first step in China's development of a modern enterprise system. Under the new law, the corporation will become the most important form of Chinese enterprise organization.

B. The Role of Private Business in the Overall Economy

National policy and attitudes regarding privately owned enterprise have fluctuated dramatically during the history of the People's Republic. After 1949, all pre-revolutionary laws, including a company law, were initially abolished. Nonetheless, more than 10,000 private companies continued to exist, and securities exchanges operated in Tianjin and Beijing until around 1952. Provisional Regulations issued in 1950 and 1951 recognized several business forms, some of which offered limited liability to investors.

The 1954 constitution, however, announced a policy "to use, restrict and transform" capitalist business, and to "gradually replace capitalist ownership with ownership by the whole people." By 1956, China had transformed virtually all private businesses into joint state-private enterprises, thereby...
eliminating the last vestiges of capitalism. Some individual firms were restored between 1957 and 1965, only to be later ruthlessly suppressed during the Cultural Revolution as the "tails of capitalism." The 1975 Constitution recognized socialist ownership only.

In 1978, Communist Party policy shifted from strict adherence to socialist state ownership to modernization and economic reform. New policies permitted small-scale individual and household businesses with limited authority to hire outside workers. Later policies imposed even fewer restrictions on private businesses. The 1982 Constitution and 1986 General Principles of Civil Law further encouraged the growth of the private economy by allowing businesses to hire larger numbers of employees. Moreover, an amendment of the constitution in 1988 expressly authorized the development of a private economy.

Such efforts to stimulate private industry have been quite successful. In 1993, private enterprise employed approximately 15 million workers. Although this number comprises only a fraction of those employed in the state sector, it is growing far more rapidly. Five years earlier, only 3.7 million people had worked in private enterprises.

Stock exchanges opened in Shanghai in 1990 and in Shenzhen in 1991. In 1992, Deng Xiaoping endorsed the operation of such capitalist instruments as securities and stock markets to operate within the socialist system.

This expansion of private enterprise has not been without difficulties.
Notably, in 1989, the government, motivated in part by concern over "bourgeois liberalism," pursued many private businesses for tax evasion and other offenses. That campaign, however, appears to have run its course.

II. MOTIVATION AND IDEOLOGICAL ISSUES

The Corporation Law is designed both to restructure state enterprises on international capitalist models and to legitimate a much smaller private sector. The Chinese government's pursuit of these goals entails major ideological adjustments. At one time, the Chinese government prohibited even discussion about establishing corporations or private ownership of stock because it deemed such concepts inconsistent with, or even heretical to, China's political and economic system. The Law now endorses notions previously anathema to Chinese domestic law, such as profits and dividends, that once meant income derived from exploiting the working class.

A. Reforming State Enterprises: Corporatization, Not Privatization

In most countries, a policy of privatization shifts control over industries and production from the state sector to private hands. The state relinquishes ownership by sale of entire enterprises to investors, typically in the form of shares. In the short term, the government enjoys the liquidity of the cash received; in the long term, it reaps the advantage of greater efficiency and improved management that results when industry is freed from close governmental control and subjected to the rigors of the market.

This form of privatization is neither a motivation for, nor consistent with, the intent of recent reforms in China. The Corporation Law repeatedly reaffirms China's commitment to socialism. Indeed, the Law's very first pronouncement is the purpose of "maintaining the social economic order and promoting the development of a socialist market economy."

China's program is not privatization of the sort experienced by the nations of formerly communist Eastern Europe. A better description of it is

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53. Conner, supra note 4, at 33-42. General Secretary Jiang Zemin accused private entrepreneurs of profiteering, tax evasion, and exploitation. Party pronouncements emphasized the need for better supervision of private businesses, though continuing to characterize them as a helpful and necessary supplement to the socialist economy. Tax enforcement increased as well. Policies had moderated by 1991. Id.

54. Qian, supra note 7.

55. Potter, supra note 3, at 14 (noting that terms such as "profits" in 1979 Joint Venture law lacked meaning in socialist legal system and made statute too vague to provide certainty to foreign investors).

56. Zheng, supra note 4, at 604 n.387 (citing 2 Xu DIXIN, DICTIONARY OF POLITICAL ECONOMICS 40 (1980)).


58. Corporation Law, art. 1.

“corporatization,” a more limited reform. Corporatization entails restructuring state enterprises, adopting the corporate form, and instituting stock ownership and trading without necessarily relinquishing the state’s controlling interest in the means of production.60

A critical feature of corporatization is the Chinese government’s retention of majority ownership in state enterprises that it has converted to the corporate form.61 By retaining this stake, the government preserves the Marxist-Leninist principle of ownership of the means of production by the people, as represented by the state.62 Sale of minority interests in these corporations’ stock allows the government to draw private capital into state enterprises without ceding ultimate control.63

This policy of corporatization supports several goals of the Chinese government. First, it channels the massive private savings of Chinese citizens into productive ventures.64 Second, it may diminish the potential threat that

60. See, e.g., Qian, supra note 7, at 91-92.
61. Bersani, supra note 4, at 303. The government has retained 51%-80% of the enterprises listed on stock exchanges. Ren Kan, The State of the State’s Shares, BUS. WKLY., CHINA DAILY, May 3, 1993, at 3, cited in Bersani, supra note 4, at 306 n.9. According to another commentator, “Safeguards in the securities laws will guarantee the state’s controlling ownership and interest in shareholding enterprises.” Qian, supra note 7, at 63. As early as 1986, Chinese scholars developing the ideological foundation for integrating the corporate form into a socialist system addressed the concern of dilution of public ownership. They stressed that the state would remain the majority shareholder in most instances. Zheng, supra note 4, at 605 (citing Tong Dalin, Gufenhua Shi Shehui Zhuyi Qixe De Yige Xinjiduan [Stock Company Being a New Starting Point of Socialist Enterprises], PEOPLE’S DAILY, Aug. 8, 1986, at 2).

62. As stated in Article 6 of China’s 1982 Constitution, “The basis of the socialist economic system of the People’s Republic of China is socialist public ownership of the means of production, namely, ownership by the whole people and collective ownership by the working people.” XIANFA [Constitution], translation available in LEXIS, Intlaw Library, Chinalaw File. Indeed, ownership of the means of production may be seen as a primary justification for the existence of the state. Privatization would therefore undercut the ideological basis of the government. Bersani, supra note 4, at 305; Gordon, supra note 57, at 519. Bersani cites a constitutional amendment, approved by the National People’s Congress on March 29, 1993, changing the designation of state enterprises from “state-run” to “state-owned,” XIANFA [Constitution] amended by art. VII, and a statement by Premier Li Peng of the government’s determination to create independent management for public enterprises. Bersani, supra note 4, at 304.

63. Bersani, supra note 4, at 303; see also Dai Yannian, Spotlight on China’s Modern Enterprise System, 37 BEIJING REV., Feb. 28-Mar. 6, 1994, at 4 (explaining that state will continue to own dominant portion of society’s total assets, but that corporations will manage them, together with other assets, in improved manner with clearly defined property rights). This new variation has been called "Market Leninism." See, e.g., Nicholas Kristof, China Sees "Market-Leninism" as Way to Future, N.Y. TIMES, Sept. 6, 1993, at A1, A5 [hereinafter, Kristof, Way to Future]. Some Chinese intellectuals are concerned that China may develop in the direction of fascism, with state-controlled corporations competing under market conditions but in an authoritarian political system. Id. (referring to “some young Chinese intellectuals”). Chairman Mao warned of this risk in 1963: “We are afraid that we will stop being a revolutionary country and will become a revisionist one. When that happens in a socialist country, it becomes worse than a capitalist country. A Communist Party can turn into a fascist party.” Id. at A5. Others think that free markets will lead China to a more open political system. See, e.g., Marcus W. Brauchli, Chaotic Change: Beijing’s Grip Weakens as Free Enterprise Turns into Free-for-All, WALL ST. J., Aug. 26, 1993, at A1. Concern that economic reforms might create a new bourgeoisie, threatening socialism, was one factor behind a campaign against private business in 1989, which appears to have run its course. Conner, supra note 4, at 33-42.

64. Bersani, supra note 4, at 304. In 1992, PRC citizens held U.S. $310 billion in private savings, in comparison to only $240 billion in assets held by the state. Id. at 304 n.4 (citing E. ECON. REV., April 1, 1993, at 83). A 1993 report noted that savings deposits of urban and rural residents increased 27.9 percent over the 1992 figures and that “energetic efforts to absorb savings deposits” were a priority of government financial policy. Statistical Communiqué of the State Statistical Bureau of the People’s Republic of China on the 1993 National Economic and Social Development (February 28, 1994), BEIJING REV., Mar. 14-20, 1994, at 24 [hereinafter Statistical Communiqué].
private financial resources pose for the government.\(^6\) Third, and of central importance, it will improve management of state enterprises, which suffer from chronic low productivity, inefficiency, and poor management. In sum, then, the state will continue to regulate the economy, but as a sovereign implementing policies of general application rather than as an owner micro-managing individual enterprises.\(^6\) Even with this new orientation, however, political pressures will prod the government to intervene in some specific decisions, such as wage levels.\(^6\)

One tactic the Chinese government is using to fulfill these goals is the assignment of state-owned shares to local state property administration departments.\(^6\) Formerly, state shares were assigned to the enterprise’s president, who had no direct stake in the state property. As a result, these representatives for the state’s shares often failed to ensure that the state received the proper bonus shares and dividends, thereby causing a drain on state assets.\(^6\)

Under a 1994 pilot program, the State Economic and Trade Commission announced that government departments will launch wholly state-owned investment or holding companies to separate ownership of state enterprises from management more clearly.\(^7\) A few of these holding companies have already been organized in areas at the forefront of enterprise reform, such as Shenzhen, Shanghai, and Beijing.\(^7\) The assignment prevents the government from nominating a state enterprise’s senior staff. Instead, the holding company’s directors, themselves selected in accordance with the Corporation Law, choose the general managers.\(^7\)

Ceding increased autonomy to enterprises does not, by itself, ensure either accountability or efficiency. Indeed, the decentralization and deregulation in recent years have sometimes resulted in managerial abuses. Without the discipline of the stock exchanges and the oversight of government officials, some managers have treated state assets like their own private property. Some, for instance, have purchased expensive foreign automobiles and other luxuries

\(^{65}\) Bersani, supra note 4, at 304; see also Kristof, Way to Future, supra note 63, at 5.

