



Newsletter No. 233 (EN)

**Rights of Shareholders
in China**

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I. Introduction

The rights of shareholders in a Chinese company depend on the type of company.

There are two types of companies with limited liability in China:

- limited liability companies (LLC), which include private companies; and
- companies limited by shares (CLS), which include both private and public companies.

II. Shareholder Rights

What powers do shareholders have to appoint or remove directors or require the board to pursue a particular course of action?

What shareholder vote is required to elect or remove directors?

The shareholders of LLCs are entitled to appoint and remove directors in accordance with the method as stipulated in the articles of association of the company.¹

The appointment or removal of directors in a CLS requires a shareholders' resolution with a simple majority of votes of the shareholders present at the general meeting.

Under the Company Law, the board of shareholders (in Chinese: “股东会”) in LLCs and the shareholders' general meeting (in Chinese: “股东大会”) in CLSs (hereinafter the “the board of shareholders” and “the shareholders' general meeting” collectively called “the shareholders' meeting”) is the highest

decision-making body of a company.

Regular meetings and extraordinary meetings held by LLCs and CLSs have differing meeting conveners and processes. Regular meetings must be held on a regular basis in accordance with the provisions of the company's articles of association, but with a maximum interval of one year. Extraordinary meetings are held in response to a legal cause or a proposal from certain proportions of shareholders, (board of) directors, or (board of) supervisors.

The board of directors must answer to shareholders at these meetings and must enforce resolutions passed at shareholders' meetings.

III. Shareholder Decisions

What decisions are reserved to the shareholders? What matters require a non-binding shareholder vote?

The Company Law reserves the final binding decisions to the shareholders (in both LLCs and CLSs) on the following matters:

- the business direction and investment plans of the company;
- the appointment and **dismissal of directors and supervisors** and their remuneration;
- increase or reduction of the **registered capital** of the company;
- the issuance of **corporate bonds**;
- the merger, division, dissolution, liquidation or change of company form;
- the amendment of the articles of association of the company;

enterprises or other LLCs, he/she shall be elected by the employees.

¹ If the director is an employee representative in an LLC established by two or more state-owned

- the review and **approval of reports of the board of directors or supervisors, annual financial budget, accounting plan, profit distribution plan and loss recovery plan**; and
- other matters as provided in the articles of association.

The following additional rights are given to the shareholders:

- The provision of security by the company for a shareholder or the *de facto* controller of the company must be approved by a resolution of the shareholders' meeting; and
- If a listed company purchases or sells major assets, or provides guarantees to third parties, and the transactional value exceeds 30% of the company's total assets within any given year, the transaction must be approved by a two-thirds majority of the voting rights of the shareholders present in the meeting.

IV. Disproportionate Voting Rights

To what extent are disproportionate voting rights or limits on the exercise of voting rights allowed?

In an LLC, the voting rights of a shareholder shall be based on the ratio of its capital contribution, unless otherwise provided in the articles of association of the company.

In a CLS, the fundamental principle of "one share, one vote" is adopted: one share of a shareholder represents one voting right in the shareholders' meeting.

² e.g. issuing new preference shares, the amendment of the articles of association related to the preference shares, a single or accumulative reduction of the registered capital of the company exceeding 10%, and the merger, division, liquidation or change of corporate form).

³ This change was introduced in Announcement No. 2 [2019] of the China Securities Regulatory

However, if a division of ordinary shares and preference shares is adopted in a CLS, preference shareholders are generally not entitled to attend or vote in a shareholders' general meeting. However, preference shareholders are entitled to vote during a separate class of meetings on a few limited matters.²

In addition to preference shares, after considering the market demand, the Chinese government has introduced a special voting rights mechanism in the Shanghai Sci-Tech Innovation Board (STAR) called "Weighted Voting Rights".³

This mechanism allows a company's shares to be split into groups with different voting rights, usually termed "A shares" and "B shares". "A shares" provide the holder with up to 10 votes per share; however, they cannot be transferred at will (therefore cannot be traded on open markets) and the shares' voting privileges must be waived if they are converted to ordinary voting shares. These are usually held by the founding team of a company. "B shares" offer a single vote per share and can be circulated as normal in the market.

V. Shareholder Meetings, Voting

Are there any special requirements for shareholders to participate in general meetings of shareholders or to vote? Can shareholders decide by written consent without a meeting? Are virtual meetings of shareholders permitted?

Commission Implementation Opinions on Setting up the Science and Technology Innovation Board and Launching the Pilot Program of the Registration System on the Shanghai Stock Exchange, which formally put forward a policy to allow "enterprises with special equity structure and red-chip enterprises to be publicly traded".

Shareholders legally registered in the shareholders' register are generally allowed to participate in general meetings of shareholders.

Exceptions:

- For a resolution in providing securities to a shareholder or the actual controlling party of the company, these shareholders or the shareholders controlled by the actual controlling party shall not participate in the general meeting of shareholders.
- Preference shareholders in a CLS can only participate and vote in the general meeting of shareholders under limited circumstances.
- A shareholder of a stock-listed company who is interested in a matter proposed for discussion at a shareholders' general meeting must abstain from voting on the matter, and his/her shares with voting rights shall be excluded from the total number of shares with voting rights which are present at the shareholders' general meeting.

Besides physical meetings, shareholders of LLCs are permitted to pass a resolution in writing without convening a physical shareholders' meeting as long as this resolution is approved unanimously and is signed and sealed by all the shareholders.

If the company's articles of association permit, the shareholders' meeting can be held by telecommunication means. It can be presumed that holding the shareholders' meeting by telecommunication is legally valid, provided that the statutory requirement relating to running the meeting and the adoption of resolutions are adhered to the relevant rules specified in the articles of association of the company.

