How Chinese Enterprises to Live in Freedom and Competition: Further Integration of the Corporate Law and Competition Law of China with Global Standards

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Preface

China once adopted the planned economy, had state-owned enterprises dominating the economy and very few private-owned enterprises. State-owned enterprises were the subordinates of governmental organs and undertook production in accordance with administrative directives. The sector of "semi-state-owned enterprises", collective or cooperative enterprises abided by similar rules and regulations as state-owned enterprises but were deprived from the advantages of state planning. In the meantime, the rest few private proprietors held minimal protections being regarded as "the tail of capitalism" and risked eradication at any moment.

Through nearly thirty years of reform and opening-up, at present, not only private enterprises, foreign–invested enterprises and cooperative enterprises may pursue the maximum profit freely, but also state-owned enterprises/companies operate in compliance with the baton of market without interferences of the government on specific affairs of management and transactions. Enterprises at last gained freedom. However, commonly recognized rules haven't taken shape due to insufficient gaming and, lots of quick introduced legislations are only superficial provisions without real observance.

Thus, many problems occurred, e.g., inner members and shareholders doing everything possible to hollow out companies, enterprises including those that are private owned occupied by non-owners on various tracks, flooding of fake and

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inferior products, cheating and fraud, abuse of any power, colluded pricing, contrived invitation and submission of bids, etc.

In such circumstances, the *Company Law of the People's Republic of China* (short for *Company Law*) has been thoroughly amended from guiding principles to concrete contents into a brand-new law. The legislature also hastens to formulate an *Anti-Monopoly Law* so as to make up the deficiency of current *Anti-Unfair Competition Law of the People's Republic of China* (short for *Anti-Unfair Competition Law*), the *Price Law of the People's Republic of China* (short for *Price Law*), the *Invitation and Submission of Bids Law of the People's Republic of China* (short for *Invitation and Submission of Bids Law*) and the like.

I. Market-oriented reform: Chinese enterprises win liberation during the development of trade and capital relations

A. The situation before the reform and the reason for the reform

The Communist Party blamed the poverty and backwardness of recent China on the oppression of the *Three Mountains*[2], thus the establishment of the People's Republic of China is synchronized to the nationalization of bureaucratic capital. In April 1949, Mao Tsetung personally drafted a *Notice of the People's Liberation Army of China*, declaring the confiscation of the bureaucratic capital enterprises[3]. By the end of that year, 2,858 industrial bureaucratic capital enterprises had been confiscated, and the proportion of production value of state industrial enterprises to that of the whole industry (handicraft industry excluded) reached to 34.7%[4]. At that time, over 1,000 enterprises in China were run by western entrepreneurs, mainly owned by shareholders of the US and Britain[5]. Although these enterprises were not commonly taken over by the new state, they were forced to close down, be purchased, expropriated by or entrusted to the government due to the drastic change of political, social and economic environments, as well as the US's embargo against China.

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[2] Namely, imperialism, feudalism and bureaucratic capitalism. The bureaucratic capitalism means the capitalism with the ambiguity of officials and entrepreneurs, more harmful than so-called crony capitalism.

[3] "Bureaucratic capital" refers to those enterprises controlled in the name of state by eminent bureaucratic families, for instance, Chiang (Kai-Shek), (T. V.) Soong, (H. H.) Kong, Chen (Li-fu). The enterprises were usually economic vitals such as banks, large factories and infrastructures. See *Selected Works of Mao Tse-Tung*, Volume IV, People's Publishing House (Beijing, 1991), 1459-1460.

[4] See ZHU Jiannong, *Study on the Issue of Socialist Ownership of China*, People's Publishing House (Beijing, 1985), 19.

[5] *Ibid*.

As for the native civilian capital and proprietors, purchase and cooperation were adopted so that the state-private enterprises and cooperatives took shape. The state-private enterprises, controlled by representatives of public shares, were in fact state-owned enterprises. After the former capitalists took back all of the fixed dividends, they became real state-owned enterprises. Due to the inertia of revolutionary movement, the whole society pursued *large in size and collective in nature*[6]. The cooperatives also followed the mechanism of state-run enterprises by canceling shares, unifying salary standards, taking on names as collective enterprises, so as to be as similar as possible to state-owned enterprises.

