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CHAMBERS GLOBAL PRACTICE GUIDES

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# Corporate Governance 2024

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**China: Law & Practice**

Kevin Wang

Global Law Office



# CHINA

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## Law and Practice

**Contributed by:**

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ing working on the first foreign general offer targeting Chinese companies on the Hong Kong Stock Exchange, the first state-owned red chip company listed in Hong Kong acquiring the controlling interest in an A-share company listed in China by means of a reverse takeover, and the first reverse merger case in which a red chip Hong Kong-listed public company span off part of its China business to list on a share market.

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## 1. Introductory

### 1.1 Forms of Corporate/Business Organisations

There are three principal forms of corporate/business organisation in China:

- companies;
- partnership enterprises; and
- individual proprietorship enterprises.

Only companies have the status of legal persons, and shareholders shall bear liabilities for a company to the extent of their respective subscribed capital contribution/shares. However, a shareholder who abuses the independent legal person status of the company or the shareholder's limited liabilities to evade debts, thereby prejudicing the interests of creditors of the company, shall be jointly and severally liable for the debts of the company.

Companies are categorised as limited liability companies and joint stock limited companies. Joint stock limited companies whose shares are listed and traded on a stock exchange are publicly traded companies.

### 1.2 Sources of Corporate Governance Requirements

The principal sources of corporate governance requirements for companies are the Company Law of the People's Republic of China (the "Company Law") and five judicial interpretations of the Company Law. In addition to the laws, judicial interpretations and regulations, the activities of a company and all participants (including shareholders, directors, supervisors and officers) are governed by the articles of association of the company.

### Publicly Traded Companies

Provisions on the supervision and administration of publicly traded companies are numerous and complex. As publicly traded companies are a type of joint stock limited company, the provisions of Chapter 5 of the Company Law, regarding joint stock limited companies, apply to them, and particularly, they are also subject to the special provisions of Section 5 of Chapter 5 regarding the organisation of publicly traded companies. The organisation and activities of publicly traded companies are also regulated by the Securities Law of the People's Republic of China, the regulatory rules of the China Securities Regulatory Commission (CSRC) and the relevant stock exchanges.

### 1.3 Corporate Governance Requirements for Companies With Publicly Traded Shares

Corporate governance requirements for companies with publicly traded shares mainly include the following:

- the company shall establish and maintain effective mechanisms of shareholder meetings, boards of directors, boards of supervisors, independent directors, board secretaries and special committees in accordance with the law;
- the company shall be encouraged to appoint officers in an open and transparent manner;
- the company shall establish fair and transparent standards and procedures for evaluating the performance of directors, supervisors and officers;
- the company shall establish a mechanism linking remuneration with the company's performance and individual performance;
- the company shall be strictly independent from its controlling shareholder and actual control persons in terms of personnel, assets,

- financial affairs, organisational institutions, business, accounting and also their respective responsibilities and risks;
- decision-making procedures and information disclosure obligations shall be strictly performed in connection with related-party transactions in accordance with the relevant rules;
- the company shall establish and implement a management system of information disclosure – it shall make public disclosures on documents such as periodic reports, interim reports, prospectuses, offering prospectuses, listing announcements, acquisition reports, etc; and
- internal control and risk management shall be established.

Corporate governance requirements for companies with publicly traded shares are mainly stipulated in the Code of Corporate Governance of Publicly Traded Companies, which was issued by CSRC in 2018. Some requirements are mandatory, while others are voluntary. However, certain provisions seem to be voluntary, but in fact have become quasi-mandatory, because companies may be confronted with unnecessary complications if they have not strictly complied with them in the IPO procedure.

## 2. Corporate Governance Context

### 2.1 Hot Topics in Corporate Governance

The Company Law was revised on 29 December 2023, and the new rules came into effect on 1 July 2024, with the following hot topics in corporate governance arising:

- the reform of registered capital system;
- the responsibility of the controlling shareholder and actual control person;
- the improvement of the legal representative system;
- the corporate governance structure about dual class equity;
- the competition between the centralism of the shareholders' meeting and the centralism of the board;
- the enrichment of shareholder derivative lawsuits;
- the protection of shareholders' rights; and
- the company autonomy and shareholder discretion in designing the company's articles of association.

The new revisions strengthen the protection of shareholders' rights and creditor's economic interest, improve the shareholder investment mechanisms, enhance compliance responsibility of corporate control persons and executives, and allow certain simplifications of company governance structure.