\(^{66}\) Clarke, supra note 2, at 15-16 (analyzing roles of law and direct state management in Chinese policy); Dai, supra note 63, at 4 (reforms are “designed to separate government administration from enterprise management, gaining expanded decision-making power and altering management methods”). A clear and comprehensive statement of the government’s rationale for the Corporation Law and allied reforms is in Wu, supra note 12, at 7.

\(^{67}\) In 1993, in response to public indignation, the government issued specific directives on wage increases that seemed to contradict its previous promise to limit itself to macro-economic policies. Brauchli, supra note 63, at A1.


\(^{69}\) Under the new policy, the representative of state shares will be the local state property administration department, an institution that is responsible to the state and therefore more likely to demand better treatment for the state shares. Id.


\(^{71}\) Shenzhen Gives Firms, CHINA DAILY, supra note 15, at 4.

\(^{72}\) Further Reforms, supra note 70, at 5. Electing directors under the Corporation Law, of course, does not preclude the government from determining who is on the board when the government is the majority shareholder.
nominal for the enterprise. In the words of one local government official, "[m]any state factories have become an empire, with the general manager as the emperor who is accountable to nobody." These enterprises have nevertheless continued to rely on the government for subsidies and loans and for protection against business failure. Many enterprises not only pay little or no taxes, but in fact drain government finances.

Supporters of the new law hope that the participation of private shareholders in selecting directors and managers will increase managerial accountability and improve economic performance. Permitting employees to own stock may also increase their performance incentives at the shop floor level.

The full potential of corporatization, however, will be realized only if the government permits market forces to operate with their full rigor and accepts certain attendant painful consequences like unemployment and dislocation. Subsidies must be removed and economically unviable state enterprises must be permitted to fail. Until that happens, managers and corporations will lack the incentives to improve efficiency and productivity as the reforms envision.

The government recognizes in the abstract that some state enterprises will not be able to compete on the free market and will be forced into bankruptcy. To date, however, examples of such bankruptcies are few, and the process of bankruptcy is deemed experimental. A principal reason bankruptcy remains rare is the absence of a state-operated unemployment compensation or other social insurance system to ameliorate the effects of bankruptcy on workers. Moreover, permitting enterprises to default on loans from state banks—which have often granted funds to enterprises to keep them in operation even when their production was not needed—would inflict huge losses on those state banks. Until inefficient state enterprises are in


74. Id. (quoting Liu Shiyi, vice mayor of Shunde, China). He added, "They hardly pay taxes. Instead, they squander the money on fancy office buildings and fast cars, and we have no way of restraining their lavish spending." Some managers even pass on managerial control to their sons or other relatives. Id.

75. Id. One example is Shougang Corporation, a Beijing-based steelmaker that purchased an iron mine in 1992, paying more than double the amount offered by the next highest bidder. Unlike other steelmakers, the company is not accountable to the Ministry of Metallurgical Industry. Instead, it reports directly to the State Council. Even though its managers are free to run the company as they see fit, they can still count on government help such as an emergency loan from the People’s Bank of China.

76. Bersani, supra note 4, at 305.

77. Geng Yuxin, Reform of State Enterprises, supra note 10, at 5.

78. Current policy calls for “experimental trials with enterprise bankruptcy.” At the time this Article went to press, the State Council was expected to promulgate a Circular on Issues Concerning the Trial Practice of the Bankruptcy of State-Owned Enterprises in Selected Cities. Wu, supra note 12, at 12.

79. Id. Government sensitivity to the issue is reflected in the delicate terminology and the corrective measures it uses. Whereas Western capitalists might simply fire excess employees, the Chinese discuss “[a]propriately rearranging redundant employees” and “encouraging redundant employees to seek new jobs.” Id.

80. Shenzhen Gives Firms Freedom, supra note 15, at 4. This article described 1995 as China’s “year of enterprise reform” and Shenzhen as a pioneering city in the effort. However, state enterprises in Shenzhen, operating before reforms without regard to profitability, had taken out heavy bank loans to maintain production even when their products were being stockpiled. Though current policy permits poorly managed enterprises to go bankrupt, the resulting losses to banks hinder implementation of the policy. Id.
fact subjected to bankruptcies and similar painful adjustments, the practical effect of the new Corporation Law will thus remain questionable.

B. Private Enterprise as a Supplement to State Industry

Another key aspect of the Corporation Law is that it offers small, private business ventures greater opportunity for expansion. Authorizing private enterprise presents greater difficulties to a socialist state than modifying the organizational form of state enterprises because private business potentially conflicts with socialist ideology. During the 1980s, the Chinese state resolved this conflict by distinguishing between “individual” enterprises (geti jingji) and “private” enterprises (siying jingji). Individual firms were based essentially on a person’s own labor although they might employ a few workers without changing their nature. In contrast, private firms relied on hired labor and hence raised serious issues of worker exploitation. Regulations used eight employees as the demarcation between the two categories, based on a number derived ultimately from Marx’s analysis in Capital. Theoreticians could reconcile individual firms with socialist ideology fairly readily. Although the state sector must remain the leading economic force, other forms could provide a “valuable adjunct” by contributing to society’s wealth. Individual firms hired workers who would otherwise be unemployed and used only small amounts of capital. These firms thus dovetailed with socialism in that they did not exploit workers, served socialist goals, and merely supplemented the dominant state economy.

Private firms, on the other hand, presented greater ideological challenges because they employ large numbers of workers and large amounts of property. Firms of this type are, in some cases, operated by entrepreneurs who appear to be capitalists — not engaging in labor, yet becoming rich.

The ideological difficulty was finally resolved at the Communist Party’s National Congress in 1987. Zhao Ziyang, then the General Secretary, advanced the theory that China was in the “primary stage of socialism,” which began in the 1950s and was expected to last one hundred years thereafter. In this stage, the main goal is to develop production to meet the material needs of the people. Public ownership must predominate, but a private sector may contribute production and employment that the state cannot currently provide. The 1988 Constitution adopted this pragmatic view and thereby

81. Conner, supra note 4, at 9-10.
82. Id. at 10 (citing regulations governing “individual” firms and writings of several Chinese writers).
legitimized profit-seeking private enterprise.\textsuperscript{86}

Today, large numbers of small businesses operate throughout China's economy. Traders run shops on small lanes and busy streets. Self-employed merchants sell goods from stalls in specialized markets, from rented counters in state-owned department stores, and at market fairs.\textsuperscript{87} These businesses account for a substantial share of commerce in which larger and state-owned enterprise are not engaged. For example, many small businesses in Beijing transfer goods from Fujian and Guangdong to the north or from rural areas to the city by purchasing wholesale and distributing within local communities.\textsuperscript{88}

In previous decades, the government would have classified many of these activities as "speculation" or "profiteering" and would have subjected them to criminal prosecution.\textsuperscript{89}

In another ground-breaking move, the Chinese government has encouraged individuals and private firms to buy small state-owned enterprises and become full owners.\textsuperscript{90} The enterprises placed for sale are ones that the government deems itself unable to manage successfully. They fall mainly into three categories: (1) enterprises that are insolvent or near bankruptcy; (2) businesses that are suffering from losses or earning minimal profits over an extended term; or (3) those selected for sale "to perfect the structure of industry." Such sales relieve the government of the burden of maintaining unsuccessful enterprises and provide an opportunity to revive them through private ownership.\textsuperscript{91}

Though significant, this program of selling selected state-owned enterprises must be kept in perspective. It does not evince a current policy or

\textsuperscript{86} ZHONGWA RENMIN GONGHEGUO XIANFA [Constitution] (P.R.C.), art. 11 (amended Apr. 12, 1988), provided: "The state permits the private economy to exist and develop within the limits prescribed by law. The private economy is a supplement to the socialist public ownership economy. The state protects the lawful rights and interests of the private economy and exercises guidance, supervision and control over it." Amendment to the Constitution of the People's Republic of China, Proclamation No. 8, April 12, 1988 by the First Session of the Seventh National People's Congress.

\textsuperscript{87} See generally Shi Xianmin, The Classification of Privately-Owned Small Businesses in Beijing, 15 SOC. SCI. IN CHINA 95 (1994). The article identifies five categories of private small business (getihu) and describes each one's management patterns, interests and external relationships, sense of affiliation, lifestyle, and value orientation.

