This is the published version:

Fu, Jane 2012, Derivative actions as a mechanism for protection of minority shareholders in China: theory, law and practice, in Contemporary private law, International Association of IT Lawyers, [Hellerup, Denmark], pp.390-401.

Available from Deakin Research Online:

http://hdl.handle.net/10536/DRO/DU:30050733

Every reasonable effort has been made to ensure that permission has been obtained for items included in Deakin Research Online. If you believe that your rights have been infringed by this repository, please contact drosupport@deakin.edu.au

Copyright: 2012, International Association of IT Lawyers
Derivative Actions as a Mechanism for Protection of Minority Shareholders in China: Theory, Law and Practice

Jane Fu*
Deakin University, Australia

Abstract. The protection of minority shareholders has become one of the key features of corporate governance in many countries in recent years. The statutory derivative action has been created as one of the major mechanisms to achieve this objective. China also adopted a similar mechanism – officially known as the “shareholder representative action” (also called the derivative action) in 2005; this mechanism was largely based upon China's understanding of statutory derivative actions in major Western countries. This article examines the shareholder representative action mechanism in China for the protection of minority shareholders from the perspectives of the theoretical debates, the legal scheme, and the practical effect. It focuses on an analysis of the confusion of theoretical debates about the nature of the shareholder derivative action and the procedural obstacles for its utilisation in China. It concludes that the shareholder representative action in China is a mechanism which rests upon a half-understanding of Western derivative actions; the incomplete law-making and the weak court system has diminished the functions of derivative actions in China.

1. Introduction

China’s laws on the protection of minority shareholders are mainly found in two pieces of legislation, namely, the Company Law and the Securities Law. These two Laws were first enacted by China’s highest lawmaking body – the Standing Committee of the National People’s Congress (NPC) in 1993 and 1998 respectively. Constant criticisms of them had been made since their enactments. One of the criticisms was that they lacked effective mechanisms for the protection of shareholders and that led to the mass abuse of powers by directors and majority shareholders.

---

* LLB (Peking), LLM (Canberra), PhD in Law (UNSW), Senior Lecturer, School of Law, Deakin University, Australia, jane.fu@deakin.edu.au. An earlier version of this article was presented at Peking University Law School conference entitled Corporate Governance and Corporate Social Responsibility in 2006.

1 Legislation in China only refers to the law making of the National People’s Congress or its Standing Committee — the equivalent as Western countries’ national parliaments.
2 Hereinafter “NPC”.
In response to the criticisms, the 1993 Company Law and the 1998 Securities Law were both substantially amended at the Eighteenth Meeting of the Tenth Standing Committee of the NPC on 27 October 2005. Both Laws came into effect on 1 January 2006. One of the key areas of amendments was the introduction of various mechanisms which sought to enhance the protection of shareholders, especially minority shareholders. The shareholder representative action is one of these mechanisms. It is provided in article 152 of the Company Law of 2005.

The shareholder representative action is commonly referred to as the derivative action by Chinese legal scholars. This action is intended to have a significant impact on the improvement of corporate governance in Chinese companies and the development of China’s socialist market economy.

However, by analysing the concept of the shareholder representative action and the problems involved with the proceedings for bringing such actions in Chinese courts, this article argues that although the shareholder representative action mechanism in China has been strongly influenced by Western models, it was built upon a half-understanding of Western derivative actions. The company law reforms up till the end of 2005 reflected an uneasy compromise between the dire need for the protection of shareholders and the ambiguities that arose in legal proceedings because of China’s weak court system. This article concludes that the mechanism of the shareholder representative action is not viable in its current form and actually causes great confusion and inconsistence. This mechanism is largely symbolic; due to the specific characteristics of the Chinese legal system, this mechanism is merely a tentative gesture with few real functions.