The new Company Law specifically focuses on the issues arising from corporate control right competition, shareholder litigation and director responsibility. In addition, it defines the content scope of articles of association that can be agreed upon by shareholders. It still leaves gaps open on many practical issues and increases the need for professional advice and even legal battles for all relevant parties.

### 2.2 Environmental, Social and Governance (ESG) Considerations

According to China regulatory rules, publicly traded companies shall disclose environmental information and fulfil social responsibilities such as poverty alleviation. ESG information disclosure is one of the obligations that publicly traded companies must fulfil, which requires them to incorporate "environment", "society" and "gov-

ernance” into the concept of enterprise development.

In 2024, China’s stock exchanges issued more specific requirements on the sustainable development report for publicly traded companies. A combination of mandatory disclosure and voluntary disclosure should be adopted for ESG reports, and violations may cause regulatory or disciplinary actions.

## 3. Management of the Company

### 3.1 Bodies or Functions Involved in Governance and Management

In China, the principal bodies involved in the governance and management of a company include the shareholder meeting, the board of directors, the board of supervisors and the manager.

- The shareholder meeting is the key organ of authority, responsible for making decisions on fundamental issues and electing the main members of the board of directors and the board of supervisors.
- The board of directors is the executive function in corporate governance. The managers are appointed by the board of directors and manager’s functions are defined in the articles of association. Depending on their relevant authorities in this executive function, directors or managers may hold the central position in the company’s day-to-day decision making process.
- The board of supervisors is the supervisory organ, responsible for supervising the execution of business and the company’s financial status. Without the board of supervisors, the company may also set up an audit committee in the board of directors to exercise the same functions and powers, in which case

the board of directors actually has the supervisory responsibilities.

In general, the new company law allows the removal of supervisors from the corporate governance structure. It may also, however, raise the concern of self-supervision by the board of directors itself, leaving an open question on how to balance the board’s power in such structure.

### 3.2 Decisions Made by Particular Bodies Decisions of the Board of Directors

The board of directors shall decide on the following matters:

- determining the company’s business plans and investment programmes;
- determining the establishment of the company’s internal management departments;
- formulating the company’s basic management system; and
- deciding on the hiring or dismissal of the managers and their remuneration.

The new Company Law deletes the board’s function of formulating plans in respect of the company’s annual budget and final accounts, which gives the company a discretion to transfer this function from the board of directors to the senior managers by an elaboration in its articles of association.

In addition, the board of directors shall exercise other powers prescribed by the articles of association and empowered by the shareholders’ meeting.

### Powers That the Shareholders’ Meeting can Give to the Board of Directors

Based on the empowerment by the shareholders’ meeting, the board of directors can decide on the following matters.

The below resolutions shall be adopted by a majority of all the directors:

- adopting resolutions on the issuance of corporate bonds;
- deciding on the company's purchasing its own shares to use shares for employee stock ownership plan or equity incentives;
- deciding on the company's purchasing its own shares to use shares for converting convertible corporate bonds issued by the company; and
- deciding on the company's purchasing its own shares because it is necessary for a listed company to protect the corporate value and the rights and interests of shareholders.

The following resolutions shall be adopted by more than two-thirds of all the directors:

- deciding on the issuance of new shares by not exceeding 50% of the issued shares within three years; but if non-monetary property is contributed as capital at an assessed value, such issuance shall be subject to the resolution of the shareholders' meeting; and
- deciding on the company's providing financial assistance for another person to acquire shares of the company or its parent company; however, the cumulative total of financial assistance shall not exceed 10% of the issued capital stock.

If the board of directors goes beyond the function stipulated in the law or the articles of association, and acts without any proper approvals by the shareholders' meeting, it will constitute a violation with potential damage to the interests of the company in judicial practice.

## Decisions of the Shareholder Meeting

In general, the new revision to Company Law narrows the scope of functions of the shareholders' meeting, and creates more rooms for the board of directors, which was appraised by many commentators as a sign of encouraging professionalism in corporate governance.

The shareholder meeting is responsible for making decisions on fundamental issues, including but not limited to:

- electing and replacing directors and supervisors, and determining their remuneration;
- reviewing and approving plans for the company's dividend distribution and loss recovery;
- amending the articles of association of the company;
- making resolutions on any increase or decrease of the company's registered capital; and
- making resolutions on merger, division, dissolution or liquidation of the company, or change of the company form.

## Protection of Bona Fide Counterparts

For the protection of the interests of bona fide counterparts and transaction stability, the Company Law stipulates the following special measures.

- For legal representatives, any restriction on their functions imposed by the company's by-laws or shareholders' meeting cannot be used as an excuse to deny the validity of the company acting against the bona fide counterpart.
- For directors, any restriction on functions of the board of directors in the articles of association cannot be used as an excuse to deny the validity of the company acting against the bona fide counterpart.