\textsuperscript{88} Id. at 100.

\textsuperscript{89} Zhonghua Renmin Gongheguo Xingfa, art. 118 [Criminal Law of the People's Republic of China] (adopted July 1, 1979, effective January 1, 1980) (translation available in LEXIS, Intlaw Library, Chinalaw File). Article 118 provides:

"Whoever makes a regular business of smuggling or illicit speculation, smuggles or speculates in huge amounts or is the ringleader of a group that smuggles or engages in illicit speculation shall be sentenced to fixed-term imprisonment of not less than three years and not more than ten years, and may concurrently be sentenced to confiscation of property."

\textsuperscript{90} Guanyu Chushou Guoyou Xiaoxing Qiye Chanquan de Zanxing Banfa [The Interim Measures Concerning Sale of Title of Wholly State-owned Small-size Enterprises] (issued February 19, 1989). These measures, issued by the Committee of System Reformation, The Ministry of Finance and the Administrative Bureau of State-owned Property, provide that: "The buyer can be wholly state-owned enterprises, or collectively-owned enterprises, or 'Joint Ventures, Wholly Foreign-owned Enterprises and Chinese-Foreign Contractual Joint Ventures,' or private enterprises, or partnerships and individuals." Corporation Law, art. 6. "After sale, the buyer shall apply for a change in the certification from the Administrative Department for Industry and Commerce. The nature of the ownership of the enterprises shall follow the nature of ownership of buyer. The enterprise shall be managed based on the newly defined nature of ownership." Id. art. 18.

\textsuperscript{91} Corporation Law, art. 4.
goal to privatize the bulk of the Chinese economy. Instead, it reflects an intention to permit the co-existence of private ownership as a supplement to state ownership, which will continue to play the leading role in the Chinese economy.

The development of private enterprise is proceeding at an impressive rate, albeit from a minute base. According to a 1994 Chinese government report, private firms in China numbered 328,000, had registered capital of more than 100 billion yuan ($11.8 billion), and employed slightly over five million people. Those figures reflect substantial percentage increases over the figures from previous years but must be evaluated in light of the sheer enormity of the country. China has a gross domestic product exceeding 3.1 trillion yuan and a population exceeding 1.1 billion. Clearly, private business currently plays a minor, supplementary role in an economy overwhelmingly based on state-owned enterprise.

III. THE PRIVILEGE AND FORMS OF INCORPORATION

The new Corporation Law establishes the basic organizational structure for Chinese enterprises, both in the dominant state sector and in the supplementary private sector. Although some provisions specifically aim toward converting state-owned enterprises into the corporate form, most of the Law applies equally well to state and private enterprises.

Three features of the statute merit special consideration. One major prerequisite under the new legislation is the registration of a corporation, which permits the state to maintain control over the privilege of incorporation. A key structural element distinguishes between two corporate forms: the Limited Liability Company (primarily for closely held enterprises) and the Joint Stock Company (primarily for publicly traded corporations). Finally, the principle of a “legal representative,” carried over from prior civil law, adds another distinctively Chinese characteristic to the Law.

A. Incorporation by Approval, Not by Right

The law tightly regulates incorporation, maintaining state control over this form and its attendant privilege of limited liability. Government departments wielding authority granted by the State Council or the provinces must approve the establishment of a company, and may do so only after the enterprise meets certain conditions. Each company must apply for

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92. These statistics were released by the Chinese State Administration for Industry and Commerce. Private Ventures, CHINA DAILY, Sept. 27, 1994, at 2.

93. In 1993, private firms numbered 238,000 (70 percent more than in 1992), had registered capital of 68 billion yuan (twice as much as the figure for 1992), and employed 3.72 million people (60 percent more than the prior year). Private Firms Burst into Boom, BEIJING REV., Mar. 14-20, 1994, at 5.

94. Statistical Communique, supra note 64, at 26. Specifically, GDP was 3138 billion yuan, up 13.4% over 1992, id. at 19, and the population was 1.185 billion, up 13 million over 1992, id. at 26.

95. Corporation Law, art. 77.

96. The prerequisites for establishing a corporation are set out in Articles 19 (for LLCs) and 73 (for Joint Stock Companies). Administrative regulations provide more details. A corporation must: 1) have its own name, organizational structure, and articles of association; 2) have a fixed place of business and the
registration and obtain a “certificate of operation.” The scope of a corporation’s permissible operations is limited to those specified in the registration unless the government department approves an amendment to the registration. Public stock offerings require State Council permission and are subject to detailed rules.

The processes of incorporation, operation, and capitalization of a business are thus plainly matters of governmental control and permission, not of right. The Law condones and even endorses private business activity but handles it warily nevertheless. The operative attitude appears to be that corporations are a necessary evil to be closely regulated rather than an economic engine to be encouraged and released.

The current Chinese approach is comparable to the “special” incorporation processes followed in England and the United States until the early 1800s. At that time, each instance of incorporation required special legislation. Current American policy, in contrast, grants corporate status to any enterprise fulfilling nominal filing requirements. Chinese legislators consciously considered whether to require prior approval to incorporate, and deemed such approval necessary. They concluded that this prior screening would ensure the healthy development of corporations and would “protect against corporations being established wantonly.” In addition, registration protects the public fisc because the enterprise must
arrange to pay taxes on business income and obtain all licenses necessary to conduct its particular line of business before being incorporated.

Most importantly, the prior registration requirement is designed to minimize fraud and abuses. In particular, registration may forestall the organization of "briefcase" companies — private corporations that have no greater substance than the contents of a briefcase and that enter into business deals and then disappear after receiving the first payments. Registration is also intended to prevent foreigners from persuading Chinese investors to contribute equipment and other resources to enterprises in which foreigners contribute only a small down payment and empty promises to contribute more later. The funds that these fly-by-night operators appear to have may be borrowed or subsequently diverted to other purposes. Similarly, promoters may promise to contribute capital in stages: a portion at the outset and the rest in the future. The future amounts may never materialize, or if they do, they may be the original contributions that the promoter has surreptitiously withdrawn. Creditors then suffer the consequences when the company cannot pay its obligations.

In a mature private economy, experienced businesses and individuals contemplating substantial transactions are accustomed to protecting themselves. They investigate the credit and reputation of the other party and often demand collateral, letters of credit, or other forms of protection. The principle of *caveat emptor* is familiar. Parties are suitably cautious.

China presents different circumstances. The vast majority of enterprises in China continue to be government-owned, accustomed to dealing only with other government-owned entities. These enterprises are oriented toward meeting production goals and administrative requirements, not generating profit. Sharp or dishonest entrepreneurs may easily mislead or cheat them. Registration serves to deter or minimize such abuse by assuring, for example, that a corporation meets minimum capitalization requirements.

Despite the burden of registration prior to incorporation, the Corporation Law relaxes regulation to some extent. Establishment of a new enterprise previously required approval to engage in the intended activity from the administrative agency in charge of the particular industry. The administrative agencies followed rigid, highly centralized planning processes. A new enterprise could seek registration as a legal entity only after receiving this preliminary approval. The new legislation, consistent with the policy to establish a socialist market economy, removes this first prerequisite in almost all cases.

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104. Business income taxes are new to China, and the system of assessment and collection remains uncertain. In the case of Sino-foreign mining joint ventures, for example, a government official said that the 33% profit tax and 17% value-added tax applicable to other businesses would apply. However, those ventures would also be subject to a "resources-compensation tax" at a rate that has not yet been decided. *Julia Leung, As China Opens Up Mining, Foreigners are Confused about Ownership, Taxes*, WALL ST. J., Mar. 21, 1994, at A7.


106. The Corporation Law preserves the possibility of requiring approval, if laws and regulations outside the Corporate Law so provide. Corporation Law, art. 8. This provision could apply, for example, to aircraft production. The provision follows the pattern of prior Chinese regulation of companies, which
B. Two Forms of Corporation: The Limited Liability Company and the Joint Stock Company

The Act provides for two forms of corporations which correspond roughly to the British distinction between the Limited Company (or Ltd.) and the Public Limited Company (p.l.c.), or the American distinction between the closely held (or close) corporation and the larger (including the listed) corporation.\(^7\) The Chinese terms are You Xian Ze Ren Gong Si or Limited Liability Company ("LLC"),\(^8\) and Gu Feng You Xian Gong Si or Joint Stock Company.\(^9\) Provisions outside the Corporation Law authorize other business forms with unlimited liability.\(^10\)

Enterprises formed by foreign investors almost always take the corporate form and are regulated by any of three other laws: the Law on Joint Ventures Using Chinese and Foreign Investment, the Law on Wholly Foreign-Owned Enterprises, or the Law on Chinese-Foreign Contractual Joint Ventures.\(^11\) These acts basically parallel the Corporation Law with regard to such matters as establishing and managing the company, but differ in some special provisions. For example, foreign-owned corporations must assign either the

prohibited private enterprises from engaging in military or financial industries or dealing in cultural objects, antiques, jewelry, stamps, firearms, ammunition, cars, and explosives. Conner, supra note 4, at 24. Some literature uses the term "socialist market economic macro-control system" to describe the policy of regulating only at the macroeconomic level, not at the level of the individual enterprise. See, e.g., Geng Yuxin, Greeting the Year for Enterprise Reform, BEIJING REV., Jan. 2-8, 1995, at 4.

