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Comparison of Legal Regulations of Controlling Shareholders Abusing Influence Between the Company Laws of China, Japan and Hong Kong

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ABSTRACT
Controlling shareholders often drive the companies to serve for their personal interests through voting rights, personnel arrangement and other influences, which leads to damages to the benefits of the company and minority shareholders. Therefore, preventing controlling shareholders from abusing their influence has always been an important task for different jurisdictions. At present, China has established a relatively systematic mechanism against the influence abuse by controlling shareholders. However, there are still some problems, such as small scope of protection, lack of regulatory effectiveness, high relief threshold and so on. Hong Kong and Japan provide creative resolutions for this issue. On the basis of case law, Hong Kong has expanded the scope of punishment for controlling shareholders' abuse of influence in statute law. Japan tries to establish an indirect regulatory system to build a good relationship between controlling shareholders and other shareholders. Although there are great differences among these three jurisdictions, this paper intends to make a comparison of their relevant legal regulations to contribute to China's current restriction system, instead of reconstructing China's current regulatory system. On the one hand, it helps to strengthen the advantages of China's direct regulatory mechanism. On the other hand, it can broaden the theoretical basis and extension of the current legal system of China.

Keywords: *Company law, Controlling shareholder, Comparative law.*

1. INTRODUCTION

1. 1. Definition of Controlling Shareholder

The definition of controlling shareholder in Chinese company law adopts the formal and substantive standard. For one thing, the company law follows the majority principle (50%). For another thing, considering the situation where shareholders control the company with less 50% of their capital contribution or shareholding, the company law takes the voting rights as the standard. Although Chinese company law does not specify the meaning of the substantive standard, in practice, shareholders can control the company through weighted voting rights, pyramid shareholding structure, cross shareholding and the arrangements in the articles of association. In addition, article 216 also defines the concept of "actual controller". But in essence, both the controlling shareholder and the actual controller are the controllers of the company, and their obligations are basically the same in the Chinese company law. Other countries have basically adopted these two standards for the definition of controlling shareholder.

However, Japanese and Hong Kong's company law don't provide the definition for "controlling shareholders". It doesn't mean that they ignore the importance of restricting the controlling shareholders. For HK, considering that every member of companies who commits misconduct or oppresses the minority shareholders is qualified plaintiff, it's unnecessary to regulate the behaviors of controlling shareholders independently. Japanese company law doesn't provide the definition because it chooses the indirect regulatory system. Their functioning mechanism will be discussed in the following.

1.2. Ways of Controlling Shareholders Abusing Influence

In practice, the ways of controlling shareholders abusing influence are as follows: Related transaction, such as the

transfer of assets between related parties; personnel arrangement, for example, the controlling shareholders use their influence to insert personal trust in key positions of the company to realize the benefit transfer; misuse or occupation of the company's capital, for example, some controlling shareholders control multiple companies at the same time and often misappropriate the capital from each other; using the majority principle unreasonably to modify the articles of association. In addition, the controlling shareholders can abuse their shareholders' rights since they are also part of ordinary shareholders.

1.3. The Reasons Why Controlling Shareholders Abuse Influence

The inherent deficiency of the majority principle: Professor Zhu Ciyun believes that the majority rule of capital provides an "institutional interest" for controlling shareholders[1]. The controlling shareholders not only have the right to propose to hold a shareholders' meeting, but also can control the contents of the shareholders' meeting. It is very difficult for minority shareholders to have a substantial impact in the decision-making process. On the one hand, controlling shareholders can maximize their own interests through their influence; On the other hand, when the decisions of the controlling shareholder harm the interests of the company, the controlling shareholder can transfer the bad consequences to the company and other shareholders.

Lack of good check and balance mechanism: At present, there are still many deficiencies of Chinese regulatory system, including but not limited to: firstly, the scope of application of voting right avoidance is too narrow. It only applied to the situation where the company provides guarantee for the company's shareholders or actual controllers. Secondly, the cumulative voting system is not good enough. It only apply to the election of directors and supervisors and is not mandatory, which reduce its utilization greatly. Thirdly, directors and supervisors often lack of professionalism and the independence of independent directors cannot be guarantee.

