

Revision of Laws and Corporate Governance in China:

With the treatment of tunneling as an example

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- Drastic modifications have been made to China's Company Law of 1994 and Securities Law of 1999, a draft revision to the Criminal Law is also put on the schedule of the Legislature.
 - One of the focuses of the law revisions is to strengthen the protection of minority shareholders and to improve corporate governance in China.
 - The revisions to the laws have been widely applauded in China. Now laws on paper seem to be able to improve minority shareholders' rights in especially the listed companies in the country.

Table 1 A Comparison of Shareholders Rights

Country Items	English- origin average	French- origin average	German- origin average	LLSV sample average	China (with the old company law)	China (with the new company law)
Proxy by mail Allowed	0.39	0.05	0	0.18	1	1
Shares Not Blocked before meeting	1	0.57	0.17	0.71	0	0
Cumulative Voting/ Proportional Representation	0.28	0.29	0.3	0.27	1	1
Oppressed Minority	0.94	0.29	0.5	0.53	0	1
Preemptive Right to New Issue	0.44	0.62	0.33	0.53	0	0
Percentage of Share Capital to call an Extraordinary Shareholder meeting	0.09	0.15	0.05	0.11	0.1	0.1
Antidirector Rights *	4	2.33	2.33	3	3	4

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- Even with the revisions, the new law provisions may still not be among the best protective laws.

 - A. They only provide moderate protections to the minority shareholders.

E.g., cumulative voting system, shareholders' proposal, derivative law suits, appraisal right of dissent shareholders.

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- B. If or if not the derivative suit mechanism can be operative in the reality may depend on the procedural rules in the forthcoming Judiciary Explanation supposed to be promulgated by the Supreme People's Court of PRC (SPC).

 - C. The courts may have not been ready to face a possible burst of private suits under the new Company Law.

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- Use “tunneling” as an example to contemplate, if the revisions to the laws will be helpful to curb looting of listed firms by their controlling shareholders.

 - A. When an armoury of private liability provisions have been added to the Company Law, legal enforcement remains a problem.

Firstly, the court system is not necessarily active to hear the related cases. Secondly, class actions are not permitted in China. Thirdly, the function of the "Private Attorney General" to recognize the role of private litigation in the enforcement of law is hindered.

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- B. The China Securities Regulatory Commission would be hampered in several ways in keeping its vow to solve the tunneling problem in China's market within 2006. First, both the Company Law and the Securities Law do not provide the agency with many specific powers to curb the tunneling illegalities. Second, CSRC is limited by its personnel scale to enforce the laws. Thirdly, the agency may even lack sufficient administrative authority to discipline those high-level state-owned shareholders behind some listed companies.

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- C. It is even more doubtful if China's two national stock exchanges have been given effective and appropriate authorities to combat tunneling. Even the CSRC and the self-regulatory organizations can be proved credible and their actions with teeth, their efficiency may be flawed since only very limited frauds have been caught and punished in the history of the securities market.

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- D. China's Criminal Law is to be revised to make the directors or managers and even controlling shareholder or de facto controlling person of a listed company to be subject to criminal liabilities if they loot the company. But when the disputed listed company is controlled by a SOE, it might be difficult to prove the "criminal culpability" which is indispensable under the criminal law for an action to constitute a crime.

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- Nevertheless, listed companies not controlled by state-owned capital are increasing year by year in China. Furthermore, "insider control" may have been not rare in state-controlled companies. Criminal penalty would have its roles in curbing looting in those companies.

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- To sum up, the institutions provided by the new Company Law and Securities Law still face quite a lot limits, which causes the tunneling occurs to China's listed companies may not be addressed in the near future. The multi-objectives of some of the shareholders (SOEs or the State itself) make the problem even complicated.

Introduction of criminal penalties may help to cure tunneling problems in the non-state-controlled listed companies, or looting of companies by their management for the latter's own interests, but it seems difficult for the criminal law provisions to be enforced when the profits siphoned off are used to prop up other state-owned enterprises in the same group.

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- Finally, while the positive effect of the adoption of minority shareholder protection or private right of action in the laws is undeniable, what and how much real effect it will have on the development of corporate governance in China still need to be seen.