\(^{107}\) See HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 259, at 704 (3d student ed. 1983). Separate statutory treatment for small corporations, typically defined by the number of shareholders, is common in the United States and Europe. Id. § 259; Colin McFadyean, The American Close Corporation and its British Equivalent, 14 BUS. LAW 215 (1958); ROBERT B. THOMPSON & FAYE L. KATT, O'NEAL'S CLOSE CORPORATIONS: LAW AND PRACTICE § 1.13, 1.18 (3d ed. 1994).

\(^{109}\) Literally, You Xian Ze Ren Gong Si translates as "limited liability company." Liability is limited to the shareholders' equity. The term gongsi, meaning company or corporation, has been used to refer to a level of administrative authority over government-owned enterprises, but can also apply to private enterprises.

The Chinese term, "Limited Liability Company," must be distinguished from the same term as it is used in American legislation. Many American states have authorized a new form of business organization, which they label a "limited liability company," in order to permit businesses to qualify for some tax benefits that partnerships typically receive while retaining the corporation's protection of investors. An American LLC, unlike a Chinese LLC, is not considered incorporated and enjoys extensive discretion to establish its own internal governance structure.

\(^{110}\) Literally, Gu Feng You Xian Gong Si translates as "shareholding limited company." An alternative is "company limited by shares," which is used in the translation published by CCH International. See supra note 1. That alternative is an accurate translation of the Chinese, but seems confusing in English. How do shares limit a company? What the term denotes is that the company is characterized by share ownership and provides limited liability to shareholders. Because all corporations provide limited liability, this Article uses the phrase "Joint Stock Company" as the most descriptive translation.

\(^{108}\) Some experts suggested that the Law should have also included the unlimited liability company and the joint company, i.e., a company formed by shareholders, some of whom are protected by limited liability, along with others subject to unlimited liability. See Quanguo Renda Fa Shi Weiyuanhui Guanyu "Zhonghua Renmin Gongheguo Gongsifa (Chaoan)" Shenyijieguo de Baogao [Law Committee of National People's Congress, Report Concerning Examination of Chinese Company Law (draft)] (Dec. 17, 1993). THE COMPANY LAW OF THE PEOPLE'S REPUBLIC OF CHINA 59 (1993). The final version omitted these other forms of economic organization.

Enterprises with unlimited liability can be treated as partnerships, which the Civil Law of China regulates. See CHINESE CIV. P. LAW, art. 52, which provides that a jointly operated business established by different enterprises or units may be subject to unlimited liability based on the requirements of relevant laws or their contract.

\(^{111}\) Translations available in LEXIS, Inlaw Library, Chinaw File, Numbers 41, 345, 463.
position of chairman or vice-chairman of the board of directors to a Chinese citizen, with the other to be held by a foreign investor. Different time restrictions also apply to investments. Because of these differences, the Corporation Law provides that "this law shall apply also to a limited liability company owned by a foreign businessman, but if this company is regulated by other laws concerning joint venture, contractual joint ventures, or wholly foreign-owned enterprise, the other laws shall be applied." The Limited Liability Company form is generally for smaller corporations, defined in terms of the number of investors and amount of registered capital. Yet, a state institute or department that wishes to corporatize one of its enterprises without relinquishing any ownership or control also may adopt the LLC form.

In most cases, a Chinese LLC must have between two and fifty shareholders and a minimum registered capital ranging from 100,000 to 500,000 yuan, depending on the type of business (unless other regulations set a higher minimum). In addition, it may not publicly offer its stock.

A Joint Stock Company typically is larger than an LLC. It may have any number of shareholders but must have registered capital of at least ten million yuan. A Joint Stock Company may distribute stock via either the "promoter method" or the "share float method." In the first option, the promoters purchase all the shares by subscription; in the second, the company offers shares to the public, but the promoters must still purchase thirty-five percent of the stock. Under either method, promoters must retain their stock for three years. The requirement that they buy and retain stock seeks to inhibit, or at least to delay, promoters' selling highly risky securities to public investors while avoiding any personal assumption of risk. By design, promoters generally are subjected to substantial personal risk during the corporation's start-up phase.

Both vehicles are available to convert state enterprises to the corporate form. When the sole investor in an LLC is from a state investment company...
or department, the LLC is termed a "wholly state-owned company" and is relieved of certain organizational requirements normally applied to LLCs. For example, the institute or department may dispense with shareholder meetings, directly appoint and change directors, hire and dismiss managers, and make key decisions concerning merger, division, dissolution, and issuance of securities. Thus, a wholly state-owned LLC is essentially an administrative unit of a government agency, clothed in a corporate form.

A state-owned enterprise that converts into a Joint Stock Company need not meet the usual requirement of five promoters. Nevertheless, it still must use the share float method. The promoter in this instance would be the pre-existing state enterprise, contributing the enterprise’s assets rather than cash. In this case the stock offering requirement serves to draw additional capital into the enterprise from the private sector.

C. Liability for Corporate Obligations: Shareholders and "Legal Representatives"

One particularly important element of the 1993 Corporation Law is its adoption of the principle of limited liability for shareholders — a concept fundamental to Western corporate law, but relatively new to China. The Corporation Law does not adopt limited liability wholesale, however. Instead, the law provides for the distinctively Chinese concept of a human "legal representative" who is subject to sanction for improper corporate activities.

The idea that those operating a business should be entitled to enjoy the profits if it succeeds, but be insulated from liability for losses if it fails, is neither intuitively appealing nor obvious. The concept inevitably denies recovery not only to contract claimants, but also to personal injury tort victims when the corporation is bankrupt. Western capitalist countries decided long ago that the benefits to society of encouraging commerce in this manner outweighed the detriment to such claimants. Only the long history of that policy decision in capitalist countries makes the principle appear basic or commonplace. In China, which lacks a comparable history of orientation toward private enterprise, acceptance of the limited liability principle could not be assumed. Earlier versions of company regulations provided for limited liability in only some forms of company organization.

It is therefore significant that the Corporation Law adopted principles of liability for corporate obligations parallel to Western — in particular American — practice in key respects. For instance, the Corporation Law adopts the familiar principle that a corporation is a "legal person," an entity that enjoys civil rights and owes civil responsibilities to the full extent of its assets. In addition, the law explicitly protects shareholders from liability

123. Id. art. 64.
124. Id. arts. 65-69.
125. Id. art. 75.
126. The 1951 regulation, for example, provided for some companies with limited liability, others with unlimited liability, and others with a combination of the two. See supra note 41.
127. Corporation Law, arts. 3, 4. For a description of the "legal person" concept in the Chinese Civil Code, see Zheng, supra note 4, at 553-57.
beyond their capital contributions, and does not mention "piercing the corporate veil" or any other limitation on shareholder immunity.

Nevertheless, the Corporation Law integrates the distinctively Chinese concept of the fading daibiaoren, or "legal representative," as an encroachment on limited liability. A legal representative is the natural person authorized to act on behalf of and to bind the company in a manner similar to the "agent" in American corporate law. The Chinese legal representative, however, serves an expanded role bearing greater risks than an agent under American law. The legal representative of a corporation is the chairman of the board of directors or president, or, in a small LLC that chooses not to have a board, the executive director. He or she must perform such functions as applying for a certificate for a branch company.

Most importantly, the Civil Code subjects a legal representative to sanctions for the legal person's misconduct. For example, the legal representative is personally at risk if the corporation engages in business beyond its authorized scope, conceals facts from registration and tax authorities, or hides property to evade repayment of debts. While the legal representative is not personally liable for corporate debts, the extent of responsibility is nevertheless serious. He or she may be fined or subjected to administrative sanctions, including warnings, reprimands, probation, and dismissal from office, with attendant loss of prestige, status, and face. Moreover, if the offense constitutes a crime, the legal representative may be prosecuted.

128. Article 3 provides that shareholders in an LLC assume liability limited to "the amount of capital that they invested," and that shareholders in a Joint Stock Company "assume... liability equal to the amount of shares purchased." The difference in phrasing might suggest that capital can be contributed to an LLC in a form other than share purchases, but the Law does not reflect that concept elsewhere.

129. Under American law, courts in exceptional cases disregard the corporate entity to impose personal liability on shareholders for debts incurred by the enterprise. This practice, called "piercing the corporate veil," stems entirely from common-law equitable principles, not express statutory authority. The cases typically involve fraud, disregard of corporate formalities, and grossly inadequate capitalization. Tort claimants are more likely to succeed than contractual claimants, because contractual claimants chose to deal with the corporation; tort victims often do not. The defendants most likely to suffer liability are active shareholders who personally caused the corporation to engage in improper conduct rather than passive investors with no participation in corporate affairs beyond their shareholding. See, e.g., ROBERT C. CLARK, CORPORATE LAW §2.4 (1986); ALFRED F. CONARD, CORPORATIONS IN PERSPECTIVE §§ 270-77 (1976); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 146 (1983).

130. The "legal representative" concept has a long history in Chinese law. For the current general statement of the rule, see The General Principles of Civil Law of the People's Republic of China, art. 43, Apr. 12, 1986, available in LEXIS, Chinalaw library, File No. 346 [hereinafter Civil Law].