- If a people's court declares invalid, revokes, or confirms the untenability of a resolution of a shareholders' meeting or board of directors, a civil legal relation established between the company and a bona fide counterpart based on the resolution shall not be affected.
- The company cannot use the company registration matter without formal registrations or modifications as an excuse against the bona fide counterpart.

The above provisions mean that, if the bona fide counterpart has justifiable reasons to believe that the company is properly empowered and acts based on such belief, the court shall assume that the actions between the company and the bona fide counterpart are valid.

## Protection of Stakeholders' Interests

For the protection of stakeholders' interests, the Company Law stipulates special procedural requirements as a precondition for the following activities of the company, which essentially reflects the multiple layers of competition among the interests of shareholders and external creditors, and those of majority shareholders and minority ones:

- if a company invests in other enterprises or provides guarantees for other external parties, the decision shall be made by the shareholders' meeting or board meeting, per the articles of association of the company; and
- if a company provides a guarantee for its shareholders or actual control persons, the decision shall be made by the shareholders' meeting; the aforesaid shareholders or the shareholders under the control of the aforesaid actual control persons shall not vote on the aforesaid matters; the decision shall be passed by more than half of the voting rights

held by the other shareholders present at the meeting.

## The Validity of Guarantees by the Company When Legal Representatives Violate Internal Procedures

Article 7 of the Interpretation of the Supreme People's Court of the Application of the Relevant Guarantee System of the Civil Code of the People's Republic of China stipulates that if the legal representative violates the legal procedure of the company providing the external guarantee and exceeds their empowerment to conclude a guarantee contract with the counterpart on behalf of the company, the validity of the guarantee contract shall be determined in accordance with the following criteria:

- if the counterpart is in good faith, the guarantee contract shall be effective for the company; externally, the company shall bear guarantee liability; internally, the company may claim indemnification against the legal representative at fault; and
- if the counterpart is not in good faith, the guarantee contract is not effective for the company.

The counterpart has the obligation to reasonably examine the validity of the company's resolutions. If the counterpart has evidence of its reasonable examination, the people's court shall determine that it acts in good faith, unless the company has evidence showing that the opposite party knows or should know that the resolution is forged or altered.

The criterion for judging the good faith of the counterpart, for a case involving a publicly traded company, is whether the counterpart enters into the guarantee contract based on the information publicly disclosed by the listed company.

### 3.3 Decision-Making Processes

Normally, meetings of the board of directors shall be convened and presided over by the chair of the board. When the board of directors votes on a resolution, each director shall have one vote.

#### Procedural Requirements for Board Meetings

For a limited liability company, the discussion methods and voting procedures of the board of directors shall be specified by the articles of association or bylaws, unless it is otherwise provided for by the Company Law.

In joint stock companies, the convening of board meeting shall follow special procedural requirements.

- The board of directors shall convene at least two meetings a year, which must be notified to all directors and supervisors ten days in advance.
- Shareholders representing more than a tenth of voting rights, or more than a third of the board of directors or the board of supervisors, may propose to convene an interim meeting of the board of directors.

For limited liabilities companies and joint stock companies, their board meeting shall follow some procedural requirements.

- No meeting of the board of directors can be held unless more than half of the directors are present.
- When the board of directors makes a resolution, it shall be adopted by more than half of all the directors.

#### Related-Party Transactions

For the management of related-party transactions, it is clarified that affiliated directors shall recuse themselves from voting; if the number

of non-affiliated directors present at the board meeting is less than three, the related-party transaction shall be submitted to the shareholders' meeting for review and approval.

#### Voting Deadlock Solution

In practice, if there is a deadlock situation in decision-making, solutions should be clearly stipulated in the articles of association or internal corporate governance rules. For example, the chair of the board can have an additional second voting right, or some key directors can have a veto right.

With respect to the shareholder meeting, please see 5.3 Shareholder Meetings regarding decision-making processes.

## 4. Directors and Officers

### 4.1 Board Structure

The board of directors in a limited liability company shall have at least three members, while there is no upper or lower limit for the number of board members of a joint stock limited company.

- Small companies, a company with a smaller scale or with fewer shareholders may only have one single director, but without the board of directors.
- For medium-to-large companies, if the board of directors has three or more members, it may include an employees' representative. The board of a limited liability company which has 300 or more employees and does not establish the board of supervisors shall include an employees' representative.

