公司法修改国际研讨会

International Conference on the Amendment of Company Law

会议论文

CONFERENCE PAPER

主办：国务院法制办公室　中国证券监督管理委员会
承办：上海证券交易所

Host: Legislative Affairs Office of the State Council P.R. China
China Securities Regulatory Commission
Organizer: Shanghai Stock Exchange

2004年10月11—12日

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1、论文以原文为准，译文仅供参考。

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Notes:

1. All papers should follow their original texts. Translations are only used for reference.
2. Some papers have not been submitted or translated in time, therefore they are not collected in this book. We will issue those papers or translations at the time of conference.

THE INDEPENDENT DIRECTOR IN CHINESE CORPORATE GOVERNANCE*

Donald C. Clarke
Professor of Law, George Washington University Law School
Fellow, China Law Center, Yale Law School
Web site: http://donclarke.net
Email: dclarke@post.harvard.edu

International Conference on Amendment of the Company Law
Shanghai, China
Oct. 11-12, 2004

Draft date: Sept. 13, 2004**

1 *Introduction*

Corporate governance (*gongsi zhili*) is a concept whose time seems definitely to have come in China, and the institution of the independent director is a major part of this concept. Policymakers in several countries such as the United Kingdom and Japan have turned to independent directors as an important element of legal and policy reform in the field of corporate governance. In August of 2001, the China Securities Regulatory Commission (CSRC) issued its Guidance Opinion on the Establishment of an Independent Director System in Listed Companies (hereinafter the Independent Director Opinion or the Opinion). Covering all companies listed on Chinese stock exchanges (but not Chinese companies listed overseas), it constitutes the most comprehensive measure taken to date by the CSRC -- or indeed by any Chinese governmental authority -- to regulate internal corporate governance through the institution of the independent director.

This paper will discuss the institution of independent directors, and the Independent Director Opinion specifically, as a potential solution to Chinese corporate governance problems. I will argue that proponents of the institution misconceive the nature of the corporate governance problem in China, as well as the functioning of independent directors in the United States, and have not taken into account specific features of the Chinese institutional environment -- particularly the legal environment -- that affect the viability of any proposed solution.

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* The current draft is a much abbreviated version of a longer, yet unpublished paper. Comments and suggestions are very welcome.

** A note on citations: For the sake of economy, this draft generally uses U.S. law review style with respect to signals, parentheticals, etc., but with abbreviations instead of full citations of sources. A table matching abbreviations to full citations is attached at the end. Note that abbreviations for legislative and similar enactments, unlike abbreviations for secondary sources, may not include the year in parentheses. Some inconsistencies no doubt remain.

2 *Corporate Governance in China*

In this paper, I will be discussing the "post-traditional" enterprise in China: an enterprise that is no longer bound tightly within the traditional state planning system and operated by its administrative superior agency essentially as a division within a larger enterprise.[1] It is an enterprise in which voluntary, contractual relationships are important and top-down commands from government are less important. Government policy is to restructure traditional state-owned enterprises into companies organized under the Company Law and owned by profit-seeking shareholders. So far, this restructuring has progressed reasonably well, but a number of problems remain.

Chinese discussions of corporate governance problems typically focus on two areas of concern. It is important to understand the distinction between them in order to assess the potential effectiveness of independent directors in addressing them.

2.1 Insider Control

One prominent complaint about the current regime governing the powers and responsibilities of enterprise managers is that there is too much "insider control" (*neibu ren kongzhi*). Because control of the firm must rest with some person or persons, and those persons are virtually insiders by definition, it is necessary to unpack this complaint a little. What is usually meant is insider control unfettered by effective accountability mechanisms, with the result that assets belonging to the corporation are converted through various subterfuges into the personal property of management. This asset-stripping is made possible by the devolution of considerable managerial authority to the enterprise level coupled with the legalization of new forms of trade and new privately-controlled entities to which the stripped assets can, by means of controlled transactions, be transferred. The complexity of property relations and ownership forms has outstripped the state's capacity to monitor, which has remained designed for the simple structures of an earlier day, when private ownership of significant property was not allowed, and transfers between enterprises were physical and not financial. The result is the phenomenon of the "absent owner" (*suoyouzhe quewei*): it is not collective action problems that prevent effective shareholder monitoring, since there is a large and possibly sole shareholder, but rather organizational problems internal to that shareholder.