This is a "centralization mode", under which the production and operation of enterprises must be subject to the state planning arrangement distributed from top to bottom. Enterprises had neither any autonomy nor the responsibility to bear losses, eating from the "big pot" of the state. Although the production and operation of collective enterprises were not incorporated into the national plan, they were simply the same as the state-owned enterprises in respect of the egalitarian wages for different work-load and quality, being controlled and taking direction from government at any time. The whole society rejected market with no need for contracts. Hence the economy ran into a disordered situation of indolence, indiscipline and irresponsibility, wantonly misappropriation of public property, waste, shortage of products and services as well as lower quality, which caused heavy complaints of the public and gave birth to hidden social troubles. The saying of the former Soviet Union "we are capable of sending satellites into space but unable to provide people with quality toilet paper and elevators" was also applicable to that times in China. The government directly controlled and managed enterprises, resulting in "the combination of regime with enterprises" as well as "integration of party and government" and "the non-separation of party with enterprises", which also intensified the loss of vitality of the society and enterprises.

To avoid social collapse and regime crash, China started the policy of reform and opening-up at the end of 1970s[7] that still continues now.

[6] It means the larger scope and the more degree of public-ownership, the better.

[7] From December 18th to 22nd, 1978, the Communist Party of China convened the third plenary session of the 11th central committee, deciding to stop the slogan of "class struggle as the center", transfer the focus of work to the modernization drive and adopt the policy of reform and opening-up.

B. Reform — the process of untied and freedom gaining of Chinese enterprises

The process of Chinese enterprises' reform has been mainly pushed by the demonstration of foreign entrepreneurs and the impulse of earning profits by private capital.

The policies of state-owned enterprises' reform and the opening-up of the country rose simultaneously in 1979. In that year, the State Council put forward the *Several Regulations on Enhancing the Self Determination of State-Run Industrial Enterprises on the Operation and Management*, saying that "gradually implementing the separation of regime and enterprises to expand the self determination of enterprises and transform enterprises to relatively independent socialist economic units", and the price control should be loosened at the same time. However, under the unchanged condition of planned and shortage economy, the (central and local) governments and enterprises gamed with each other on the redistribution of power and rights. Meanwhile, the "market" could not rationalize enterprises' behavior by the "invisible hand" due to price distortion[8].

However, the *Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures* (short for *Law on Chinese-Foreign Equity Joint Ventures*) passed in the same year, the *Regulations on Special Economic Zones of Guangdong Province* promulgated in 1980, together with the *Law of the People's Republic of China on Foreign-Capital Enterprises* (short for *Law on Foreign-Capital Enterprises*) and the *Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures* (short for *Law on Chinese-Foreign Contractual Joint Ventures*) came successively later, and created favorable environments for foreign capital to flood into China. At the beginning, foreign investors adopted the mode of Chinese-foreign joint venture in entering China's market, and the Chinese partners were state-owned enterprises or governments. Due to the concern of foreign entrepreneurs on their investment return as well as the stake of interests between the Chinese and foreign parties, these enterprises were strictly on the basis of capital relations and the calculation of interests, which had given state-owned enterprises and governments a vivid and impressive lesson, stimulating their awareness of capital, contracts and market economy.

[8] The typical case was the "official profiteering", the behavior of raising prices by the power of distribution planning and control of commodities in short supply. This was one of the main causes for students crowded into streets to demonstrate in 1986 and 1989.

Rural and private enterprises were also vigorous impetus for Chinese enterprises to march towards market and liberalization. At the outset of 1980s, the people's commune system moved towards its end, the heavy population burden of land and the crowded cities forced farmers to make a living all by themselves. They left land but didn't leave the countryside and established a great number of rural enterprises. At first, such a typical enterprise was owned by one (administrative) village or a smaller unit of a village[9]. These enterprises completely faced to market without any "public grain funds" from the government. Moreover, the operators and managers could not be as easy to abuse their rights as those of state-owned enterprises due to the healthy property relations under the village or rural community self government mechanism, which created a kind of most dynamic enterprise in China. Early in 1990, the profits, return on sales as well as the production growth of rural enterprises had all surpassed the index of state-owned enterprises[10]. In 1992, employees in rural enterprises reached 100 million, exceeding for the first time that of state-run enterprises[11]. Besides quite a lot large-scale enterprises owned by villages with advanced equipments, strong competitiveness and adaptabilities began to come into being. Private enterprises started from the end of 1980s, and have enjoyed considerable development until now: most lighters and shoes exported from China are products of private enterprises in Wenzhou; the private enterprises have taken foothold in a number of industries such as catering, hotels, even iron and steel as well as automobile manufacturing. In recent years, many rural enterprises have transited from village ownership to private ownership. However, some still maintain community collective ownership and survive in market competition, such as the famous Huaxicun Stock Co., Ltd.[12]

While the emergence of foreign, rural and private enterprises may be silent, the share holding system reform of state-owned enterprises is much more exciting and spectacular. When people realized that the development of transactions and market could not automatically solve the problem of state-owned enterprises, they turned eyes to the reform of enterprise property system. The so-called share holding system

[9] Usually a "natural village", one that spontaneously and naturally exists, correspondingly the former generally means an administrative village which is a fundamental (but non-governmental) unit of rural area in the legal system of China.