131. Corporation Law, arts. 45 (applicable to most LLC's), 68 (applicable to LLC's wholly owned by the state), 113 (applicable to joint stock companies).

132. Id. art. 51.

133. Id. art. 96.

134. Id. art. 49.

135. Id.

136. Id. (stating that legal representative is subject to administrative sanctions). The term "administrative sanctions" is defined in, for example, Zhonghua Renmin Gongheguo Xingzheng Jiancha Tiaoli (The Provisions of Administrative Supervision of PRC), passed on November 23, 1990 by the State Council and issued on December 9, 1990 by the 69th decree of the State Council of PRC. Sanctions include warning, minor and severe reprimands, probation, demotion, dismissal, and discharge.
IV. INTERNAL GOVERNANCE

The Corporation Law details permissible forms of internal corporate organization and governance. Distinctive features include a supervisory committee to oversee the board of directors, extensive shareholder authority in major managerial decisions, and specific references to the rights of workers.

A. Board of Directors and Supervisory Committee

Every corporation must have a board of directors, generally elected by the shareholders for terms of up to three years. A small LLC may have a single executive director instead, but an LLC that is formed by more than two state-owned entities must have a board that includes representatives democratically elected by the workers.

The board selects managers and makes other key business decisions. The Communist Party Committee no longer dominates the management decisions of the factory directors. The board’s procedures and powers are largely analogous to those in American corporate practice, with a few minor variations.

One of the more distinctive variations from the American law is the supervisory committee, a concept adopted from German law. Supervisory committees are optional for LLCs and Joint Stock Companies. If a company opts to have one, the supervisory committee must be comprised of at least three individuals, each with a term of three years. Some members are

137. An LLC may have between three and thirteen directors, id. art. 45, and a Joint Stock Company may have between five and nineteen, id. art. 112.
138. Id. art. 115.
139. Id. art. 51. An executive director may serve concurrently as manager of the LLC.
140. Id. art. 45.
141. Id. art. 46 (listing powers of directors).
142. The government urged transition from the system of overall responsibility by the factory director, under the leadership of the CPC Party Committee, to exercising a system of overall responsibility by the factory director alone. See Zhonggong Zhongyang, Guowuyan Guanyu Renzheng Guanche Zhixing Quanmin Suoyuzhi Gongyeqyfe Sange Tiaoli de Buchong Tongzi [The Central Committee of the Chinese Communist Party and the State Council, Additional Information of Conscientiously Carrying Out Three Provisions Regarding Wholly State-owned Industrial Enterprise] (Nov. 11, 1986). This system changed the CPC from the primary organization in an enterprise to an active supporter of the factory director. See Zhongguo Gongchandang Quanmin Suoyuzhi Gongyeqyfe Jicengzhuzi Gongzuo Tiaoli [The Working Provisions For CPC Primary Organization In the Wholly State-owned Industrial Enterprise] (issued on September 15, 1986 by the Central Committee of CPC and the State Council).
143. For example, the Corporation Law specifies the number of directors, limits terms to three years, and allows directors not attending a meeting to vote by proxy. Corporation Law, arts. 112, 115, 118. In comparison, American corporation laws typically set no standards on the number of directors, limit terms to one year in most cases, and do not allow directors to vote by proxy. Revised Model Bus. Corp. Act. §§ 8.03 (one or more directors), 8.05 (one year term unless terms are staggered over either two or three years), 8.20 (directors may participate without being present in person if communications allow all to hear each other, but proxies are not sanctioned) (1991).
144. The German concept of supervisory councils, with labor representation, has been used in newly adopted corporation acts in Eastern Europe. Gordon, supra note 57, at 546-48. For a description of the German model, see Gregory J. Thwaite & Jürgen Pesch, A Guide for the Perplexed: Some Aspects of German Merger and Acquisition Law Explained for Foreign Counsel, 20 INT’L BUS. LAW. 566, 571 (1992); Hopt, supra note 9, at 203.
145. The provisions for LLCs are substantially identical to provisions for Companies Limited by Shares. Compare Corporation Law, arts. 52 and 53 with Corporation Law, arts. 124 and 125.
elected by shareholders, others by workers, in a ratio specified by company regulations. Directors, managers, and personnel in charge of financial affairs may not serve concurrently as supervisors.

The supervisory committee oversees the board of directors and assures that it pursues the policies fixed by the shareholders. Its members attend meetings of the board of directors in a non-voting capacity and inspect the company's financial affairs. The Corporation Law imposes upon supervisors the responsibility "to prevent the board of directors and company managers from violating laws, regulations, and the company's by-laws," and "to force the directors to correct their mistakes if their actions have harmed the interests of the company."

Both directors and supervisors owe fiduciary duties to the corporation and are subject to liabilities for breach. The statute specifies that they must obey administrative rules and company regulations and that they are responsible for damages if a breach harms the corporation. Directors and supervisors must fulfill their duties "sincerely and diligently," a prescription that corresponds to American law's duties of loyalty, good faith, and care.

B. Shareholders' Rights and Powers

Shareholders have extensive powers in Chinese corporate law. The Law provides that the "shareholders' meeting is the most powerful authority." The shareholder holding the most equity calls and presides over the first shareholders' meeting. Thereafter, in addition to mandatory annual meetings, shareholders, directors, or supervisors may call special meetings. At this meeting, shareholders elect and dismiss directors and members of the supervisory committee, set their salaries, and consider their reports. Shareholders have the right to inspect financial records, to decide on issuance of additional shares, and to vote on such fundamental changes as mergers, dissolution, and liquidation. Shareholders may vote by proxy.

These rights resemble those of shareholders under American law, but

146. Corporation Law, arts. 52 (for LLCs), 124 (for Joint Stock Companies).
147. Id.
148. Id. arts. 54 (for LLCs), 126 (for Joint Stock Companies).
149. Id. art. 54.
150. Id. arts. 63, 128.
151. Id. art. 128.
152. Id. arts. 57 (for LLCs), 102 (for Joint Stock Companies).
153. Id. art. 42.
154. Id. art. 104.
155. In LLCs, interim meetings may be called by more than one quarter of the shareholders, one third of directors, or one third of the supervisors. Id. art. 43. In Joint Stock Companies, interim meetings must be called if requested by a ten percent shareholder, the directors, or the supervisors (with no percentage vote specified). Meetings must be called if the number of directors falls below the statutory requirements or if losses reach one third of paid-up capital. Id. art. 104.
156. Id. art. 38 (for LLCs), 103 (for Joint Stock Companies).
157. Id. A two-thirds majority can approve fundamental changes. Id. art. 39.
158. Id. art. 108 (describing Joint Stock Companies).
159. See, e.g., Revised Model Bus. Corp. Act §§ 7.01 (annual meeting), 7.02 (special meeting), 7.21 (voting entitlement of shares), 7.28 (voting for directors), 8.08 (removal of directors by shareholders), 8.11 (compensation of directors), 10.03 (amendment by Board of Directors and Shareholders), 11.03 (action on
the Chinese statute adds others. Unlike their American counterparts, shareholders of Chinese corporations “decid[e] the policy of management and the plan of investment of the company,” approve the budget, and vote on the issuance of bonds.\textsuperscript{160} Perhaps most notably, the shareholders “consider[] and approv[e] the plan of distribution of profits and recovery for losses”\textsuperscript{161} and decide whether to issue dividends.\textsuperscript{162} American corporate law, in contrast, places those decisions exclusively within the scope of the directors’ authority.\textsuperscript{163}

Shareholders also have the right to sue for an injunction and damages if a decision of the board “violates laws and administrative rules, and invades the legal interests of the shareholders.”\textsuperscript{164} The statute does not specify whether a shareholder’s action is direct (asserting the shareholder’s own rights) or derivative (asserting rights on behalf of the corporate entity), or even whether that distinction is recognized.\textsuperscript{165} Apparently a shareholder may bring such suits directly. The statute does not provide expressly for derivative actions, wherein a shareholder asserts rights on behalf of the corporate entity.

The extraordinary power accorded to shareholders is consistent with the Corporation Law’s overall approach to managing state-owned enterprises. The government, which will be a huge shareholder in corporatized companies, did not intend to relinquish ownership or ultimate control over China’s productive enterprises. Rather, it sought to remove itself from the micro-management of enterprise decisions. By assigning management authority to the board of directors, while retaining majority stock ownership and a strong role for shareholders, the government can maintain the level of control that it chooses.