2.2 Dominant Shareholder

A second complaint is that management may respond all too well to a board under the control of a dominant shareholder (*yigu duda*), which will use its power to exploit minority shareholders through such devices as manipulating prices in transactions with controlled entities. Indeed, when corporate governance failings are specifically studied, they typically relate to abuse by the dominant shareholder of its position, not to the depredations of management at the expense of shareholders as a whole. For example, a 2002 study of corporate governance by the CSRC and the State Economic and Trade Commission (SETC) found that 676 listed companies had had their funds misused by their parent company (the controlling shareholder) in the amount of almost US$12 billion.[2] Thus, policymakers are

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[1] Most such enterprises are governed by the State-Owned Enterprise Law.

[2] See JJRB (2003a).

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concerned with the consequences of both underconcentration and overconcentration of share ownership.

2.3 The State as Dominant Shareholder

The picture is further complicated by the fact that although the state has an interest in preventing dominant shareholder exploitation of minority shareholders when it is a passive shareholder, it may itself be guilty of such exploitation when it is the dominant shareholder.[3] Indeed, the entire project of retaining majority state ownership, and therefore control, in particular firms or sectors has as its purpose the use of that control to achieve objectives other than profit maximization -- for example, full employment or strategic control of a particular industry that for some reason cannot be achieved through regulation.[4]

The ideological justification for retaining state majority ownership cannot lie in simple profit maximization for the state, since there is no *a priori* way of knowing whether profits would be maximized by keeping the state's holdings in a particular firm or by selling them, and indeed firms without dominant state ownership have been shown in several studies[5] to outperform firms with dominant state ownership. Thus, as long as state policy requires the state to stay as an active investor in firms of which it is not the sole shareholder, meaningful legal protection for minority shareholders is going to mean either constraints on the state's ability to do precisely those things for which it retained majority ownership, or else a *de facto* separate legal regime for enterprises in which the state is the dominant shareholder.

3 *Independent Directors as a Solution to Corporate Governance Problems*

3.1 Conceptions of the Non-Management Director

To understand more fully the functions and potential of the independent director in China, it is useful to canvass other conceptions of the independent director. To do so, we must first seek a more general term, for not all jurisdictions place a great deal of importance on directors who might plausibly be called "independent". Different jurisdictions and

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[3] Mar and Young, for example, report that China Southern Airlines and China Eastern Airlines, both of which are publicly listed but in which the dominant shareholder is a state agency, can be forced to purchase aircraft they may not want from the state: "[W]hen [the Civil Aviation Authority of China] buys too much [aircraft], they have to put them somewhere" (quoting a Hong Kong industry analyst). See Mar & Young (2001: 297). The potential for a conflict of interest is explicitly recognized in by one commentator, who proposes that dominant state shareholders voluntarily refrain from policies that hurt minority shareholders so as not to discourage investment in the securities markets. See Jiang (2001). See, however, the remarks of Xiang Bing at the text accompanying note 42 infra.

[4] The notion that state control will be maintained in particular sectors with the specific intent of "influencing and guiding" the use of social capital -- *i.e.*, causing it to be used in ways that serve the state's interests, which are not necessarily those of small investors -- was expressed recently in an interview by Jiang Qiangui, chairman of the SETC. See JJRB (2003a).

[5] For example, Chen (2001b), Qi et al. (2000), and Xu & Wang (1999).

corporate governance norms speak variously of directors who are "non-interested",[6] "independent",[7] "outside",[8] "non-executive",[9] "non-employee",[10] and "disinterested".[11] Each of these terms is defined differently and implies a different role for the director it describes, yet they are frequently discussed together as if they were all describing the same thing, and conclusions about directors of one type are applied to directors of another.[12]

The generic term I shall use here is "non-management" director (NMD), because it captures the one element all the above terms have in common: the director in question is not a member of the current senior management team.[13] This negative feature is, however, consistent with several different positive features, some of which are mutually inconsistent, and each of which contemplates a different conception of the role of the non-management director.

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[6] See Investment Company Act (ICA), codified in relevant part at 15 USC 80a-2.

[7] See Securities Exchange Act (SEA), Sec. 10A, codified in relevant part at 15 USC 78f(m)(3)(B). The provision in question comes from Section 301 of the Sarbanes-Oxley Act of 2002 (SOA).

[8] See Shôhô (Commercial Code of Japan), Art. 188(2)(7.2) (using the term *shagai torishimariyaku* -- literally, "director from outside the company").