[10] See *Economic Daily*, August 15th, 1981.

[11] See *People's Daily*, March 22nd, 1991.

[12] Situated in Jiangyin, Jiangsu Province, an enterprise group share-controlled by the known "first village under the heavens" — Huaxi Village. As is estimated, in 2006, its sales income could reach RMB 4 billion. See http://www.chinahuaxicun.com/home.asp (the website of Huaxi Village), visited on September 7th, 2006.

reform occurred just as the privatization movement in western countries: to turn the bureaucratic state-owned enterprises into multi-shareholder companies, let them operate in face of market, including share sales to private enterprises and individuals. The State Commission for Restructuring the Economic Systems ever in charge of the reform policy had time after time called on share holding system reform in its annual guides released at the end of 1980s and the beginning of 1990s. It put forward the requirements in relation to employee shareholding, mutual shareholding between enterprises, issuing shares publicly, breaking-off the limits among regions, governmental organs and different ownerships, etc. This is a great trend under which almost all state-owned enterprises, especially the competitive ones, were restructured into companies. The central and local governments have gradually learned to serve as shareholders like private bosses; meanwhile the enterprises shook off the constraints of any governmental authorities.

In comparison with the long river of history, enterprises gained their freedom in a sudden and seemed unadapted.

C. Problems: viewing from corporate governance and competition

Major problems lie in the insufficient protection of property rights and the unordered competition.

Under the corporate mechanism, investment and operation are generally separated from each other. China has barely walked out of the “acquaintance society” driven by market, such legal factors as right, obligation, trust, credit, honesty, responsibility on contracts, sacred and inviolable property are not steadily established. There still exists in the legal and judicial circle of China a tendency to overstress the status of the “independent juristic person” of a company or an enterprise while neglecting the actual behavioral persons behind it. These have opened a convenient door for non-owners to misappropriate owners or some owners to trespass on other owners.

Thus, “absence of bosses” becomes a common phenomenon. The following are the main embodiments: grabbing enterprises by non-owners, hollowing out and ruining of enterprises by large share-holders and inner members, which are only different from the scandals of Enron and WorldCom with a much severe extent and in a slight different way. Such an instance usually exists when some shareholders control a company, claiming loss while earning profit, such as reporting a profit of

RMB 50,000 but actually earning RMB 5 million, even refusing other shareholders entrance to the company. The police may insist on no power to involve since it was "not a criminal case"; while the court would not accept the litigation sued by other shareholders for the disputes "not related to the company". As a result, the harmed share-holders have no way to redress their grievance. Another situation which rarely occurs in western countries is that the directors and managers of a company replaced the owners' position by purchasing shares of the company at a low price with another company newly established or controlled by themselves. More often than not, it usually occurs in state-owned or state share-holding enterprises, resulting from the fact that the central or local government, as a bureaucratic system, is rather a "fool" compared with the canny individuals or private enterprises, insensitive to the stake of interests, slow in reaction as a representative and shareholder of the state ownership[13]. A typical Chinese listed company is also famous for willful manipulation of the company and appropriation of its funds by large shareholders, in which, the company becomes their "ATM", and would collapse when it is exhausted to a certain extent. The case of Hongguang Industrial, the scandal of Jun'an Securities and Zhengbaiwen event[14] are the very epitome of this sort of malpractices.

Freedom also means enterprises cast off "paternal love" of the government. Earning a living freely is in direct proportion to the pressure of competition. Money

[13] This has aroused a heated discussion in China over the justice of MBO (Management Buy-Out) of state-owned or state share controlled companies and how to regulate it, which is called "Larry Lang Phenomenon" together with the unmerciful exposure of listed companies' frauds (especially in state share controlled companies). Larry Lang, a professor of Hong Kong Chinese University, attacked in public the self pricing of senior administrators and the purchase of controlling shares with loans pledged by this very company, and disclosed the "inside story" of large companies by independent financial analysis, which attracted wide attention and public interest.