This article is structured as follows: Part II reviews the background to the making of China’s 2005 Company Law and Securities Law with the focus on the introduction of the shareholder representative action. Part III compares the provisions on the protection of minority shareholders in the 1993 Company Law and the 1998 Securities Law with those found in the 2005 Company Law and Securities Law. Part IV offers some conclusions and suggestions.

2. Background

When the first PRC Company Law was enacted on 29 December 1993, the aim of this law was to ‘meet the need of a socialist market economy and establish a modern enterprise system by adopting a shareholding system in state-owned enterprises (SOEs).’ The provisions of the 1993 Company Law were focused on transforming SOEs into either limited liability companies or shareholding limited liability companies. The securities markets were established as an experiment in the early 1990s and the first Securities Law was not enacted until December 1998. With the rapid development of
the socialist market economy it soon became apparent that the old Company Law and Securities Law would not suit the development of China’s economy.  

One of the major problems with the 1993 Company Law was that ‘it did not have effective mechanisms for the protection of shareholders, especially minority shareholders’ and it also lacked ‘... effective tools to protect creditors, other stakeholders and public interests’. For a long time the Chinese securities market had often been described as being worse than a ‘casino’ and it was said that investing in such market was like ‘dancing with wolves’. Thus the aims of the 2005 amendments to both Company Law and Securities Law were to ‘adjust relevant systems, maintain the market economic order and reduce transaction risks so as to make the Company Law more suitable for the economic and social development, and provide legal protection for the overall development of the economy and society’. 

During the drafting process, the drafters conducted studies of foreign company laws by visiting foreign countries and convening symposia in China on foreign company laws with the participation of foreign company law experts. The major foreign models that China studied were those of the USA, Germany, Japan, Korea and Hong Kong. Several drafts of the Company Law Amendment Bill were prepared. The last version of the Bill drafted by the State Council was sent to the Standing Committee of the National People’s Congress for the first reading in December 2004. The second, third, and final versions of the Company Amendment Bill were written by the Legislative Affairs Commission (LAC) of the Standing Committee of the NPC based on the bill of the State Council. The LAC acknowledged that its bill was still transitional and that some of its aspects remained unchanged either due to a lack of experience or consensus. Nevertheless, the 2005 Company Law contains thorough amendments to the old law with most of the old articles being rewritten.

Before the 1993 Company Law was enacted, the drafting of the Securities Law had already started. In August 1992, the Fiscal and Finance Committee of the NPC formed a Securities Law Drafting Group. A draft bill was prepared in August 1993 after the study of foreign securities market regulations and practices, as well as the study of the experiences of the Shanghai, Shenzhen and Hong Kong Stock Exchanges. The aims of the draft Securities Law bill included: ‘the improvement of the development of the socialist market economy; ensuring openness, justice, fairness, efficiency and unity in the securities market; and the protection of the interests of investors.’

---

9 Ibid.
10 Ibid.
11 In 2001, Professor Wu Jinglian, one of the most influential economists in the Chinese economic reform alleged that China’s securities market was even worse than a casino as ‘a casino at least has rules for games’. See Wu Jinglian, Ten Years of the Securities Market (Shinian Fengju Hua Guang), Beijing, Economic Reform Press, 2003, pp 1-32.
13 Above note 5, p 351.
15 Ibid.
16 Ibid, p 4.
17 Ibid, p 5.
19 Ibid.
However, due to the short history of the Shanghai and Shenzhen Stock Exchanges and a lack of experience from practice, China’s cautious legislators postponed the drafting. The Securities Law was not enacted until 29 December 1998. This is a very narrow and simple piece of legislation; its principal focus is upon the regulation and supervision of the securities market.

After some 15 years of securities market practice and studying, the legislators had finally released the serious inadequacies in the 1998 Securities Law. They also realised the importance for the introduction of mechanisms for the protection of minority shareholders as this market is predominated by vulnerable retail investors. New provisions on the shareholder representative action were introduced in both Company Law and Securities Law of 2005.

The following Part reviews these new provisions. Rationales for the shareholder representative action will be examined. The procedures for such actions will also be investigated.