[9] See Cadbury Report, para. 4.1.

[10] See Rule 16b-3 under the Securities Exchange Act promulgated by the Securities and Exchange Commission (SEC).

[11] See, e.g., Delaware General Corporation Law (DGCL), Art. 144, and the Revised Model Business Corporation Act (MBCA), Sec. 8.31.

[12] Miwa and Ramseyer, for example, use data on *outside* directors in Japan to refute what they take to be the conventional wisdom about the role of *independent* directors. For statistical convenience, however, they follow what they say is the Japanese custom of defining as "outsider" anyone who has a past or concurrent career outside the firm. This would include, for example, partners at law firms whose major client was the firm in question, who would not qualify under most definitions of "independent". Indeed, they explicitly note that the vast majority of outside directors take such directorships as full-time jobs with the firm on whose board they sit. See Miwa & Ramseyer (2002). The conventional wisdom about independent directors may indeed be wrong, but no conclusion derived from a study of this kind of outside director can rigorously demonstrate it. The definition of "outside director" (*shagai torishimariyaku*) in Japanese law is somewhat stricter than the Miwa-Ramseyer definition, and the distinction between outside directors and independent directors is well understood. See NKS (2003).

[13] This is, of course, what is usually meant by "non-executive" director. On the other hand, some people say "non-executive" when they really mean "independent" or "outside". I am deliberately creating a new term here so that what I mean by it can be kept clear.

3.1.1 *The "Independent" Director*

A major theme in corporate governance writing is the need for non-management directors on the board to serve as a check on management in the interests of shareholders. In other words, non-management directors are there to help shareholders solve the agency problem. If such directors are to monitor management effectively, they must be independent of management. From this contemplated role stems the typical definition of independent director: one who has no need or inclination to stay in the good graces of management, and who will be able to speak out, inside and outside the boardroom, in the face of management misdeeds in order to protect the interests of shareholders.

A competing conception of the director who is independent of management holds that the director's duty is to protect the interests of a number of different groups, not just shareholders, and indeed sometimes to act against the interests of shareholders in order to protect, for example, employees.[14] The latter view of the role of the independent director -- one who is independent of profit-seeking shareholders as well as independent of management -- has not, however, found fertile soil in American corporate law scholarship or practice. The dominant view has been that directors who are responsible to many constituencies are in effect responsible to none, and that while many of those who deal with the firm, such as customers, workers, and suppliers, can protect themselves through contract and the threat of terminating their association with the firm, the shareholders are uniquely unable to do so because their investment is sunk and cannot be withdrawn.[15]

Both conceptions share the idea that the directors expected to perform their designated function cannot do so unless they are independent of management. This idea is familiar to corporate law practitioners and scholars in the United States, but interestingly, its reach is limited almost exclusively to federal law as applied to corporations whose stock is listed on a national exchange.[16] Section 301 of the Sarbanes-Oxley Act (SOA) requires[17] that all

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[14] For a discussion of these competing concepts, see Brudney (1982: 602).

[15] See, e.g., Hansmann & Kraakman (2001: 442) and Hansmann (1996: 56). Gilson and Kraakman go beyond emphasizing the independence of the non-management director in order to stress the desirability of her *lack of independence* from shareholders: "[W]hile most recent efforts addressing the governance role of the board have urged increasing the independence of outside directors from management, we advocate increasing the dependence of outside directors on shareholders. In our view, corporate boards need directors who are not merely independent, but who are accountable as well." Gilson & Kraakman (1991: 865).

[16] I deal below with state corporate law and its different concept of "disinterested director". Because this is a paper about comparative corporate law and is not intended to be an exhaustive discussion of American corporate governance, I discuss the latter topic in general terms only and do not note the numerous exceptions and qualifications to the general rules set forth here. Almost every statement in this paper about requirements for non-management directors outside of China is, in some sense, wrong.

[17] Strictly speaking, the SOA requires that the SEC adopt rules requiring national securities exchanges and national securities associations to prohibit the listing of the securities of any issuer that does not comply with the standards for independence of audit

members of a listed company's audit committee be independent directors, and its definition of independence precludes a business relationship or other affiliation with the issuer or any subsidiary.[18]

The SOA has no role for independent directors other than as audit committee members, but requires the audit committee to have quite substantial powers, including the sole authority to hire, oversee, compensate, and fire the outside auditor. Its definition of independence is quite strict compared with others. The director may not, for example, accept *any* compensation from the issuer other than for his services as a director.