[14] Chengdu Hongguang Industrial Co., Ltd was restructured from a state-owned enterprise, the birthplace of the first color display tube in China. In its share issuance and listing application material, it made a false report of profit of RMB 54 million for the actual loss of RMB 103 million in 1996 by measures such as false product sales, magnified false product inventory and illegal account. On the very year of being listed, it received the special treatment (ST) from the Securities Exchange. Public shareholders were deceived and the company was punished by the China Securities Regulatory Commission.

Jun'an Securities was founded with the investment of five state-owned enterprises. In the beginning, it was very successful and entered swiftly the rank of the top five securities brokers in China. But in 1998, the National Audit Office found out that it concealed income of RMB 1.23 billion, its chairman Zhang Guoqing registered a company in his name with some hidden income and controlled two major corporate shareholders, and Zhang obtained about 77% corporate equity of Jun'an and put it into his own possession. Soon after it was disclosed, the scandal became a piece of explosive news of that year and later, Zhang was put into prison.

Zhengbaiwen was once known as the "head" of Chinese wholesale industry and entered the top 100 of Chinese listed companies. However, the raised fund when it was listed was borrowed and appropriated by its senior administrators and big shareholders. Hundreds of million funds were either entered the pockets of individuals or become bad account, resulting in the successive close-down of dozens of its affiliates around the country. It would have won the "honor" of the first bankrupted listed company in China if a Sanlian Group had not repaid its debt and turned it into a "shell company" to be listed.

making is so hard and competition too unpleasant, the result is either slender profit or leaving the game. There is slim possibility to hold the ground and earn good money. Therefore, two tendencies come into being naturally, which adversely affect market and fair competition. One is to compete by unscrupulous methods, excessively in violation of credit and honesty — namely, unfair competition. The other is to reject competition so as to make big money without paying sufficient efforts — namely, monopoly. Both tendencies are much more obvious and serious in China than in western developed countries, although they are not Chinese characteristics.

For instance, such behaviors as fake and imitated trademark, decoration and commodity, false advertisements, misstatement in goods introduction or mark, commercial bribery and infringement of know-how etc. are often heard of as well out of China. Since the prevailing commercial bribery corrupts society and affects the long-term healthy development of economy, the Chinese government initiated an anti-commercial-bribery campaign since 2005. Partly due to the requirements of its own development, and besides the pressure from the US-led developed countries, China is in a continuous movement against infringement of intellectual property rights. However, anti-unfair competition is restricted by common notion and weak enforcement of judicature. For example, regarding the impingement of know-how by job-hop of employees, the governments, courts and the society lean to the side of the doer, which has weakened the protection of know-hows. The most serious problems are linked with consumers' protection. From 1998 to 2004, there were a total of 1,896 food-poisoning cases in China with 73,534 victims — 1,254 of them died[15]. Most of the cases were caused by undesirable behaviors of some enterprises, such as Fuyang milk powder case and Guangzhou poisonous alcohol case.[16] The administrations for industry and commerce of the government in charge of unfair competition and market supervision did not attach due importance, were not strictly in their enforcement and supervision of the law, and thus failed to effectively curb counterfeits putting a premium on the overflow of fakes and forgeries.

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[15] See ZHU Min, *The Issue of Security Challenges the Development of Food Industry*, http://www.ofcc.org.cn/a_wwwroot/content.php?newsid=350 (the official website of China Organic Food Certification Center), September 13th, 2005.

[16] *Ibid*. In 2004, some "big-head babies" appeared in Fuyang, Anhui province. They were slow in growth and poor in immunity with various subsequent symptoms of disease, even died. Through investigation, it was found that such diseases were caused by taking "milk powder" of low protein for a long time. Accumulatively, 189 infants were found in low to medium-level malnutrition and 12 of whom died. Some manufacturers mass-produced such "milk powder" and sold it to relatively laggard and forlorn rural areas.

In the same year, poisonous alcohol case took place in Guangzhou. Illegitimate merchants mixed industrial alcohol — methanol into rice wine in bulk, resulting in 56 persons poisoned and 11 died.