2. CHINESE LEGAL REGULATIONS ON CONTROLLING SHAREHOLDERS' ABUSE OF INFLUENCES

2.1 Obligations of Controlling Shareholders

According to Article 21 of Chinese company law, controlling shareholders, actual controllers, directors, supervisors and senior managers of a company shall not damage the interests of the company by taking advantage of their related relationship. Article 216 clarifies the concept of "related relationship" further: related relationship refers to the relationship between the company controller, actual controller, director, supervisor, senior management and the enterprise that are directly or indirectly controlled by them, as well as other relationships that may result in transfer of company interests.

In addition, controlling shareholders should also undertake their obligations as ordinary shareholders. Article 20 stipulates that shareholders shall not abuse their rights to damage the interests of the company or other shareholders and they bear compensation liability to the company and other shareholders if their abuse of the ordinary shareholder's rights lead to damages upon shareholders and company. However, article 21 does not mention the situation that controlling shareholders use related transactions to harm other shareholders, which is unfair to other shareholders, especially for those minority shareholders. Therefore, "improper use of related relationship" ought to be included in "the abuse of ordinary shareholders' rights"[2], In other words, other shareholders are also the protection objects under article 21.

2.2 Accountability Mechanism

As mentioned above, when the controlling shareholders abuse their influence (related relationship and shareholders' rights) and hurt the interests of the company or other shareholders, the company and other shareholders can bring lawsuits and claim compensation toward the controlling shareholders. In addition, other shareholders can also seek relieves through derivative action. Based on Article 151 of Chinese company law, when someone infringes upon the legitimate rights and interests of the company and causes losses to the company, the shareholders have the right to sue on behalf of the company. "Someone" here absolutely includes controlling shareholders[3].

According to Article 22, if their contents and procedure violate laws, administrative regulations or article of association, shareholders can apply the people's court to revoke the resolution within 60 days from the date of making the resolution. Under the majority principle, the resolution of general meeting is likely to be the resolution of controlling shareholders. This provision prevents controlling shareholders from abusing their influence on the general meeting.

Considering the abuse of influence by the controlling shareholders of listed companies may cause more serious adverse impact, the CSRC will not only supervise the behavior of the controlling shareholders of listed companies, but also take administrative measures to punish them when they violate the relevant laws and regulations. For example, if a controlling shareholder of a listed company fails to disclose information in accordance with the related regulations, or the disclosed information has false, misleading statements or major omissions, he will be ordered to make corrections, given a warning, and fined not less than 300000 yuan but not more than 600000 yuan.If a controlling shareholder or actual controller of a listed company arbitrarily changes the purpose of the funds raised by the public offering, he will be punished in the same way.

3. STATUTORY REGIME OF HK ON RESTRICTING CONTROLLING SHAREHOLDERS

Hong Kong and mainland China are more or less the same because of the ownership concentration. But from another perspective, HK belongs to the common law jurisdiction and its statutory regime develops based on various cases, which makes its statutory regulations different from Chinese ones. In view of the fact that HK and Chinese companies have many similarities in aspect of culture and governance, the statutory regulations of HK can offer some inspirations for China.

3.1 Statutory Derivative Action (SDA)

The shareholders of the company can also claim their rights basing on the exception of the proper plaintiff rule. In case controlling shareholders commit misconduct against the company, a member of the company has standing to sue the controlling shareholders. Actually, the provisions of SDA provide lower requirements for minority shareholders to sue the controlling shareholders. Firstly, as long as you are the member of the company, you have right to bring SDA. There is no restrictions of the members' condition. Secondly, a member of an associated company of the company also has right to sue in the name of the company, which expand the scope of proper plaintiff. Thirdly, the concept of "misconduct" under statutory provisions is wider than that under Common law derivative action, including fraud, negligence, breach of duty and default[14]. Lastly, the grant of leave is conditional on two relatively low threshold: "appear to be in the company's interest" and "there is a serious question to be tried"[4]. The court normally doesn't have to enter into the merits of the proposed action to any great degree and only requires the plaintiff to show at least a probability that the company will succeed.

3.2 Unfair Prejudice Remedy

CO s724(1) regulated that the court may exercise the power on a petition by a member of a company if the company's affairs are being or have been conducted in a manner unfairly prejudicial to the interests of the members. The statutory laws don't offer a very precise definition to the concept of "fairness' and it must be understood in the context and background. Judges will provide different understanding for "unfair prejudice" in different cases. Traditionally, "unfair prejudice" are applied to the quasi-partnerhsip where a company is more like a partnership because actually this concept come from the partnership law. But now the courts have held that the shareholders of a listed company can also bring unfair prejudice claim, regardless of the scale or types of the company.