In response to the requirements of the SOA, the NYSE has proposed rules that mirror the SOA's independence requirements for audit committee members, but that retain some flexibility with respect to other independent directors.[19] Independent directors must, however, constitute a majority of the board as a whole. The theory behind the NYSE rules seems to be that corporate decision making will be improved if a majority of the board can be structured so that a particular motivation -- that of pleasing management -- is *absent.* The rules do not attempt to ensure that a particular motivation is *present.*

While "independence" has generally proven fairly easy to conceptualize, if more difficult to define in precise legislative language, one area in which substantial disagreement exists even in principle is that of the significance to be given to stock ownership by the putatively independent director. Those who see the independent director primarily as a defender of shareholder interests against management will naturally see more share ownership as better, because it will more closely align the interests of the director with the shareholders as against management.[20] Those who view the independent director as someone whose judgment should be untainted by any financial interest in the company are suspicious of share ownership.[21]

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committee members set forth in Section 301. The SEC adopted such rules on April 1, 2003. See SEC (2003). See generally SEC Audit Committee Standards.

[18] SOA, Sec. 301, codified at 15 USC 78f. *Note that "affiliated person" could include someone who has no ties to management but owns a large block of stock* and therefore has, one would think, an extra incentive to monitor management for the benefit of stockholders. "Affiliated person" is defined for purposes of this section by new Rule 10A-3 under the SEA (17 CFR 240.10A-3) and tracks (more or less) the definition of "insider" under Section 16 of the SEA (17 USC 78p). "Affiliate" is defined in terms of control, and control is defined in part in terms of stock ownership: ownership of less than 10% is defined, in a safe harbor, as *not* constituting affiliation, but ownership of at least 10% could (but need not necessarily) be considered an affiliation sufficient to negate a finding of independence.

[19] See NYSE Listed Company Manual, proposed Section 303A.

[20] In general, ownership of stock by directors, and by independent directors in particular, appears to be positively correlated with company performance. See Bhagat et al. (1999) and the review of several studies in Balotti et al. (2000).

[21] As will be discussed below, Chinese legislation and academic commentary generally adopts the suspicious approach and disfavors stock ownership by independent

The SEC has stated that shareholding of 10% or more will not automatically be construed to constitute an "affiliation" sufficient to prevent a director from being found "independent". The NYSE simply incorporates by reference the requirements of federal law as far as audit committee members are concerned. But where its own requirement for a majority of independent directors is concerned -- a requirement not imposed by federal law -- it imposes no limits on shareholding whatsoever. Indeed, the NYSE has specifically noted the views of commentators that share ownership should be viewed as desirable, and stated that "since the concern is independence from management, ownership of even a significant amount of stock, by itself, is not necessarily a bar to an independence finding."[22] Moreover, the NYSE's requirement of a majority of independent directors disappears when the company is a "controlled company" -- *i.e.*, when a single person, group, or company controls more than 50% of the voting power.[23] In other words, it sees independent directors as a protection for shareholders *specifically against management*, not against other shareholders. A shareholder who controls a company does not need an external rulemaker to protect him from a management team that he himself has the power to appoint. Minority shareholders may well need protection from controlling shareholders, but the exchanges are apparently willing to leave this task to other bodies of law, such as federal securities law requiring disclosures and state corporate law mandating certain fiduciary duties.

Under the SEC's approach, however, when stock ownership is enough to lead to control, affiliation exists and independence disappears. The NYSE's approach might be characterized as finding that when stock ownership is enough to lead to control, the director is *super*-independent of management -- so much so that the need for paternalistic protection by a rule disappears. But the SEC's view of the proper role of independent directors seems consistent with the second view canvassed earlier: that they should have ties neither with management nor with the fortunes of the company itself. Yet this view of independent directors seems to see them as ideally having no consistent incentives whatsoever. While clearing away visible ties to management interests, it fails to substitute a tie to the interests of any other constituency. Consequently, it is hard to see how such directors can be expected to act in any predictable way other than in avoiding obvious (and punishable) illegalities, and the purpose of having them on the board seems suddenly obscure. The lack of any serious underlying theory of independent director motivation is startlingly manifest.