As for monopoly and anti-monopoly, both notions and supervision have even not been put into place yet. Typically, Chinese enterprises and ordinary people take for granted the horizontal price league deeply abominated in western countries since Adam Smith. The media even often call for enterprises to collaboratively fix prices to stop "excessive competition".[17] Although relevant laws stipulate that enterprises should not conspire to manipulate prices[18], they would not work if the society and stakeholders did not take it as an issue, and such judicial cases are seldom heard. It is also common to see that enterprises abuse their dominance. The most representative example is that large-scale supermarkets and retailers oppress and exploit small suppliers, which has not yet been curbed. Besides, the government hasn't fully realized that monopoly impairs efficiency and economic vitality as well as fosters commercial bureaucracy. In 2000, General Administration of Civil Aviation of China, based on such reasons as market supply exceeding demand, discretionary discounts of flight tickets and disordered sales, compelled all air companies to implement an "airline alliance", unifying profit accounting and sharing in accordance with identified capacity and seats of each airline. Of course, such a practice could not last due to its violation of market rules. The government has inadequate supervision over such lawful monopoly enterprises as oil, electric power and telecom, thus the public never stops complaints on the operating mode and pricing policy of them.

In a word, freedom needs to be accompanied by rule and order. On one hand, time has been too short for the law to catch-up; on the other hand, rules not generated internally in China are inevitably inadaptable and defective. Therefore, disorder appears.

[17] Last year, I was invited to an annual meeting of certain biological pharmaceutical chamber and was asked to assist them in setting a bottom price limit and corresponding punishment rules. How absurd it was.

[18] As is prescribed in Article 14 of *Price Law*, business operators shall not commit the act of "manipulation of market price in collusion to the detriment of the lawful rights and interests of other operators or consumers"; Article 41 prescribes: "any operator who causes consumers or other operators to pay more prices for illegal price acts should refund the portion overpaid; where damage has been caused, liability for compensation shall be borne according to law"; Article 40 prescribes that "any operator who commits any of the acts listed in Article 14 of this Law shall be ordered to make a rectification, confiscation of the illegal gains and may be concurrently imposed a fine of less than five times of the illegal gains; where there is no illegal gains, a warning shall be administered and a fine may be imposed; where the circumstances are serious, an order shall be issued for the suspension of business operations for consolidation, or the business license revoked by the agency of industry and commerce administration…".

II. Freedom and order: the corporate law and competition law of China have been impelled by practice and circumstances

Freedom and competition had been forgotten almost three decades. The people, government and the legislature did not know what the companies, freedom and competition were at the beginning of the reform and opening-up. Practice has been developing so fast that relevant laws were pushed forward limply. Companies and competition preceded the rules, therefore, the law would be hard to avoid such situations as improper restrictions, inadequate regulation, or lack of timely support, etc.

A. Freedom and responsibility: the two contrary but not contradictory trends in the reform of Chinese corporate law

While China practices market economy, any subjects of property must enjoy the freedom of investment and business operation, and enterprises should be re-endowed with their commercial nature. A company is generally by nature a legal form or means for different subjects of property to engage in investment and business operation based on freedom of association and gaming with each other. But under the separation of ownership and operation, people are liable to forget the subjects behind companies. A society and its law should make constant efforts to rectify the misunderstanding and confirm that: although companies and enterprises may be legally subjects different from their shareholders, they do have not their own independent will. But rather, the will should be the common volition of the share-holders. Operators must give top priority to the shareholders, in addition, take into consideration of the interests of employees, creditors, governments and the society, operating others capital cautiously and conscientiously as a “factotum”. Therefore, just as the trend of corporate legal system in developed countries, freedom and responsibility are the two contrary but not contradictory directions during the reform of China’s corporate law.

1) Market and self-governance: let enterprises recover their general nature of commerce and market

Foreign-invested companies are the forerunner of free enterprise idea in China. The *Law on Chinese-Foreign Equity Joint Ventures* prescribes that Chinese-foreign joint ventures are limited liability companies, which sparked off the first fever in foreigners to invest in China. However, the unitary form of enterprises also restricted

foreign investment, so the *Law on Foreign-Capital Enterprises* and the *Law on Chinese-Foreign Contractual Joint Ventures* were enacted orderly in 1986 and 1988. Thus, one or several foreigners can run an enterprise alone in China without the trouble of seeking Chinese partners. Such an enterprise can take the form of either company or non-company, legally being called foreign-capital enterprise. As for Chinese-foreign contractual joint ventures, the parties may define their rights and liabilities by contracts, and need no longer to be confined to the legal framework of a limited liability company.[19] Under the former planning system, the examination and approval for establishing an enterprise was a long bureaucratic process which usually lasted quite a few years. In order to win the confidence of foreigners, China prescribed for the first time in the *Law on Chinese-Foreign Equity Joint Ventures* that the examination and approval authorities shall decide whether or not to approve the establishment of an enterprise within three months. Later, the *Law on Foreign-Capital Enterprises* and the *Law on Chinese-Foreign Contractual Joint Ventures* specified that the time limits for the examination and approval of these two kinds of enterprises should be 90 days and 45 days respectively.[20] We have every reason to say that opening-up has sped up the Chinese government's adaptation to market orientation and the rule of law.