3. Protection of Minority Shareholders and the Shareholders Representative Action in the Chinese Law

3.1 Schemes for the Protection of Minority Shareholders

It is clear from analysed above that the 1993 Company Law did not focus on the protection of minority shareholders, although this matter was declared as one of its purposes. The 2005 Company Law, however, has strengthened the protection of shareholders, especially minority shareholders. It has imposed new duties on directors, supervisors and other senior officers of the company. These provisions have indirectly provided a possibility for the protection of minority shareholders. The new Company Law has also added articles with respect to the direct protection of shareholders. First, shareholders are now given the right to know about the company’s business. This right is seen as the foundation for the protection of minority shareholders. This type of right includes the right to inspect and make a copy of the company’s articles of association, the resolutions of the meetings of the board of directors, the resolutions of the meetings of the supervisory board, as well as the financial accounting reports of the company; joint stock companies have a duty to prepare and provide relevant information and documents at designated places, and must provide shareholders with periodic reports of the remuneration paid to directors, supervisors and senior managerial officers of the company.

Secondly, new provisions have been inserted to deal with the calling of shareholders’ general meetings and meeting rules have been improved.

---

41 Above note 5.
42 PRC Company Law 1993, article 1.
43 Articles 34, 98.
44 Article 97.
45 Article 117.
46 Articles 40, 101, 102, 103, 105, 106.
Finally, the provisions on the shareholder representative action provide the ultimate remedy for the minority shareholders. The shareholder representative action mechanism defined in article 152 of the 2005 Company Law will be discussed in detail later.

Following the amendments made in the 2005 Company Law, corresponding changes were made in the 2005 Securities Law:

(i) some misconduct in the securities market such as insider trading, fraud and market manipulation will bear civil compensation liability as well as criminal liability; 27
(ii) when a takeover bidder company or its controlling shareholder has infringed the interests of the target company or the interests of other shareholders and caused loss to them, the bidder company and its controlling shareholder must bear liability to pay compensation; 28
(iii) in particular, shareholder representative actions can be brought by shareholders when directors, supervisors, senior managerial staff or shareholders holding more than 5% or more of the company shares have breached the restriction on trading in company shares during a six-month period and the company fails to take actions. 29 This is a special type of shareholder representative actions.

Obviously the shareholder representative action has been introduced into Chinese law as an important mechanism aimed at the protection of minority shareholders. 30 Next this article will deal with the issues with respect to the shareholder representative action.

3.2 Concepts of Shareholder Representative Action, Derivative Action and Shareholder Direct Action in China

Just as China's economy is at a transitional stage, 31 China's enterprise system and securities market are also going through transitional changes. 32 China has been drawing upon foreign experience in developing its own companies and securities regulatory regimes since the early 1990s. 33 However, much knowledge about foreign law and practice came from study of provisions of foreign laws and short visits to some foreign countries by China's law drafting people, 34 and from the ten-member Company Law Amendment Expert Advisory Group of whom few had a thorough understanding of foreign company laws when the first Company Law and Securities Law were being revised. Thus accuracy and completeness of this knowledge was somewhat in doubt. This situation resulted in the confusing provisions in the new Company Law and Securities Law. The concepts of shareholder representative action, derivative action and direct action are examples of such confusion.

27 Articles 69, 76, 77, 79.
28 Article 124.
29 Article 47.
32 Ibid.
34 An, J (ed), p 350.
Article 152 of the 2005 Company Law is the key provision on shareholder representative action. It provides that 'when any director, or any senior managerial officer has breached laws, regulations or the articles of association of the company, and thereby caused damage to the company, a shareholder, or a group of shareholders holding 1% or more of the company shares (either separately or jointly) for a consecutive period of 180 days, may in writing request that the supervisory board or the supervisor (in the case of a limited liability company), bring an action against this director, supervisor or senior managerial officer to the court; if any supervisor is involved in such a breach, the aforesaid shareholder(s) may in writing request the board of directors or the executive director (in the case of a limited liability company which has not established a board of directors) to bring such an action before the court.