3.1.2 *The "Outside" Director*

The concept of outside director is often confused with that of independent director, but it makes sense to distinguish the two, because they can play different roles. By "outside

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directors. See, e.g., Yan & Chen (2001: 26), Ma (2002: 62), SZSE (2000: Art. 2.2.3(3)), Independent Director Opinion, Section 1(1) (forbidding any relationship with a large shareholder that would impair independence), Section 3(2) (denying independent status to holder of 1% of company's shares or one of top ten shareholders or relative of the latter), Commercial Bank Independent Director Guidelines, Art. 2 (denying independent status to holder of 1% of company's shares or employee of shareholder).

[22] See NYSE Proposed Rule Change, April 2003.

[23] See Nasdaq Proposed Rule Change, March 2003; NYSE Proposed Rule Change, April 2003.

director" I mean here any director who is not a company employee[24] *whether or not* she meets a standard of independence. Japanese corporate law uses the concept of "outsideness" for directors and auditors (*kansayaku*), and in neither case does it exclude persons such as lawyers, suppliers, and others who may do large amounts of business with the company.

The distinction between independence and outsideness is, however, well understood in Japan -- the Revised Corporate Governance Principles of the Japan Corporate Governance Forum, for example, differentiate the two.[25] In the 2002 corporate governance reforms that became effective in April of 2003, however, outside directors are expected to play a role more akin to that expected of independent directors in United States federal securities law: companies may opt into a U.S.-style corporate governance structure in which outside directors are required to be present on nominating committee, audit committees, and compensation committees.[26]

3.1.3 *The "Disinterested" Director*

Far more important than federal law in the United States for purposes of internal corporate governance is state law, and this for the most part -- at least in terms of economic impact -- means the law of Delaware. United States corporation law at the state level does not in fact generally provide for the institution of independent directors as such or define them.[27] Instead, state corporate statutes focus on particular conflict-of-interest transactions -- transactions, for example, between a corporation and one of its directors or officers, or between a corporation and another entity in which one of its directors or officers has an interest, or the taking by corporate officers of business opportunities that arguably belong to the corporation -- and provide that certain consequences will follow depending on whether or not those with decisionmaking power who have a conflict of interest recuse themselves from the decisionmaking process.

The traditional common law rule in Delaware is that a transaction in which a director or officer stands on both sides is voidable by reason of a conflict of interest. This common law rule, however, is modified by Section 144 of the Delaware General Corporation Law, which announces that such a transaction shall *not* be voidable by reason of a conflict of interest if one of the following conditions is met: (1) the relevant facts are known to the board

[24] "Outside director" and "non-executive director" are often used interchangeably. I do not use the term "non-executive" director here because on its face such a term could include directors who were employees, but not executives -- for example, worker representatives. Such directors would be neither outside directors, in the sense of being able to bring some special expertise to the board not otherwise available to the company, nor independent directors, in the sense of feeling free to oppose management. Because the role of such employee directors is very different from the role of non-employee non-executive directors, I do not favor using a term that on its face encompasses them both.

[25] See JCGF (2001).

[26] See Hashimoto (2002: 10).

[27] A limited exception can be found in Michigan; for an introduction to the Michigan statutory scheme, see Gorsline (1989) and Moscow et al. (1990).

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and a majority of disinterested directors approve; or (if, for example, the entire board has a conflict of interest) (2) the relevant facts are known to the shareholders, and the shareholders approve;[28] or (if for any reason neither of the first two occurs) (3) the terms of the transaction are, as of the time it is authorized by the directors or the shareholders, fair to the corporation.

The rules of the Revised Model Business Corporation Act are essentially the same as the DGCL rule, except that the MBCA spells out the requirement of approval by *disinterested* shareholders.

In short, both the DGCL and the MBCA have a concept of independence, but it amounts only to *disinterest* in a particular conflict-of-interest transactions – something quite different from abstract independence. Both attempt to deal with such transactions generally through disclosure to and approval by directors who are not involved in the transaction. But they do not assume that such directors will always be the same person, and do not require the institution of abstractly independent directors. Instead, they take a transaction-by-transaction approach, and ask in each case whether there was approval by directors (or other decisionmakers) who were disinterested *in the transaction in question.*

3.2 The Independent Director in China

The Chinese literature and regulations contemplate a number of roles for independent directors. One sees generalities about how they will reduce corruption, bring an objective view to board meetings, dare to ask uncomfortable questions, criticize company management, and ensure good corporate governance practices,[29] but specific, measurable goals and predictions are few. Yet one cannot design and evaluate rules about independent directors without knowing what problems the institution is designed to address.