Judges are granted very broad power in terms of unfair prejudice actions. For one thing, the courts have power to decide weather the defendant's conducts constitute "unfair prejudice". For another thing, based on CO s724, the court may make any order that it thinks fit. Theoretically, there are no limitations about what kinds of orders the court can make. Among the example orders, 'buy out orders' is frequently used by the court. If a controlling shareholder abuses its influences to treat members of the company unfairly, the members can sue the controlling shareholder to ask him or her to purchase the member's shares. Under this situation, the court can also order the controlling shareholders to pay any damages and interest on those damages to the victims. Therefore, the court have great powers to restrict the controlling shareholders from abusing influences to oppress the minority shareholders.

4. THE LEGAL REGULATION OF JAPAN FOR PARENT COMPANY

Because enterprise groups play an important role in the Japanese economic system, Japanese law makes a more detailed regulations on the abuse of influence by the parent company (controlling shareholders). In view of the fact that the company law system in China does not involve the issue that parent companies abuse influence, its regulatory regime deserves further analysis.

4.1 Strengthen the Independence of Subsidiaries

The parent company can have a de facto influence on the operation of the subsidiary through voting rights (especially the right to elect and dismiss the directors of subsidiaries). In this case, the Japanese company law establishes the independent status of the subsidiaries. Even if it belongs to an enterprise group, as long as it is an independent company legally, directors of subsidiaries must act for the benefit of the subsidiaries. Although the directors of subsidiaries actually have to consider the interests of the enterprise group or parent company, directors of the subsidiaries must perform their functions and powers for the benefit of the subsidiary under the Japanese company law. Even if a transaction is beneficial to the whole enterprise group, it cannot be the reason to deny the liability of the directors of subsidiaries if the transaction is contrary to the benefits of subsidiaries. According to Article 423, when a transaction occurs between the parent and subsidiary companies and the transaction obviously hurts the interests of subsidiary, the board of directors of the subsidiary will be considered slack of duty. In this case, in accordance with Article 827, shareholders of the subsidiary can bring derivative action to hold the directors accountable. In addition, the shareholders of subsidiaries may also apply to the court to stop the transaction to continue in accordance with articles 360 and 385. In order to strengthen the independence of the directors of subsidiaries, article 342

stipulates that when the company elects more than 2 directors, the shareholders who have voting right can request the company to adopt the cumulative voting system.

4.2 Disclosure Obligation

Japanese company law and related regulations require subsidiaries to disclose important transactions with their parent companies. Article 112 of Japanese Company Accounting Rules requires subsidiaries to show the content, amount and conditions of important transactions with the parent company in financial accounting reports. Subsidiaries need to record the directors' opinions on such transactions in company's business report. In addition, under article 129, item 1, No. 6 of the Japanese company law, opinions of supervisors or the board of supervisors on the important transactions with the parent company must be recorded, too.

5. COMPARISON AND IMPROVEMENT

5.1 The Comparison between Three Jurisdictions

From the above, we can see that there are many differences of the regulations in these three jurisdictions. These differences reflect the different regulatory ideas. China's company law has established a relatively complete system for controlling shareholders' abuse of influence and has two obvious characteristics. Firstly, China's system adopts the direct regulation method; secondly, the situation setting of controlling shareholders abusing influence is more specific in Chinese company law. The advantage of this system is that it is convenient to regulate the abuse of controlling shareholders in specific situations, which improves the judicial efficiency. But the disadvantage is that it can't regulate the behavior outside some specific situations, such as company group. This shortcoming further leads to the lack of accountability channels and the situation where victims have no law to rely on. Lawyers or judges can only resort to those limited regulations and walk hard on way of making creative explanations and regulatory approaches.