Article 152 continues to provide that shareholders shall bring a shareholder representative action on their own behalf for the interests of the company. Western lawyers may find it hard to understand how an action brought by shareholders on their own behalf can be called a derivative action. This is because the derivative action in Western countries refers to an action brought by shareholders on behalf of the company for a wrong done to the company where the company is unwilling or unable to bring the action. 35 Thus an action under article 152 would be seen as a direct action in Western countries.

In China it was widely believed by Chinese legal scholars that the shareholder representative action was the same as the derivative action. 36 Professor Liu Junhai, one of the prominent company law scholars, held the view that 'the shareholder derivative action referred to an action which was brought by shareholders on their own behalf when the interests of the company had been infringed by other parties, especially by the controlling shareholder or directors.' 37 He argued that although the derivative action was focused on shareholders exercising the company's rights, the representative action was focused on the shareholders' status as the representative of the company in the action, and both actions really meant the same thing. 38 Professor Yan Qing noted that the term "derivative action was used in common law countries, whilst in civil law countries this action was called representative action". 39 In a book edited by Professor Jiang Ping, one of the ten experts of the Company Law Amendment Experts Advisory Group, it was also held that "the derivative action is also called the shareholder representative action". 40 Even the State Council drafters of the original Company Law bill held the same view. 41

To some degree there was therefore an incomplete understanding in China of derivative actions. Most of the literature mentioned above describes the shareholder

---

35 *Australian Corporations Act 2001 (Cth)*, section 236; *Australian Corporate Law Economic Reform Program Bill 1998 Explanation Memorandum*, para 4.2
38 Ibid, p 85.
representative action as one action brought on behalf of shareholders. Few people advocated that the derivative action must be brought on behalf of the company. It seemed that the draftsmen of the LAC were reluctant to use the term derivative action which came from the US law. Instead, they chose the terms of shareholder representative action which is used in the Japanese law and the Taiwanese law. However, the LAC did not elaborate whether the shareholder representative action was different from the derivative action. Some legal academics continue to hold the view that the derivative action is "the same as the shareholder representative action".

What is clear among most of the scholars who think that the derivative action is the same as the shareholder representative action is that both terms refer to an action based on the right to sue which belongs to the company; what is confusing is that they believe that shareholders should sue on behalf of themselves, rather than on behalf of the company. This is confusion between the direct action and the derivative action.

There were three major reasons for the Chinese legislators' preferred use of the term shareholder representative action. First, if the Company Law allowed shareholders to bring an action on behalf of the company when the interests of the company have been infringed, and the company is unable or fails to bring such an action against the wrongdoer, there would be a conflict with the current PRC legal representative system. China introduced a system of director in charge from the former USSR in the PRC General Principles of Civil Law 1986. Under this Law and the Law on Industrial Enterprises Owned by the Whole People 1988, the director of a factory was the legal representative of that factory. The legal representative refers to a person who represents the company when dealing with outsiders. This concept is officially defined as 'the person who signs on behalf of the enterprise'.

Secondly, the functions of a legal representative also include representing the company to appear in courts. Under the 1993 Company Law, the Chairman of the board of directors was the legal representative. During the process of drafting the 2005 Company Law, the Supreme People's Court argued that if shareholders were allowed to bring an action on their own behalf when the interests of the company were infringed, these shareholders would be representing the company in courts and thus would become a legal representative of the company. Therefore, this would be in conflict with the legal representative provisions found in the previous legislation.