C. Workers’ Role in Corporate Governance

The right of workers to participate in corporate decision-making is codified in the Corporation Law. Those rights do not include voting and, at least by the Law’s express terms, appear far more limited than the rights provided for under earlier legislation. Previous law, for example, accorded workers the rights to remove the director of an enterprise, subject to government approval, and to decide matters directly affecting the workers.\textsuperscript{166}

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\textsuperscript{160} Corporation Law, art. 38.
\textsuperscript{161} Id. art. 103(7) (for Joint Stock Companies).
\textsuperscript{162} See, e.g., Revised Model Bus. Corp. Act § 8.01(b) (1994), stating the general rule: “All corporate powers shall be exercised by or under the authority of, and the business and affairs of the corporation managed under the direction of, its board of directors . . . .” More specific powers of directors are provided in, e.g, the Revised Model Bus. Corp. Act §§ 6.21 (issuance of shares), 6.40 (distributions to shareholders) (1994).
\textsuperscript{163} Id. art. 111 (describing Joint Stock Companies).
\textsuperscript{164} For summaries of the concepts and procedures of shareholder direct and derivative actions in American corporate law, see ROBERT C. CLARK, CORPORATE LAW §§ 13.4 E. LATTIN, THE LAW OF CORPORATIONS §§ 102-116 (1971).
\textsuperscript{165} The Law of the People’s Republic of China on Industrial Enterprises Owned by the Whole People, adopted by the People’s Congress in 1988, provided for a Workers’ Representative Assembly. Through the assembly, workers could not only advise management but “elect and remove the enterprise director subject to government approval . . . and decide on plans regarding workers.” Wang, supra note
Under the Corporation Law, a company must "hear the opinions" of workers and their union before making a decision affecting their vital interests.\textsuperscript{167} Vital interests include salary, welfare, work safety, labor insurance, important decisions over production and operation, and significant rules and systems.\textsuperscript{168} Workers or their union representatives may attend directors' meetings.\textsuperscript{169} They do not, however, have veto power or even the right to vote at these meetings.\textsuperscript{170}

The Corporation Law confers additional powers on workers in certain situations. For instance, corporations formed by more than two state-owned enterprises or state-owned investing bodies must include democratically elected representatives of the workers on the board of directors. The statute is silent, however, as to the number or percentage of worker directors.\textsuperscript{171}

Similarly, if a corporation has an optional supervisory board, then at least one of the members must be a democratically elected workers' representative. The statute provides that worker representatives must be in "the proper ratio," but it leaves the definition of that critical term to the corporation's regulations.\textsuperscript{172}

The aggregate of explicit powers accorded to workers by these various provisions is not extensive. Workers in Chinese corporations appear to have less power than their peers in Germany, for example, which has statutorily mandated nearly equal representation of workers and shareholders on the board of supervisors.\textsuperscript{173}

Nevertheless, in practice, Chinese workers may well wield great influence because of the extensive power of the Communist Party. An official commentary on the reforms stated that, within enterprises, "the Party organization will continue to play its role as the political nucleus, and workers and staff will participate in democratic management."\textsuperscript{174} If they follow past practice in selecting their leaders, workers will probably elect Party members to be their representatives on the board of directors or the supervisors' committee. Because the "leading role" of the Party is enshrined in the Constitution and pervades the economy, the presence of Party members on these governing boards will result in substantial influence, particularly in corporations where the state maintains majority ownership. This Party influence does not depend on Party members' having extensive formal voting

\begin{itemize}
  \item \textsuperscript{14} at 99.
  \item \textsuperscript{167} Corporation Law, art. 55.
  \item \textsuperscript{168} Id. arts. 55, 56.
  \item \textsuperscript{169} Id. art. 55.
  \item \textsuperscript{170} Id.
  \item \textsuperscript{171} Id. art. 45.
  \item \textsuperscript{172} Id. art. 124.
  \item \textsuperscript{173} Hopt, supra note 9, at 204 (citing German statutes).
  \item \textsuperscript{174} Dai, supra note 63, at 5. This \textit{Beijing Review} editorial on the current economic reforms described the new approach to enterprise organization, but emphasized that public ownership would remain dominant in the economy. \textit{Id.} An analysis of the 1988 Law of the People's Republic of China on Industrial Enterprises Owned by the Whole People noted that although the Workers' Representative Assemblies created by that law seem to assure that workers have representation in management, realistically they "sometimes provide[] a channel for Party officials to wield power." Wang, supra note 14, at 99.
\end{itemize}
powers on the boards of directors.  

D. Safeguards Against Malfeasance

The Corporation Law specifies in detail the penalties for violating its various rules, duties, and requirements. Enforcement of these specific provisions is based on administrative and criminal processes rather than on derivative civil liability actions brought by shareholders. The Law does not even mention derivative actions, and such actions, if allowed, would in all likelihood be unsuccessful. Under current conditions, few if any Chinese corporate officers or directors would be financially able to pay a substantial civil judgment for breach of a fiduciary duty and thus could provide little relief to aggrieved shareholders suing derivatively.

The enforcement scheme of the Law relies on progressive discipline. As a first step, those who make false reports or statements relating to such matters as registration capital and accounting shall be, in the statute’s terms, “ordered to correct their mistakes.”  

When the offense involves cheating creditors, investors, or society, fines are imposed.  

The Law defines the range of fines by amount (typically between 10,000 and 100,000 yuan) or percentage (such as between 1% and 5% of illegally raised capital, or between 5% and 10% of illegally withdrawn subscription amounts).

Directors, supervisors, and managers are subject to “administrative sanctions,” which pose a serious threat to the individual’s position and career. Other laws lend meaning to this term, specifying as included in “administrative sanctions” such penalties as probation, demerits, demotion, and dismissal.  

In addition, any improper gains, i.e., those derived from accepting bribes, appropriating corporate capital or lending it to others, or operating a business in competition with the corporation, are subject to forfeiture.

Criminal liability potentially attaches to all violations of the Corporation Law. The punishment for white-collar crimes can be severe, including the death penalty. For example, a corporate president convicted of

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175. The widespread concern that the death of Deng Xiaoping may fundamentally alter the course of reforms and government policy, even though Deng has relinquished all his offices, suggests that real power in China does not always require formal trappings.

176. Corporation Law, arts. 206, 209, 211.

177. See, e.g., id. arts. 206-12.

178. Fines between 10,000 and 100,000 yuan may be imposed for submitting false documents relating to registration, id. art. 206, keeping a false set of accounting records, id. art. 211, and providing false reports of financial affairs, id. art. 212.


180. Id. art. 209.

181. For a definition of “administrative sanctions” see supra note 136.

182. Corporation Law, art. 214.

183. Id. art. 215.

184. At least 15 separate articles state that in addition to the other more specific sanctions, criminal liability (which is not defined in the Corporation Law) applies “in accordance with the law.” Id. arts. 206-14, 217-24.

185. Robert Steiner, Big Chinese Bank, Citing Fraud, Won’t Honor Letter of Credit, ASIAN WALL ST. J., June 23, 1993, at 3. For instance, the Xinhua News Agency reported that the president of a Chinese company who embezzled about $375,000 was executed in April 1994; that a vice-minister was sentenced to 20 years in prison in the same case; and that a company president was executed for embezzlement and
embezzlement, bribery, and selling bonds through a pyramid scheme was executed in 1994.\textsuperscript{186}

Short of these extreme sanctions, the Law imposes procedures and requirements in an effort to minimize the opportunities for abuse. Such safeguards are deemed necessary to prevent fraud and misappropriation in the creation and operation of corporations. The danger of such abuses is apparent, particularly because potential investors are not yet sophisticated and because control by private parties of the state’s property invites misappropriation.

To safeguard against these abuses, the Law precludes individuals from holding office as a director or manager if they have committed any crime involving corruption, embezzlement, or offenses against the social economic order, or if they have held office in a company whose operating license was revoked for illegal acts.\textsuperscript{187} State officials are also disqualified,\textsuperscript{188} presumably to reduce the risk of improper influence. Corruption of government officials, in forms including insider trading of securities,\textsuperscript{189} has been a serious problem.\textsuperscript{190}

Besides requiring corporate officers to have clean records and imposing general principles of fiduciary duty, the statute specifically prohibits misappropriation of company funds, deposit of company funds in personal bank accounts, and use of company assets as surety for a director’s personal debts.\textsuperscript{191} Directors may not conduct business with the company except as provided in the bylaws or in resolutions promulgated by the shareholders.\textsuperscript{192}

V. STOCKS AND DIVIDENDS

Issuance of corporate securities has significance beyond the fortunes of particular corporations and their investors; it represents allocation of a portion bribery totaling $373,500. \textit{Chinese Executive Convicted of Embezzlement Executed}, OREGONIAN, Apr. 12, 1994, at A4.

186. Shen Taifu, former president of the Beijing Changcheng (Great Wall) Machinery and Electronics Group, was convicted of embezzling two million yuan and taking a ten percent patent commission on all company transactions. He also devised a national pyramid scheme, selling bonds by promising interest rates of 43% and defrauding approximately 100,000 investors of more than one billion yuan. Finally, he paid bribes for favors. Shen was executed, and all of his personal property was confiscated. His wife, Sun Jihong, a vice president of the company, was convicted of converting one million yuan of company money, sentenced to fifteen years in jail, and deprived of political rights for three years. Jiang Jiang, \textit{Finally, Alarm Bells Sound}, BEIJING REV., May 2-8, 1994, at 13.