Hong Kong and Japan have provided their own solutions for the issues above. On the one hand, the company law of Hong Kong does not stipulate the specific conducts of controlling shareholders abusing their influence. Instead, it regulates people who hurt the interests of minority shareholders and the company through "misconduct" and "unfair prejudice". This mechanism paves the way for broadening the scope of the plaintiff's qualification and litigation channels. Any shareholder of the company can directly bring lawsuit against the controlling shareholder abusing their influence by SDA or unfair penalty, without the consent of company. Because there is no clear definition of abuse conducts, judges have been given great power to explain the defendant's behavior and give orders, which provides more possibilities to protect victims. Although Hong Kong lacks of class action regime, the relevant legislation has been put on the agenda. However, it is worth noticing that Hong Kong's regulatory idea is based on its status as a common law jurisdiction and a financial center: the combination of common law system and written law brings judges broader discretion; The status of financial center requires Hong Kong to safeguard the interests of minority shareholders so as to maintain market stability. Therefore, China should learn from Hong Kong on some key points, rather than copy it.

On the other hand, although both of Japan and China belong to the civil law system, they have great differences. First of all, like Hong Kong, Japan does not directly regulate controlling shareholders. Due to the inherent deficiency of majority principle, it is difficult to limit controlling shareholders abusing influence in the actual operation. Therefore, Japanese company law chooses to restrict them by strengthening the independence of their subsidiaries. This not only prevents the parent company from interfering in the operation of its subsidiaries, but also provides an opportunity for its subsidiaries to learn how to deal with the relationship with the parent company. Secondly, some special situations are added in Japanese company law. For example, Japanese company law impose various disclosure obligations on subsidiaries. With the development of China's capital market, corporate groups have become more and more significant[5]. However, there is no the legal regulations on preventing parent company from abusing influences in China. So it is still necessary for China to further strengthen the understanding and exploration of the extension of controlling shareholders on the basis of the existing regulatory regime.

5.2 Improvement for Chinese Regulations based on The Comparison

Enrich the connotation of controlling shareholders in the legal regulations. At present, the definition of controlling shareholder in China lies in article 216 of Chinese company law. Although it adopts both formal and substantive standards, it's not enough. The parent company should also be included in the category of controlling shareholders. In addition, in reality, a group of people can also jointly control a company since individual in the group may not has significant impact on the company's operations. This situation ought to be included in the law, too. In addition, China's securities law and other listing rules comply with the definition of controlling shareholder in Chinese company law. Considering listed companies have greater influence in the market economy, I think we can follow the example of Hong Kong and lower the threshold for controlling shareholders of listed companies, for example, reducing the formal standard from 50% to 40%.

Strengthen the indirect regulation for controlling shareholders. Indirect regulation can be divided into two aspects: one is to strengthen the power of minority shareholders, the other is to strengthen the supervision function of internal organizations. For one thing, Chinese company law should expand the scope of application of cumulative voting system, and implement the normalization of cumulative voting system on some important issues. In addition, I suggest that the controlling shareholder should be included in article 152 so that other shareholders can directly sue the controlling shareholder for their personal interests. On the other hand, it's necessary to strengthen the authority and function of the directors, supervisors and senior executives in the company's operational process to restrict controlling shareholders.

Improving the direct regulation for controlling shareholders. First of all, it's not enough to limit the avoidance of the controlling shareholder's voting only to guarantee. On some important issues, controlling shareholders should also be forbidden to vote to avoid conflict of interest. Secondly, even if the controlling shareholders are not required avoid voting, the controlling shareholders also have the obligation to disclose the possible conflict of interest before voting. Members of the board of directors and shareholders shall vote on the matters with knowledge. If the controlling shareholder intends not to disclose relevant information, other shareholders can request the court to revoke the company's resolution in accordance under article 22.

6. CONCLUSION

China has established a relatively complete system for controlling shareholders' abuse of influence. Compared with Hong Kong and Japan, China focuses on the direct regulation of controlling shareholders. This kind of point-to-point strike is in line with China's national conditions, and is also a regulatory direction that China should adhere to in the future. However, this system is not perfect and there are many deficiencies in its theoretical basis and regulatory structure. Compared with China, the statutory regulations of Hong Kong have reserved sufficient space for the interpretation of these abusing conducts, expanded the scope of legal regulation on controlling shareholders and provided diversified ways for other shareholders to safeguard their rights. Japan maintains the dynamic balance of the relationship between parent and subsidiary companies through indirect restrictions and regulations in some special situations. Experience of these two judiciaries not only can contributes to the concrete Chinese legal regulation, but also promotes Chinese regulators to think about the new connotation and regulatory approaches from a deeper and broader perspective.

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