Thirdly, if shareholders were allowed to bring an action on behalf of the company, were they the plaintiffs or the agents of the plaintiff? To avoid the ambiguities in the

---

43 Shi, Tiantao, p 304; Cao, Kangtai et al (eds), A Research Report on Amendments to the New Company Law, p 159.
45 Jiang, Ping and Guoguang Li (eds), The New Company Law Training Textbook, Beijing, People's Court Press, 2005, p 327.
47 Author's interview of Professor Wang Baoshu of Tsinghua University Law School, a member of the Company Law Amendment Experts Advisory Group on 4 December 2005 in Beijing.
48 Ibid.
49 The State Administration for Industry and Commerce, Amendments to the Implementing Rules Concerning Registration and Administration of Enterprise Legal Persons 1996, article 27.
50 Ibid, articles 45, 113.
51 Author's interview of Professor Wang Baoshu, above note 47.
legal status of such shareholders before courts, the Supreme Peoples’ Court objected to allowing shareholders to bring an action on behalf of the company against the wrongdoer. This argument was reflected in the language of article 152. Article 13 of the Company Law 2005 expands the ‘legal representative of the company’ to include the chairman, the executive director or the manager. Nowadays, a new persuasive view is to treat the company as a third party without separate right to sue.

In China, the concept of the derivative action has been widely used by academics. As they have acknowledged that although this concept originated in the Anglo-American legal system, the concept in the Chinese law was unfortunately based on half-understanding and confusion. The views of the influential Chinese academics would later have to some degree misled the legislators.

The first confusion is between the shareholder representative action and the direct action. Under article 153 of China’s 2005 Company Law, if the misconduct of directors or senior managerial personnel of the company has infringed the interests of a shareholder, the shareholder may bring an action against them to the court. The action brought in this way is direct action. The legislative drafters explained that the direct action was an action brought by shareholders on their own behalf when their personal interests were infringed. Article 153 article originated from article 111 of the 1993 Company Law. There are four major differences between the shareholder representative action and the direct action: (i) the shareholder’s right to bring a representative action comes from the right belonging to the company while in a direct action the shareholder’s right to sue belongs to himself/herself; (ii) in the shareholder representative action, the wrongdoer is the defendant, including not only directors or supervisors, but also a third party; in the direct action, directors, supervisors or senior managerial personnel are the defendants; (iii) the shareholder representative action deals with the infringement of the interest of the company while the direct action deals with the infringement of a shareholder’s personal interest; (iv) the proceeds of the shareholder representative action belong to the company and the interests of all other shareholders are indirectly protected, while the proceeds of the direct action belong to the individual shareholders who have sued in the direct action.

The concept of the shareholder representative action is very confusing for another reason. Such representatives can be easily mixed up with the representatives in joint actions which are regulated under article 53 of the PRC Civil Procedure Law. Article 53 provides that if the subject matters in two or more actions are the same or of the same kind, these actions are joint actions; and the People’s Court may merge these cases with the agreement of all parties. It also provides that if there are too many litigants, shareholders may elect representatives in the litigation. However, in the class action, the subject matters of plaintiffs may not be the same. So far no further laws have been made or amended to accommodate the utilisation of the shareholder representative action.

China has not accepted the class action into its legal system. The joint action is widely used when there are more than one plaintiffs or defendants. In fact, it is slightly different from the class action which exists in many Western countries. The applicants in the joint action have the same dispute and the same judgment binds every applicant; while in the class action, the judgment applies to the same kind of litigants no matter whether they agree with the judgment or not.

---

52 Ibid.
54 AN, J (ed), p 219.
55 Ibid.
3.3 Comparison of the Shareholder Representative Action under the 1993 Company Law and the 2005 Company Law

To assess the functions of the shareholder representative action precisely and objectively, it is vitally important to review the law making process. The 1993 Company Law was silent on whether shareholders could bring representative actions; only article 63 provided that 'directors, supervisors and managers should bear liability to pay compensation if they had breached laws, administrative regulations, or the articles of association of the company, and thus had caused damage to the company'. This article could be interpreted as the basis for bringing shareholder representative actions. However, the 1993 Company Law did not use the term of shareholder representative action nor did it have any related provisions for actions under article 63. Consequently, old article 63 was merely a symbolic gesture without any real legal effect.