The three laws have adopted the flexibility of Anglo-Saxon legal system by imitating Hong Kong at the early stage of the reform. For example, the statutory capital system implemented on domestic-invested enterprises is not strictly adopted, the shareholders are permitted to pay their contributed capital by installments after the establishment of an enterprise; it is not necessary for a Chinese-foreign limited liability company to form a shareholders' meeting, while the board of directors shall play dual roles of a company's highest authority as well as the organ of business operation and its decision-making; no upper limit to the proportion of foreign investment in a Chinese-foreign joint venture, it is required "normally" not less than 25%[21], etc. It is a Chinese character compared to most developing counties of embracing rather than suspecting foreign investments. Later on, many revisions have been made to the laws in order to facilitate foreign investment in China. For instance, the *Law on Chinese-Foreign Equity Joint Ventures* formerly specified that there must

[19] Plus Chinese-foreign equity joint enterprise, there are three legal forms of foreign-invested enterprises in China, being popularly called "three foreign capital ventures".

[20] See Article 3 of *Law on Chinese-Foreign Equity Joint Ventures*, Article 6 of *Law on Foreign-Capital Enterprises* and Article 5 of *Law on Chinese-Foreign Contractual Joint Ventures*.

[21] Cf. Article 4 of the *Law on Chinese-Foreign Equity Joint Ventures*.

be time limit for joint ventures; of course, such an unnecessary restraint on foreign investment should be cancelled. The specification was revised as: except for those industries or projects with legal restrictions and special regulations such as resources exploration, land and real estate development, the parties of a joint venture may agree on a time limit or not. The law formerly prescribed that the chairman position of the board of directors must be held by Chinese side, which obviously went against the capital doctrine; later, it was took the place that the chairman office may be assumed either by Chinese parties or the foreign side, but if the Chinese or foreign side occupied the office of the chairman, the other side shall occupy the office(s) of the vice-chairma(e)n. With the growing opening-up and freedom of Chinese economy, the foreign exchange under current accounts has been convertible freely to meet the requirement of fulfilling the duty of WTO. In 2000 and 2001 respectively, new revisions were made to these three laws, abolishing the clauses that Chinese-foreign contractual joint ventures and foreign-capital enterprises should balance their foreign exchange income and expenses as well as the prescription that under the same condition, in relation to their required raw materials, fuels and auxiliary equipments, Chinese-foreign equity joint ventures and foreign-capital enterprises should give priority to purchase in China.

Entrepreneurs outside the frontier unbolted the floodgate of market economy, stimulating any kinds of subjects of ownership to invest and engage in business operations. Especially in the name of the “separation governments from enterprises”, “streamline administration and institute decentralization”, soon after 1980, there began to appear a high fever of the party and governmental organs setting up various companies. The Communist Party, any level of governments, even courts and legislative bodies all opened companies and did business by taking advantage of their authorities. The companies were combination of officials and merchants, being detested by the public. And besides the thriving of private enterprises, the State Council promulgated in 1988 *Provisional Regulations of the People's Republic of China on Private Enterprises*, specifying that private enterprises could adopt forms of sole proprietorship, partnership and limited liability company. But at that time, only foreign-invested companies could be standardized by law and there still wasn’t a corporate law applicable for all legal subjects especially domestic persons to engage in investment and business operation. The chaos of public power together with individual vitality plunged enterprises into a mess and intensified corruption. Therefore, drawing up a corporate law was placed on the agenda. In 1992, the State

Commission for Restructuring the Economic Systems and some other authorities published 15 regulating documents such as *Pilot Methods for Shareholding Enterprises*, the *Standard Opinion on Companies Limited by Shares* and the *Standard Opinion on Limited Liability Companies* which had for the first time broken the situation that each region acted on its own will without mutual cooperation and established a unified corporate system nationwide. Then in 1993, Standing Committee of the National People's Congress examined and passed the *Company Law*, specifying the two forms of companies, namely, the limited liability company and the company limited by shares. It was a landmark achievement in the reform and opening-up as well as the construction of a market economy system. The issued shares as well as numerous share-issued companies emerged under the impulse of earning money all over the country were regulated by the national law at the time.