187. Corporation Law, art. 57.
188. \textit{id.}, art. 58.
189. Investors in A-share stock markets, which are open only to Chinese citizens, frequently complain of rampant insider trading by government officials and private citizens such as business leaders and stockbrokers who have undisclosed information about regulatory policies and corporate developments. One brokerage firm has been found guilty of trading on advance knowledge of a corporate takeover, forced to disgorge its profits, fined, and shut down for two months. Joseph Kahn, \textit{China Fines Broker in First Crackdown on Insider Trading}, WALL ST. J., Feb. 7, 1994, at A11. In 1993, the Communist Party’s top disciplinary committee formally banned party officials from playing the stock market. Brauchli, \textit{supra} note 63, at A1.
190. President Jiang Zemin has warned that corruption has grown so common that it threatens to ruin the Communist Party. Party and army officials have stolen billions of yuan, engaged in massive smuggling and other rackets, and sought bribes and payoffs. \textit{Way to Future}, \textit{supra} note 63, at 5.
191. Corporation Law, art. 60.
192. \textit{id.}, art. 61.
of society's capital or investment resources to particular enterprises. Securities sales also present the danger of fraud against investors and, particularly when control of state enterprises shifts to private owners, against the corporation. Accordingly, the Corporation Law provides for close regulation of the issuance of equity and debt securities. By imposing a unique system for controlling the distribution of profits and dividends, other provisions of the Law represent a transitional stage between the traditional social-service role of state enterprises and the profit-driven model of corporations:

A. Characteristics of Stock

Issuance of shares must conform to the “open, fair and impartial principles; shares of the same class must have equal rights and profits for each share.” The reference to “class” indicates that corporations may divide their stock into common, preferred, and other classes.

Curiously, the Corporation Law is entirely silent on one of the most distinctive features of Chinese corporate stock: classes defined not by the characteristics of the shares, but rather by the status and nationality of the shareholders. “Class A” stock is available for purchase by Chinese citizens only, “Class B” is for foreigners, and “Class H” stock has been used for transactions on the Hong Kong stock exchange. The prevalence of B and H shares is a useful indicia of China's openness to foreign investment. At the end of 1992, the Shanghai and Shenzhen stock exchanges listed the stock of seventy companies, including eighteen issues of B shares. In addition, nine state enterprises were selected for listing in Hong Kong.

The statute, unfortunately, does not indicate how the holders of A, B, H, and other stock classes may exercise their rights. In particular, it makes no mention of whether they vote in common with all other shareholders or whether they vote by class, in which case the vote of each class would be necessary to approve a resolution. Class voting can be vital, particularly for foreigners holding “B” shares, because a corporation might adopt a rule of equal application on its face that is actually far more onerous to some. For example, a rule requiring transfers of shares to be made by registration in person at corporate headquarters would affect foreigners far more than Chinese shareholders. Without voting rights as a class, B shareholders would have no effective remedies.

Shares may, but need not be, in the form of a paper certificate. Thus,

193. Id. art. 130 (specifying further that all shares issued at same time shall have equal conditions of issue and price, and that any unit or individual buying shares shall pay equal value). But see id. art. 135 (reserving power in State Council to “regulate other shares not provided for by this Act,” which might be interpreted to permit preferred or other classes of stock, in addition to common shares).
195. Qian, supra note 7, at 67.
196. Id.
197. A commentator offered this example in his discussion of the provisional corporate law regulations that the Corporation Law superseded. Bersani, supra note 4, at 322. The point is equally valid under the 1993 legislation.
198. Corporation Law, arts. 129 (requiring share certificates), 132 (specifying contents of certificate).
Chinese corporations may follow current American trends toward "book entry" or uncertificated stock transactions. In some cases, stock certificates may be preferable, for they provide tangible, verifiable evidence of ownership that may be useful to counteract fraud.

Corporations may issue shares in registered or bearer form. Shares sold to promoters or government departments must be registered, making their identities and holdings known to the corporation. The general public may purchase bearer shares, for which corporations do not maintain records of ownership. The statute does not provide a mechanism for identifying the owner of bearer shares for voting or disbursing dividends. Presumably, the owners will have to present their certificates to the corporation.

Existing shareholders have priority in contributing to an LLC's newly added capital. This right appears comparable to the Western concept of preemptive rights, which allows shareholders to purchase new stock in proportion to their previous percentage ownership so they can maintain their percentage of ownership and control. The Chinese statute, however, merely mentions a "priority" without providing details. The Law does not specify the quantity or percentage of stock that a shareholder may purchase, the price or procedures, the remedy for violations of the priority right, or whether the right applies when the company sells stock for property or services.

Shareholders of an LLC may transfer their stock subject to restrictions that balance the rights of the selling shareholder and of the remaining shareholders. The seller must obtain permission from a majority of the other shareholders. If the shareholders approve the sale, they have the first chance to purchase the stock. If they disapprove the sale, the shareholders who voted against the sale must purchase the stock. Hence, this mechanism assures the selling shareholder the right to dispose of the stock and guarantees the remaining shareholders control over the purchaser's identity.

A corporation may not repurchase its stock unless the corporation amends its registration to reduce its capital. The effect of this restriction is to prevent a corporation from buying its stock at depressed prices and selling it later at higher prices. The provision is an example of strict governmental control over the allocation of capital, at the expense of enterprise flexibility.

B. Going Public and Issuing Bonds

A "public company" is a Joint Stock Company that has issued stock to the

199. See, e.g., Alexandria Peers, "Paperless" Wall Street is Due Next June, WALL ST. J., June 7, 1994, at Cl (describing federal deadline to eliminate stock certificates, unless investors pay extra for them as part of program to expedite settlement and delivery of stock after trades on exchange).
200. Corporation Law, art. 134. These types are also called "name" and "non-name," respectively.
201. Id. art. 133.
202. Article 134 provides for a shareholders' list of name shares.
203. The provision most relevant to these procedures specifies that, when a company has bearer shares, the company must announce the issues to be discussed at a meeting 40 days prior to the meeting, and the holders of these shares must hold their stock 5 days prior to the meeting. Corporation Law, art. 105.
204. Id. art. 33.
205. Id. art. 35.
206. Id. art. 149.
public with permission from the State Council.\textsuperscript{207} Such companies must have at least fifty million yuan in capital and at least one thousand shareholders. Furthermore, public shareholders, i.e., government entities, must hold at least twenty-five percent of the stock.\textsuperscript{208} The state also requires public companies to disclose and periodically publish records of their financial affairs and operations.\textsuperscript{209}

To issue stock or to maintain a listing on a stock exchange, a Joint Stock Company must have existed and earned profits for the past three years.\textsuperscript{210} The profit requirement protects investors against buying shares of failing companies. That protection, however, has a troubling consequence. Companies in difficult financial circumstances are deprived of capital even when additional investment would facilitate a recovery. Excluding those companies from the capital markets at the moment of their greatest need may doom them and exacerbate the losses to creditors, employees, and shareholders.

Wholly state-owned LLCs and Joint Stock Companies may also raise capital by issuing bonds. Privately held LLCs may not.\textsuperscript{211} Like stock, bonds may take either registered or bearer form.\textsuperscript{212} The statute also allows public companies to issue convertible bonds — bonds that the holder may convert into stock at will.\textsuperscript{213} Like stock, bonds may be traded on exchanges.\textsuperscript{214}

A host of restrictions apply to bond issuance. These restrictions assist in combatting fraud, which has already appeared in the bond market,\textsuperscript{215} and secure the government’s control over the use of investment capital. Any bond issue must conform to the state’s industrial policy\textsuperscript{216} and receive the State Council’s approval.\textsuperscript{217} Further standards ensure that only large and profitable companies may issue bonds. Each company must already have minimum capitalization and must not issue bonds in excess of forty percent of net capital.\textsuperscript{218} In addition, the issuer’s profits over the last three years must cover interest payments, and the proceeds of the issuance cannot be used to make up losses.\textsuperscript{219} Failure to make payments on previous bonds or default on other debt disqualifies a company from issuing bonds.\textsuperscript{220} Although these provisions tend to protect new investors, they also deprive struggling companies of the ability to borrow money possibly essential to their survival and growth.
C. Consideration for Shares

The financial provisions of the Law apply the concept of par, or face value, for stock. Although American corporate law is abandoning the concept of par,221 it may serve a useful purpose in China, at least temporarily, as the country grows more experienced with the corporate form. Chinese corporations may not issue stock for less than par value.222 This provision assures that all investors pay the same amount per share and hence effects an element of equity. A simple and age-old device called "low par" can readily and routinely defeat this approach,223 but the Law precludes use of "low par" unless a government agency permits it in a particular case.224

Other problems concerning the amount of consideration for stock arise from the use of tangible and intangible property. Directors may assign an excessively high value to certain property received in exchange for stock. This dilutes the value of other public investors' shares, which they purchased at full value. Because foreigners often have the assets that Chinese companies need, they are particularly well placed to take advantage of a corporation by demanding excessively high valuations for property contributed in exchange for stock.225

Conversely, the state worries that the value assigned to its contribution will be too low and will unfairly transfer some of the nation's wealth to a private or foreign entity.226 Private entities, and even local governments, have reaped windfalls as state-owned assets are sold.227