#### Audit Committee or Board of Supervisors

A company may set up an audit committee in the board of directors to exercise the supervisory

functions and powers to replace the board of supervisors or supervisor. The audit committee of a joint stock company shall have at least three members.

## 4.2 Roles of Board Members

The board of directors shall be presided over by a chair, and may have one or more vice-chairs. The chair shall be responsible for presiding over shareholder meetings, convening and presiding over meetings of the board of directors, and inspecting the implementation of resolutions of the board. A vice-chair assists the chair in their work. If the chair cannot or does not carry out their duties, such duties shall be carried out by the vice-chair; if the vice-chair cannot or does not carry out its duties, the duties shall be carried out by a director jointly elected by more than half of the directors.

A publicly traded company shall have independent directors and board secretaries. Independent directors shall be responsible for supervising the directors and officers, and shall report their work to the shareholder meeting annually. The board secretary shall be responsible for the preparation of shareholder meetings and meetings of the board of directors, custody of documents, management of shareholders' materials, disclosure of information, investor relations and other matters.

## 4.3 Board Composition Requirements/ Recommendations

### Qualifications of Directors

Persons may not serve as a director of a company in any of the following circumstances:

- they are without civil capacity or have limited civil capacity;
- they have been sentenced to criminal penalties for corruption, bribery, embezzlement or

misappropriation of property or for sabotaging the socialist market economy order, and less than five years has elapsed since the expiration of the period of execution, and less than two years has elapsed since the expiration of the probation period of suspended sentence;

- they have been deprived of their political rights for committing a crime, and less than five years has elapsed since the expiration of the period of execution;
- they have served as a director or manager of an enterprise that has been declared bankrupt and they bear personal responsibility, and less than three years has elapsed since the date of completion of the bankruptcy liquidation;
- they have served as the legal representative of an enterprise whose business licence has been revoked or has been ordered to close its business operations due to a violation of law and bear personal responsibility, and less than three years has elapsed since the date of the revocation of business licence or the date of the order of closing down; and
- they have been listed by the people's court as the persons subject to the enforcement for breach of trust obligations because they have a large amount of debt, which is due but has not been repaid.

### Special Requirements for Chairman and Staff in Certain Industries

There are special senior position segregation requirements in specific industries. For an example, the chairman of a bank or an insurance company shall not concurrently serve as the CEO or the general manager for the institution. And members of commercial banks and state-owned companies may not take part-time jobs in other economic organisations.

## 4.4 Appointment and Removal of Directors/Officers

The directors who are not representatives of the employees shall be appointed and removed by the shareholder meeting. The employees' representatives shall be democratically elected by the employees through the employees' congress, through the employees' meeting or in other ways. The method of appointing the chair and vice-chair of the board of directors in a limited liability company shall be stipulated in the articles of association of the company.

In practice, the chair and vice-chair can be elected or recommended by the shareholder meeting or the board of directors. The chair and vice-chair of the board of directors in a joint stock limited company are elected by more than half of all the directors on the board of directors.

The manager shall be appointed and removed by the board of directors. The appointment and removal of the deputy manager and chief financial officer shall be recommended by the manager and decided by the board of directors.

### Legal Representative

For the legal representative, the new revision to Company Law has special provisions.

- The legal representative of a company shall be a director or general manager who carries out business on behalf of the company.
- If a director or manager who serves as the legal representative resigns, they shall be deemed to have resigned from the legal representative position at the same time. If the legal representative resigns, the company shall appoint a new legal representative within 30 days from the date of resignation.
- The articles of association of a limited liability company shall specify the methods of

appointing and replacing the company's legal representative.

The new revision to Company Law expands the scope of candidacy of legal representatives beyond chairpersons or the CEO, and resolves a potential difficult situation that the legal representative may not be available for performing duty if no successor to the chair or CEO is available. The new revision also encourages the diversity of members of board of directors.

## 4.5 Rules/Requirements Concerning Independence of Directors

As a general rule of fiduciary duty, directors must act with good faith and independently for the best interests of the company. Regarding the rules or requirements concerning independence of directors, the current regulations about independent requirements are mainly for the independent directors.

### Independent Director Requirements

Independent directors of publicly traded companies are required to meet the general requirements for directors as stipulated in the Company Law, as well as the specific qualifications for independent directors under regulatory supervision rules applicable for publicly traded companies.

- Persons who work or provide services in the publicly traded company, its controlling shareholders, its actual control persons, or their respective subsidiaries and their related persons, or persons who have significant business dealings with the above-mentioned enterprises, or persons who work in companies having significant business dealings with the above-mentioned enterprises, their controlling shareholders or their actual control

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