As discussed above, a major perceived problem in Chinese corporate governance is the dominance of large shareholders. (This is sometimes confused with the problem of insider control, although that problem stems from the inability of shareholders to supervise management effectively.) Many Chinese commentators appear to view concentrated ownership as almost perverse and unnatural, and see the stereotypical Berle-and-Means corporation as the ideal ownership structure.[30] Independent directors will, it is hoped, represent the interests of small shareholders and prevent the recurrence of corporate

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[28] The Delaware statute, deliberately or not, contains no requirement that shareholder approval be by *disinterested* shareholders only, but this requirement has been in effect read into the statute by case law. See, e.g., Marciano v. Nakash, 335 A.2d 400, 405 n.3 (Del. 1987) ("[A]pproval by fully-informed disinterested directors under section 144(a)(1), or disinterested stockholders under section 144(a)(2), permits invocation of the business judgment rule and limits judicial review to issues of gift or waste with the burden of proof upon the party attacking the transaction.").

[29] See, for example, China News Agency (2001).

[30] See, e.g., Li (1999c: 41), Ma (2002: 62), and Zheng & Chen (2001: 180). One Chinese academic asserts (incorrectly) that corporate law in the United States prevents large shareholders from dominating by prohibiting any person from exercising over 20% of shareholder voting rights. See Gu (2000: 60).

scandals,[31] and many of the criticisms of existing independent directors center around their powerlessness to effectively protect the interests of small and medium shareholders from the depredations of large shareholders and management.[32] They are said to fail in this mission because, among other things, they are a minority on the board and they are nominated by controlling shareholders.[33]

The emphasis on the need to protect the small shareholder from the dominant shareholder or shareholders is no doubt due to the shareholding structure of stock companies in China. Companies with widely dispersed public ownership where no individual owns a controlling block of shares are virtually, and perhaps completely, non-existent. Thus, the agency problem identified by Berle and Means in their classic work, *The Modern Corporation and Private Property*,[34] is not a major concern. Chinese listed companies typically have a few large, dominant shareholders (often holding unlisted state or legal person shares) and a minority of small shareholders holding listed shares. Certainly the perception in the literature seems to be that there is a serious problem of abuse of power by dominant shareholders to handpick compliant boards and management who will operate the company in such a way as to favor those dominant shareholders. Thus, the problem to be addressed by the institution of the independent director is that of abuse of dominant share ownership at the expense of small shareholders.

A major problem with this approach is that it starts from the notion that control of the company by any particular large shareholder is itself bad. The literature is full of lamentations that shareholder votes are mere formalities because one shareholder owns an overwhelming block. But directors, independent and otherwise, are supposed to be elected by shareholders. For the majority shareholder to outvote minority shareholders is precisely the intended consequence of the voting system set forth in the Company Law of China[35] and the corporate laws of other countries. Thus, the complaints of some commentators that companies with dominant shareholders are not run "democratically",[36] or lack true collective decision making,[37] seem based on a conception of the company as a political enterprise, not as an economic one.[38]

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[31] See, e.g., Jiang (2001), Yan (2002b) and Ye & Cao (2002).

[32] See, e.g., Economic Daily (2001).

[33] See Economic Daily (2001). Not surprisingly, nomination by those in control of the company continues. A survey conducted in early 2003 found that 90% of independent directors had been nominated by the controlling shareholder or by management. See Jin Xin (2003).

[34] Berle & Means (1933).

[35] See Company Law, Art. 106.

[36] See, e.g., Wu et al. (2002) and Sun (2001: 65).

[37] See, e.g., Luo & Mao (2001: 50).

[38] Ma complains that the board represents the interests of only a minority (*shao bufen*) of the shareholders. See Ma (2002: 63). In economic terms, of course, the board may

Given that large shareholders get to choose directors, it is hard to see how directors representing minority shareholders could be elected to the board in the first place unless the basic principles of director selection were changed. Cumulative voting is a possible solution -- it is in fact encouraged by the Corporate Governance Principles[39] -- but this system will at best elect directors representing a concentrated minority, not a dispersed minority, and even then such directors will be in a minority on the board and can always be outvoted.