This *Company Law*, at the critical moment of the development of market economy, provided standard for investment, business operation and the legal organization forms, played a significant role in correcting the disorder caused by the "company fever". However, the law was formulated by continued inertia of commanding economy and introduced some foreign legislation during a very short time, which was at odds with rules required by market economy. The judicial system was also hard to catch up with the development of corporate practices and the law. From the perspective of detriment to free investment and business operation, the establishment of a company limited by shares needed to be approved by a department authorized by the State Council or a provincial-level governmental authority, which was likely to be hindered by bureaucratic organs. The much higher requirement of the minimum registered capital of a company[22], besides the strict statutory capital system which means a company mustn't be established before the shareholders pay the total amount of capital described in the company's articles of association, were rather unpractical and induced shareholders to falsely contribute capitals frequently. In terms of corporate governance, the law also lacked flexibility, for instance, only the chairman of the board could assume the post of legal representative of a company.

In consideration of that, the government legislative affairs agency and the state legislature made great revisions to the *Company Law* by referring the latest

[22] The registered capital of a limited liability company should not be less than RMB 100,000, while the minimum amount of it for a company limited by shares was RMB 10 million. Cf. Article 23 & 78 of the *Company Law* (1993).

developments of corporate law in advanced countries on the basis of in-depth analysis and demonstrations, the third reading of the amendment was passed in 2005 by Standing Committee of the National People's Congress. The unrevised articles of the law comprised less than 10%; therefore it is called a "new" *Company Law*. The newly amended *Company Law* prescribes that except the otherwise provisions formulated by laws or administrative regulations, the establishment of a company doesn't need any administrative examination nor approval in advance and the investors may directly handle establishment registration in an administration for industry and commerce.[23] In order to lower the threshold for establishment of companies, it is prescribed that even one single person (including individuals and juristic persons) can establish a limited liability company[24]; in addition, the minimum registered capital of a limited liability company is reduced to RMB 30,000 and that of a company limited by shares is reduced to RMB 5 million, which can be paid in installments within two years.[25] Besides, the restriction that except for investment companies and holding companies, a company's re-investment mustn't exceed 50% of its net assets is cancelled[26]; the legal representative will no longer be "statutory", the shareholders are allowed to agree on the legal representative in accordance with the company's articles of association which will be served by the chairman of the board of directors, executive director or manager[27]; the restrictions for the promoters, directors of the board, supervisors and top managers to transfer their shares of the company are slackened, for example, the promoters may transfer their shares one year after the company is established rather than the previous three years; directors, supervisors and the manager of a company are allowed to transfer the shares they hold in the company on certain condition instead of the prohibition during their term of office,[28] etc. All of these changes have not only promoted the investment and business operation on the part of private enterprises and individuals, but also facilitated the position of investment subjects on the part of state-owned organizations (state-owned enterprises or companies, any institutions or departments that are entitled to make investment with the state-owned assets in their charge) so that they can enjoy further self-governance and pursue capital returns by "dancing" to the baton of market.

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[23] See the current *Company Law* Article 6.
[24] *Id*., Article 58-64.
[25] *Id*., Article 26, 81.
[26] Cf. Article 12 of the *Company Law* (1993).
[27] See the current *Company Law* Article 13.
[28] *Id*., Article 142; Cf. Article 147 of the *Company Law* (1993).

In addition, the unlimited companies in the civil law system are regulated by the *Law of the People's Republic of China on Partnership Enterprises* (short for *Partnership Enterprise Law*) in China. But there had been lack of legal forms of commandite companies suitable for the need of private placement for a long time in China. Although a small number of regions such as Beijing and Shenzhen ever permitted the registration of limited partnership, the enterprises' activities were restricted by geographic conditions without valid security nationally. Given this, the legislature has just adopted the revision of *Partnership Enterprise Law*, which has not only added the traditional simple commandite company or limited partnership (LP), but also introduced limited liability partnership (LLP) by learning from the United States which has most advanced capital market as well as investment relations. Thus the investors are provided with a variety of enterprise organization forms for their choice. It will boost the development of the market economy without a doubt.

2) The *Company Law* has been supplemented with provisions of responsibility and liability for controlling shareholders and business operators

Responsibility is the other side of freedom. Whoever lawfully makes investment in a company, his or her property and shareholder's rights must be protected under the law. Otherwise, some people would frequently and universally encroach on others' property rights by taking advantage under the lawful form of a company. As a consequence, the property right is no longer sacred and the market economy as well as the whole society will collapse instantly. Business operators must take corresponding responsibility, being held accountable and liable to the shareholders. The same is true of some (esp. controlling) shareholders to the others, certain shareholders to the company (viz. the whole shareholders) and the society as well as a company to its shareholders, creditors, employees and any other stakeholders.