In China the shareholder representative action was seen as a mechanism for directly protecting the interests of the company and indirectly protecting the interests of the minority shareholders. The 2005 Company Law has formally adopted the concept of the shareholder representative action. Although Chinese lawmakers have tried to mirror the derivative action mechanism that is used in Western company laws, the shareholder representative action nevertheless has been tailored to suit the needs of China's legal environment. Unfortunately the Chinese law has mixed up the shareholder representative action with the direct action because Chinese law-makers are reluctant to accept the class action.

To get a clearer picture of the shareholder representative action mechanism, it is necessary to visit the relevant provisions in the 2005 Company Law in detail. Article 152 allows certain shareholders to bring a shareholder representative action 'on behalf of themselves'. Article 153 goes on to provide for shareholders' direct actions. It states that 'when directors or senior managerial personnel have breached laws, administrative regulations or the articles of association of the company, and have infringed the interests of shareholders, shareholders may bring an action to the court.' It is confusing to allow both the shareholder representative action and the shareholder direct action to be brought on the shareholders' own behalf.

3.4 The Shareholder Representative Action under the 2005 Securities Law

Most of the situations in which shareholders may bring representative actions are covered by article 152 of the 2005 Company Law. In addition, there are still other situations where shareholder representative actions can be brought, such as those provided under article 47 of the 2005 Securities Law. Article 47 aims to prevent the insiders of listed companies from making personal gains. It provides for a special type of shareholder representative actions. It is worth noting that the action under article 47 must also be brought on behalf of the shareholders, rather than on behalf of the company, although such a right to sue belongs to the company.

56 Ibid.
3.5 The Parties and the Requirements for Bringing a Shareholder Representative Action

Chinese law-makers have tried to balance the right to bring shareholder representative actions and the business efficiency of the company. On the one hand shareholders are given the right to bring representative actions for the purpose of protecting minority shareholders. On the other hand, some restrictions are imposed so that there are no frivolous actions and company's resources will not be wasted. Article 152 of the 2005 Company Law provides that a shareholder representative action can only be brought to the court on the following conditions:

- **Only certain shareholders can sue and only certain officers can be sued**
  Under paragraph 1 of article 152, only current shareholders may bring a representative action. Former and future shareholders do not have the right to sue on behalf of the company. As the Chinese Company Law only allows limited liability companies and shareholding limited liability companies to be formed, the persons intending to sue must be current shareholders of the company. In Australia, the range of plaintiffs is very broad: not only a current shareholder, but also a former shareholder, or even an officer of the company can bring a statutory derivative action.

- **Article 152 only allows a director, a senior manager, or a supervisor to be sued.**
  It excludes the important officer - the secretary of the board of directors. But it does not specify who is a 'senior manager'. Although it allows 'another person' who infringed the interests of the company to be sued, the concept of 'another person' is too broad for Chinese judges who have no power to interpret substantive law.

- **Requirements for the minimum shareholding and the minimum duration of shareholding**
  Article 152 further requires that the shareholder(s) in a joint stock company which can issue securities to the general public must either separately or jointly hold 1% or more of the company shares and this shareholding must last for 180 consecutive days before the action can be brought. In a big SOE which issued millions of shares, it is not easy to hold 1% of the total shares. 180 consecutive days of shareholding is also too restrictive as most individual shareholders prefer short-term trading in the Chinese securities markets. In Western countries such as Australia there is no requirement for shareholding percentage or shareholding duration.

As mentioned earlier, during the drafting of the 2005 Amendments, there had been different opinions on whether the system of a sole representative of the legal person should be reformed as this system was in conflict with the shareholder derivative action and was not in use in other countries. After examining the counterpart laws of the US, Japan, Korea, Germany and Taiwan,
and considering that China had no sound credit and trust system, the majority of the legislators formed the view that it was necessary to maintain the status quo. Nevertheless, the 2005 amendments have expanded the scope of the people who can act as the legal representative of the company. The national legislature so far has not made any accommodating litigation laws or interpretations about the detailed procedure for bringing the shareholder representative action. It is hard for Chinese judges to effectively and fairly implement article 152 for the same reason as that mentioned above.