The view that large shareholdings are bad also ignores the problems with dispersed share ownership pointed out so long ago by Berle and Means, as well as the considerable evidence that having a controlling shareholder may be good for corporate performance.[40]

Finally, this view runs up against the special position the state wants to reserve for itself when it is the dominant shareholder.[41] The Dean of the Changjiang School of Business, who serves as an independent director, was recently quoted as saying,

> I have never thought that the independent director is the protector of medium and small shareholders; never think that. My job is first and foremost to protect the interests of the large shareholder, because the large shareholder is the state.[42]

A second proposed function for independent directors is to monitor related-party transactions, where there could be a conflict of interest.[43] Note that if independent directors are to perform this function effectively, "independence" cannot be an abstractly defined concept referring to independence from management. A transaction-based approach that looks at the director's interest in a particular transaction is required; otherwise a director wholly independent of management would be deemed fit to vote on a transaction between the company and himself. This conception of the independent director's function is similar to that used in United States state corporation law, in which independence means independence from management, but not independence from shareholders.

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represent all too effectively the interests of the majority holder. It is the political conception of the company that makes the number of small shareholders, regardless of their holdings, significant.

[39] See Corporate Governance Principles, Art. 29. The CSRC has not explained how cumulative voting could be carried out consistently with Art. 106 of the Company Law, which mandates one vote per share.

[40] See, for example, Tenev & Zhang (2002: 110).

[41] The view that independent directors have a role to play in counteracting the (presumably deleterious) effects of state shareholding is not unique to Chinese commentators. See, for example, Broadman (2001b: 23) (calling for the election of "independent, non-state representatives" to the board of directors).

[42] Xiang Bing, quoted in GAXXRB (2003). Note that Xiang made this remark well after the promulgation of the CSRC's Independent Director Opinion, which specifically rejects his interpretation of an independent director's responsibilities. See Section 4.2 infra.

[43] See Yan (2002b) and Ye & Cao (2002).

A third function for independent directors frequently mentioned is that of brain trust or consultant.[44] This is an often-touted virtue of *outside* directors as well. In either case, however, it is not clear why the company would not do better to hire consultants and other experts for advice, instead of having them sit on the board until such time as they might be needed.[45] Furthermore, if giving advice is the appropriate role, why do the directors need to satisfy any criterion of independence at all?

Finally, a fourth function sometimes mentioned is that of serving the public interest.[46] I use this broad category to include concepts of the independent director as a kind of agent of state regulatory bodies[47] or as a kind of mole operating on behalf of the state to monitor its assets and prevent managerial waste. As Han points out, however, this is exactly what the directors appointed by the state shareholder -- and in many cases, there will be a dominant state shareholder perfectly capable of appointing whatever directors it pleases -- are supposed to be doing.[48] Why does there need to be a special independent director to carry out this task?

Where the director serves the "public interest," arguably he or she should be independent of *everyone* -- dominant shareholders, management, and indeed all those who have an interest in the company -- and follow only the dictates of his or her conscience.[49] Assuming accountability to be a good thing, however, it is hard to see how such a director could properly be made accountable.[50]

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[44] See, e.g., Wu et al. (2002), Ye & Cao (2002), and Yan & Chen (2001: 26).

[45] A few skeptics in the Chinese literature make this point as well. See Han (2002b) and Yu (2002b).

[46] See, e.g., Yan (2002). Yan is the head of the Fujian Academy of Social Sciences, which makes him a senior academic of national standing. He writes with pride of his position as the only independent director on the 7-member board of the Shuikou Electric Power Generating Company, a limited liability company (*youxian zeren gongsi*) with only two shareholders. According to the article, Yan believes he can be legally liable for his votes at board meetings, yet accepts no fee for his position and is honored to feel that he is making a contribution to the state. For the story of Lu Jiahao, another academic who despite no experience in business was asked to serve as an independent director, did so without compensation, and ended up being fined 100,000 *yuan* by the CSRC for his troubles, see Wu (2002b) and Wei (2002).

[47] Mentioned but ridiculed by Han (2002b).

[48] See Han (2002b).

[49] This argument is made in Ye & Cao (2002: 30).

[50] He and Yu point out that there is no reason to think that a director accountable to nobody will do more for corporate results than an inside director. See He & Yu (2001: 29).