VI. Shareholders and the Board

Are shareholders able to require shareholders' meetings to be convened, resolutions and director nominations to be put to a shareholder vote against the wishes of the board, or the board to circulate statements by dissident shareholders?

To convene a meeting of shareholders, the following must be done:

- In a CLS, shareholders who hold 10% or more of the company's shares for 90 consecutive days or more can convene and preside over a general meeting on their own initiative if the board of directors and the board of supervisors have failed to fulfil their obligations to convene a general meeting.
- In an LLC, if the shareholders' meeting is not called, shareholders who represent 10% or more of the voting rights can convene and preside over the meeting on their own initiative.
- A shareholder may petition a court to invalidate or withdraw a general meeting if the procedure or content of the meeting violates any law, administrative regulation or the company's articles of association.

The Company Law does not provide specific rules on the nomination of directors. However, pursuant to the Guidelines on Governance of Listed Companies, listed companies shall stipulate in their articles of association standardized and transparent procedures for the nomination and election of directors, and ensure that the election of directors is transparent, fair and equitable.

In practice, if a meeting of shareholders is convened, shareholders are able to make shareholder proposals, such as nominating a person to be a director before the notice of invitation (which includes the program and agenda of the

meeting) is circulated to the shareholders. However, in a CLS, any shareholder holding 3% or more of the shares of the company can submit a written proposal to the board of directors at least 10 days in advance of a general meeting.

VII. Controlling Shareholders' Duties

Do controlling shareholders owe duties to the company or to non-controlling shareholders? If so, can an enforcement action be brought against controlling shareholders for breach of these duties?

Under Chinese law, a company's controlling shareholder cannot abuse its controlling position, rights and pre-existing relationship with the company (including through manipulation of related-party transactions) to the detriment of the interests of the company and other non-controlling shareholders. Otherwise, this controlling shareholder shall be liable for the damages caused.

The controlling shareholder of a stock-listed company owes a duty of good faith towards the company and its shareholders.⁴ In addition, the controlling shareholder should exercise its rights complying with laws and regulations strictly. Any act that could infringe the company's interests or other shareholders' legal rights is prohibited. The controlling shareholder is also forbidden to acquire additional profits by virtue of its controlling position.

If the controlling shareholder infringes the lawful rights and interests of the company, causing the company to incur a loss, any shareholder or shareholders who alone or jointly hold at least 1% of the company's shares for at least 180 days

in succession have the right to request the supervisory board (or the supervisors, for an LLC without a supervisory board) to start legal proceedings in court regarding the infringement.

If the supervisory board or the supervisors reject this request, fail to start legal proceedings within 30 days upon receipt of this request or in urgent circumstances where failure to promptly start legal proceedings could cause irreparable harm to the company's interests, the shareholders have the right, in the interests of the company, to directly start proceedings in a court in their own name against the controlling shareholder.

In addition, when the interests of investors in a stock-listed company are damaged due to actions of the company (e.g. misrepresentation), the investors can file a securities civil compensation lawsuit or entrust an investor protection organisation to do so.⁵ However, the latter requires at least 50 investors to join in the request. If the issuer engages in fraudulent issuance, misrepresentation or other illegal acts committed at the direction of a controlling shareholder or the actual controller, the controlling shareholder or the actual controller will be directly civilly liable to the investors.

Besides, if a resolution of the shareholders' meeting violates any law or administrative regulations, this resolution will be null and void. In the former case, or where the resolution violates the articles of association of the company, the non-controlling shareholders can request a court for rescission of the resolution. Moreover, the non-controlling shareholders are entitled to directly initiate a lawsuit against the controlling shareholder before a court if their own

⁴ Article 63 of the Guidelines on Governance of Listed Companies.

⁵ Article 95 of the Securities Law.

interests are infringed by the controlling shareholder.

VIII. Shareholder Responsibility

Can shareholders ever be held responsible for the acts or omissions of the company?

Shareholders shall not abuse their shareholders' rights to cause damage to the company or the interest of other shareholders or abuse independent legal person status of the company and limited liability of the shareholders to cause damage to the interests of the creditors of the company.⁶

Shareholders are however responsible for the acts of the company if the acts or omissions are considered the result of an abuse of shareholders' rights and they cause the company or other shareholders to suffer damage.

Shareholders of a company who abuse the independent legal person status of the company and the limited liability of a shareholders to evade debts and cause serious damage to the interests of the creditors of the company shall bear joint and several liability for the company's debt.

During a company's liquidation process raised by the specific dissolution situations of the Company Law, creditors can make direct claims against the shareholders of an LLC or the controlling shareholders of a CLS for the company's debt **in certain circumstances**,⁷ such as:

- The liquidation team fails to form within 15 days, and thus causing the devaluation, loss, damage or extinguishment of the company's property.
- The liquidation team neglects to proceed with the liquidation, resulting in the extinguishment of the company's primary property, accounts and important documents, resulting in the impossibility of liquidation.
- The company carries out the deregistration without liquidation process, resulting in the impossibility of liquidation.
- Other circumstances stipulated in the Supreme Court Provisions.

*We hope that the information provided in this newsletter was helpful for you.
If you have any further questions, please do not hesitate to contact us.*

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⁶ Article 20 of the Company Law.

⁷ Outlined in Sections 18, 19, and 20 of the Provisions of Supreme People's Court on Several

Issues Relating to Application of Company Law of the People's Republic of China (II) (Amended in 2020) (the "Supreme Court Provisions").