- **Pre-requisites for bringing a shareholders representative action**

There are three pre-requisites: (i) the shareholder must have referred the subject matter to the directors or supervisors of the company, or the executive director of a company without a board, or the supervisor of a company without the supervisory board, before he/she can bring an action to the court; (ii) the request for dealing with the subject matter must be made in writing; (iii) the action may only be brought after the board of directors, the supervisory board, the executive director of a company without a board of directors, or the supervisor of a company without a supervisory board has refused to bring an action, or has failed to bring an action, or if there is an emergence and non-immediate court proceedings will make the company suffer unrecoverable loss. These prerequisites were designed for China’s domestic situations. But in practice they are extremely hard to meet. First, it is very time-consuming, complicated, and even costly for minority shareholders to request the company to first deal with the matter because individual shareholders live in different cities and companies are not very responsive to outsiders. Secondly, it is also very hard to prove the urgency of the subject matter. Thirdly, it is impractical to request directors to first deal with supervisors’ misconduct as directors and supervisors do not have equal status in China. Supervisors can give orders to directors and senior managers or even bring legal actions against them. In practice, supervisors are senior to directors. It is not easy for the board of directors to sue supervisors as the latter are usually appointed by the government. It is not efficient and effective in China to use the company itself as a filter to prevent frivolous actions.

### 3.6 Costs Issues

A common problem in both China and Australia is the ambiguity about the costs issue. Legal costs can operate as a disincentive to litigation and thus Australian courts were given the power to make costs orders in derivative actions. This power to make costs orders is very broad and discretionary. Sometimes the costs problem under the Chinese law is simpler to solve than Australia because the Supreme People’s Court (SPC) has set the rules on litigation fees. However, there is still some uncertainty. The 2005 Company Law does not have detailed procedures for bringing the shareholder representative action, let alone the

---

63 Ramsay, ‘Corporate Governance, Shareholder Litigation and the Prospects for a Statutory Action’, p. 163.
provisions on the indemnity of the costs of the shareholder who brought such action. If a shareholder representative action is brought to a Chinese court and accepted, most probably the court will apply the general rules on litigation costs released by the Supreme Peoples’ Court. One such rule is that the loser pays the cost of the winner. In a shareholder representative action, the shareholder plaintiff will be treated the same as any other plaintiff in any other civil cases. If he wins, his legal costs will be first fully indemnified out of the remedies awarded to the company. If the monetary remedies are big enough to cover the shareholder’s litigation costs and the loss of the company, it is going to be fine. But if the monetary remedies are not enough to cover the loss of the company, or not enough to pay the shareholder’s litigation costs, which of the litigating shareholder and the company will be paid first remains a question. This uncertainty to some degree is one of the disincentives for using of the shareholder representative action. If the remedies are not monetary at all, it will certainly deter the use of the shareholder representative action.

4. Conclusion

The mechanism of the shareholder derivative action was only introduced into China very recently. It is a great leap forward in the Chinese company law and corporate governance reform.

Yet, the shareholder representative action in China is an ambiguous and confusing mechanism which is based on a half-understanding of the derivative action scheme of Western countries. This mechanism is also incomplete and symbolic. It will only assuage the law-makers’ good intention but be of limited effectiveness in providing the protection of the minority shareholders in China.

To improve this mechanism much work has to be done: China first has to be clear to what extent it can transplant the common law seeds into China’s civil law soil; the confusion of the nature of the derivative action with that of the shareholder direct action must be cleared; detailed litigation procedures (especially jurisdiction and status of each litigation participant) must be set urgently; the indemnity of litigation costs must be clearly provided.

---