221. Anglo-American corporation law traditionally recognized par as a way to protect both investors and creditors of a corporation. The modern trend in American law, however, has been to abandon the concept of par, and all of its elaborate restrictions, in recognition of serious conceptual flaws in its structure. For example, the Revised Model Business Corporation Act now being adopted throughout the United States does not assign any legal significance whatsoever to par. See Robert C. Art, Corporate Shares and Distributions in a System Beyond Par: Financial Provisions of Oregon's New Corporation Act, 24 WILAMETTE L. REV. 203, 204 (1988).
222. Corporation Law, art. 131.
223. Stock is called "low par" when par value is lower than the price received. To illustrate, a corporation may set par at one dollar, or even one cent, and then sell the shares to the public at twenty dollars per share, their fair market value. The corporation then sells additional shares of the same class to certain favored insiders at only five dollars per share. Because both sales generate at least par value, the company has fulfilled the statutory requirement and fully circumvented the Law's intent to assure that all shareholders are treated equally.
224. The price received for stock cannot be less than "par value," but can be greater if "permitted by [the] securities management department of the State Council." Id.
225. The Chinese are sensitive to the perception that foreigners seek to exploit China — a perception with justification in history. Consequently, the joint venture law permits only those ventures that employ advanced technology, modern scientific management methods, innovation, and/or training. Potter, supra note 5, at 16. The belief that China should not be a dumping ground for obsolete or unwanted products and equipment from technologically advanced countries seems also to contribute to the Corporation Law's requirements for appraisal by government offices.
226. In Eastern Europe, for example, privatization of state enterprises often resulted in the enrichment of managers and the nomenklatura. Because of the lack of supervision and control, the nomenklatura arranged transfers of state assets to companies owned by themselves or friends. Gordon, supra note 57, at 523. Abuses experienced include insider dealing and gross undervaluation of assets. Philbrick, supra note 57, at 580.
227. China Limits Sale of Assets Held by State Companies, WALL ST. J., May 17, 1994, at A15. Wen Hui Bao, a government-run newspaper in Shanghai, reported that local government agencies and companies often sell assets or equity formally controlled by Beijing, using the proceeds for their own benefit. The central government estimates an annual loss of $3.4 billion due to undervaluation of its contributions to
The United States and China have chosen contrasting solutions to this problem. In the United States, a corporation’s board of directors assigns values to assets, subject to judicial review only in the case of fraud. China has opted for greater regulation. Companies may issue shares for noncash consideration, including goods, industrial rights, unpatented technologies, and land use rights, but they must appraise all such consideration in accordance with laws and regulations.\textsuperscript{228} Pursuant to these regulations, a specialized government office performs the appraisal, not the board of directors.\textsuperscript{229} Moreover, the statute caps a corporation’s swaps for industrial property rights or technology at only twenty percent of its stock.\textsuperscript{230}

D. Dividends and Allocation of Profits

The Chinese statute imposes detailed restrictions and requirements on balance sheets for shareholder equity accounts. The statute models some of these procedures on rules traditionally followed in American corporation laws. While the American rules have been largely abandoned as outmoded and ineffective, they are still familiar to American corporations and attorneys. Other restrictions reflect the unique accommodations necessary to adapt a capitalist organizational form to a socialist goal and the historical role of Chinese enterprises as vessels for delivering social services to workers.

When a corporation sells stock, the statute labels aggregate par value “registered capital.” If the stock sells for more than par value, the excess value is placed in an account called a “capital accumulation fund.”\textsuperscript{231} Traditional American corporation acts used the same procedures, though with different terminology (“stated capital” rather than registered capital, and “capital surplus” rather than capital accumulation fund).

The Corporation Law provides that revenues from stock transactions and business operations be accounted for separately. Although traditional American statutes also use a separate account for business revenues, labeled earned surplus by the statutes and retained earnings by accountants, the similarity ends there. The Chinese statute controls the allocation of the corporation’s profits and protects specified interests of corporate constituencies other than shareholders.

The “statutory collective accumulation fund” is the ongoing balance of a portion of the company’s profits, minus all of its losses, dividends, and other transfers. The account starts at zero when the company is first organized. When the company suffers a business loss, as calculated on its Income Statement (also known as Profit and Loss Statement), the amount will be subtracted from the statutory collective accumulation fund. The number this calculation produces may be negative. As long as that account remains

\textsuperscript{228} Corporation Law, arts. 26 (applicable to all shareholders), 80 (applicable specifically to promoters). A further provision, \textit{id.}, art. 81, adds that when a state-owned enterprise converts to corporate form, the assets it contributes must be fairly evaluated.

\textsuperscript{229} \textit{Id.} art. 26.

\textsuperscript{230} \textit{Id.} art. 80.

\textsuperscript{231} \textit{Id.} art. 178.
negative, all future profits must be allocated exclusively to the account.232

When the corporation earns profits (and the statutory collective accumulation fund is positive), then the statute mandates certain allocations. The corporation must dedicate ten percent of its profits to the statutory collective accumulation fund233 as a reserve for possible future losses and for reinvestment in the business.234 The corporation cannot use this fund to justify dividends to shareholders.235 The corporation must also allocate five to ten percent of profits to a "statutory public welfare fund"236 to provide for the collective welfare of workers.237 Interestingly, the allocation requirement does not apply if the statutory collective accumulation fund has reached fifty percent or more of registered capital.238 Thus, a corporation that has been successful enough to accumulate profits equal to half of the original investment is freed from the obligation to set aside a fund for its workers' benefit because it is considered sufficiently reliable to provide for them adequately.

After the mandatory allocations, a corporation has discretion in distributing its profits. It may allocate profits to a "discretionary collective accumulation fund" — essentially retaining the profits in the business. Alternately, it may distribute the amount as dividends to shareholders. Overall the Corporation Law is less restrictive in this area than previous law because it does not impose ceilings on the rate of return from stocks and bonds.239

This regulation of profit allocation is but a pale reflection of the traditional role Chinese enterprises played in providing lifetime employment, housing, medical care, retirement, and other social services to its workers. Requirements for "welfare funds" and regulation of the use of "accumulation funds" appear oriented toward maintaining, in some measure, the traditional social functions and responsibilities of enterprises for their workers.

The profit allocation requirements are not onerous, but to date there is no evidence that the state is substituting those requirements for the more encompassing, traditional obligation of state enterprises to provide social services to their work units. If Chinese corporations are to develop into independent, profit-maximizing economic entities on the international model, they must be relieved of their social welfare burdens. Organizing social services through enterprises worked only because extensive state subsidies kept each enterprise operating. The government must construct a new network of social welfare agencies to fill the gap240 — a mammoth task far beyond the

232. Id. art. 177.
233. Id.
234. Id. art. 179.
235. Id. (omitting dividends from permitted uses of fund).
236. Id. art. 177.
237. Id. art. 180.
238. Id. art. 177.
239. Zheng, supra note 4, at 610-11.
VI. CONCLUSION: CHINESE CHARACTERISTICS OF THE 1993 LAW

Though the PRC's Corporation Law of 1993 closely follows Anglo-American and Western patterns, it aims for different goals and will produce different results. Most fundamentally, China's Corporation Law is not primarily oriented to entrepreneurial, capitalist business in the Western sense. Instead, it is designed to restructure state-owned enterprise, which can be expected to remain the dominant feature of the Chinese economy for the foreseeable future. While the state intends to step out of direct management, it maintains ultimate control through majority stock ownership. The Law addresses private business only as a subsidiary goal. It governs, facilitates, and legitimizes private business merely as a supplement to the state economy.

The provisions for internal corporate governance include a number of distinctively Chinese characteristics. For example, the statutes call for a "legal representative," an individual capable of binding the corporation who is personally liable for misconduct. Other examples include the option to have a supervisory committee to oversee the board of directors and the specification of a role for workers in determining corporate policy. Further, the Corporation Law defines the powers of shareholders broadly so the government may exercise its ultimate powers over enterprises through stock ownership. Protections for workers and investors are built into the law. For instance, administrative sanctions for managers' breaches of duty substitute for the derivative actions used in corporate law outside China. Moreover, profit allocation is regulated in a unique fashion, reflecting the historical role of work units as providers of social services to workers.

Despite its promise for stimulating investment and improving enterprise management, China's social, economic, and political environment inherently limit the statute's potential effect. Courts may not effectively and accurately enforce rights and standards established by statute.241 The effect of national legislation in various regions is not uniform. The Communist Party's continued role within state-owned corporations may also inhibit or retard change. The Corporation Law may in the end merely mimic the jargon it borrows from the West without providing the full legal and social infrastructure necessary to make it meaningful and reliable.242

Current reforms represent corporatization, not privatization. Still, corporatization is a major step toward achieving international standards of business organization and motivation. Moreover, once state enterprises are converted into a corporate form with private ownership and transferability of shares, it will be logical and relatively easy for them to sell additional shares

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241. According to one commentator, multiple institutional features limit the ability of China's courts to enforce legal standards. These problems include poorly indexed laws and regulations, inadequate legal training of judges, vulnerability of judges to corruption and outside pressures, and obstacles in the enforcement of judgments. In addition, judges' decisions can be overridden by superiors who do not always follow legal standards. Clarke, supra note 2, at 57-71.

242. See, e.g., Potter, supra note 5, at 35 (expressing similar reservations regarding China's laws and rules affecting foreign joint ventures).
to the private sector.

Overall, China’s new Corporation Law is an important reform from both pragmatic and ideological perspectives. In the small private sector, the new law is likely to be highly useful. In the far larger state sector, which now and in the near future will dominate China’s non-agricultural economy, the effect is less clear. Repackaging state enterprises in the garb of Western capitalism will have merely cosmetic consequences if the underlying incentives remain unchanged. Success of the central goal of promoting efficiency and productivity depends on resolve and policies beyond the Corporation Law. The state must relieve state enterprises of their social-service functions and must resist pressures to intervene in, manage, and subsidize inefficient enterprises. Corporations unable to compete must be permitted to fail. Without such resolve and discipline, the Corporation Law may be doomed to the fate of a series of previous failed efforts to reform inefficient state enterprises.