4 *Regulatory Responses: The CSRC's "Independent Director Opinion"*

China's two stock exchanges, local governments, and various branches of the central government have all issued documents of various kinds either encouraging or purporting to require companies to install independent directors on their boards. For reasons of space, I will consider here only the most important of these, the "Guidance Opinion on the Establishment of an Independent Director System in Listed Companies" (Independent Director Opinion) issue d by the CSRC on August 16, 2001. The Opinion covers Chinese companies listed in China; it does not cover Chinese companies listed overseas. It constitutes the most comprehensive measure taken to date by the CSRC -- or indeed, by any Chinese governmental authority -- to regulate internal corporate governance through the institution of the independent director.

In analyzing the Independent Director Opinion, considerable insight can be gained by comparing the final version with an earlier draft released by the CSRC in May of 2001 (Draft Independent Director Opinion) in order to solicit comments.

4.1 Basic Requirement of Independent Directors

The basic rule of the Independent Director Opinion is set forth in Sec. 1(3): listed companies are to revise their articles of association to provide for independent directors. At least one of these should be an accounting professional. Listed companies were required to have at least two independent directors by June 30, 2002, and such directors should constitute at least one third of the board by June 30, 2003.[51]

4.2 Whose Interests Are the Independent Directors to Serve?

The independent directors are said to owe a duty of good faith (*chengxin*) and diligence (*qinmian*) to the company and to the entire body of shareholders, but the Opinion singles out for special attention the interests of small and medium shareholders, and states that the independent directors are not to be influenced by major shareholders, controlling persons, or others who have a relationship of interest with the company.[52] To the extent, then, that the drafters have considered the question at all, the Opinion seems to come down clearly in the camp of viewing the independent director as independent from everyone with a significant interest of the company, and as the protector of small shareholders against both management and dominant shareholders.

4.3 Qualifications of Independent Directors

Unlike, for example, the corporate law and jurisprudence of most states in the United States (but like various United States federal statutes and regulations), the Opinion defines "independence" in a single way, instead of taking a purposive transaction-by-transaction approach.

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[51] The Company Law provides that JSCs should have five to thirteen directors.

[52] See Independent Director Opinion, Sec. 1(2).

The Opinion takes a positive approach and a negative approach to the qualifications of independent directors. On the positive side, an independent director must possess various qualifications evidencing a genuine ability to monitor management. On the negative side, persons may not serve if they have various kinds of affiliations with the company, including employment or ownership of at least 1% of the company's stock.

4.4 Special Powers

The Independent Director Opinion seems to give special powers to independent directors by requiring that they constitute at least half[53] of the members of board's audit, nomination, and compensation committees. On the other hand, there is no requirement that these committees be established, so a company could keep inside director control over such matters by having them decided by the entire board.[54]

In addition, independent directors are to have the following powers: (1) to pass on important transactions with affiliates, defined as transactions with affiliates (*guanlian ren*) where the amount at stake is more than 3 million *yuan* or more than 5% of the net asset value of the company according to its most recent audit report; (2) to recommend engagement or dismissal of the company's accounting firm; (3) to recommend the holding of interim shareholders' meetings; (4) to recommend the holding of board meetings; (5) to hire outside auditors and consultants (at the company's expense); and (6) to solicit proxies prior to a shareholders' meeting.

Some of these powers are quite ambiguous. For example, the independent directors, like the members of the board of supervisors, apparently do not have the power actually to *call* a meeting of shareholders or the board; they have only the power to *recommend* to the board that such a meeting be called. More importantly, the Opinion does not actually confer these powers on independent directors. It calls on companies to confer these powers, presumably through provisions in their articles of incorporation or other internal rules. A company that does not do so may encounter pressure from the CSRC to make appropriate changes, but it would not be acting illegally in failing to do so.

4.5 Enforcement

A key question that is often not clearly answered in the various standards for corporate governance is how, if at all, they shall be enforced. The Independent Director Opinion, by its very name (it is a "guidance opinion"), suggests that it is not strictly mandatory, even though listed companies are invited to implement it. There is nothing in the Opinion to suggest what kind of sanctions might follow upon a company's failing to implement its provisions. The Draft Independent Director Opinion provided that if a company failed to implement the provisions "without a proper reason", it would be publicly criticized by the CSRC and ordered to implement the provisions within a specified time, and would be required to note the circumstances in its public disclosures. Even this rule did not specify exactly how the

[53] Possibly "more than half." The Chinese term (*er fen zhi yi yishang*) is ambiguous.

[54] A recent survey of listed companies showed that as of mid-May 2003, about half had not established any of the board committees on which independent directors have a special role under the Independent Director Opinion. See Jin Xin (2003).

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