In this aspect, although the *Company Law* before its recent amendment did not include concrete contents as the directors' duty of care, related transactions and piercing the corporate veil etc., the fundamental problem lies in the lack of effective rule of law. In a modern society rule of law, whoever has any right should have relevant right of suit and whoever has any obligation or duty should bear corresponding liability, but rather being described in statutes as to whether or not one can file a suit and acquire remedies. Small shareholders harmed by the unfaithfulness of large shareholders and directors as well as related transactions should have

obtained proper remedy and protections. However, courts in China have been reluctant to accept such kind of cases and even if they did so, there would still be an absence of justice. The evasion is just that "there are no provisions about it in any legislations". In 2001, the Supreme Court[29] issued to local courts a "*Notice on Refusing to Accept Civil Compensation Cases Involving Securities for the Time Being*". As implied by the name, the court did violate the natural duty of judicature under the public nose. In 2003, it took a further step triggering broad criticism, that is, should any shareholders file a suit for civil compensation with relation to the false representation in securities market, they must submit any administrative punishment decisions by such organs as the Securities Regulatory Commission and the Ministry of Finance to the person who commits false representation or the documents of criminal judgment by courts, or else, the case won't be accepted.[30] It must be known that only interested persons can feel their interests damaged in the first time, and then seek a remedy immediately. Cases been subject to administrative punishment and the court's criminal penalty are only a very small part of those involving false representation. Besides, it will be after quite a few years that a case can be solved when the expectant compensation is impossible. Doesn't this sort of court bring only trouble to the corporate governance and the market order?

Nevertheless, the *Company Law* has added some provisions about responsibility mainly in the following four aspects:

First, not only should a company abide by laws and be indicative of discipline, but also it should undertake social responsibility [31] — necessary moral responsibilities shouldered for general masses and the public interests.

Second, the law emphasizes the shareholder based principle and protection of minority shareholders' rights and interests. It has provided or made over that: the rights to know of shareholders — they are entitled to refer to company documents and financial reports[32]; the shareholders' inquiry right — to address inquiries to directors, supervisors and top managers[33]; the right to withdraw — shareholders may ask a company to repurchase their equity at a reasonable price in case the company

[29] The full name is the Supreme Court of the People's Republic of China.

[30] See Article 6 of *Trial of Civil Compensation Cases Arising from False Representation in the Securities Market Several Provisions* promulgated by the Supreme Court. The two judicial documents are seen at http://www.chinacourt.org/flwk/index.php (the website of CHINACOURT), visited on September 11th, 2006.

[31] See Article 5 of the current *Company Law*.

[32] *Id*., Article 34, 98.

[33] *Id*., Article 98, 151.

refuses to share out profits or takes any move that harms the value of the shares[34]; when the manner of the convening or resolution of a shareholders' meeting or a meeting of the board of directors violates the law or goes against the company's articles of association, or when the contents of a resolution of these meetings are illegal, the shareholders are entitled to file a suit to court, asking to rescind the resolution or to declare it null and void[35]; a company's vouching for others must be decided by the board meeting or shareholders' meeting, during the voting on the matter, such interested persons as the controlling shareholders or the actual controllers should be absent[36]; a company is prohibited from lending money to its directors, supervisors and top managers directly or through its subsidiaries[37]; when any shareholders abuse their rights so that any damage is caused to the company or other shareholders, or when any controlling shareholders, actual controllers, directors, supervisors and top managers take advantage of their associated relations with the result that the company's interests are spoiled, they should bear the compensation liability[38]; directors, supervisor as well as top managers should undertake both duties of loyalty and care to the company, for example, they can no longer shirk their liabilities for a wrong decision or malpractice upon the pretext of "objective circumstances" or "to pay for some lessons"[39]. Moreover, shareholders enjoy the right of derivative suit or representative action and the right of direct litigation as the ultimate measure for remedies. When a company's interests are damaged because of the control of large shareholders, actual controllers or inner members, for the sake of the company, the interested shareholders are entitled to bring litigation in their own name, and also entitled to sue directly the shareholders, directors as well as top managers who have harmed their interests[40].

Third, the protection of creditors and the safety of transactions of the society are enhanced. The most noteworthy revision is the introduction of the practice of "piercing the corporate veil" or "denying the corporate legal personality", which prescribes that if any shareholders abuse the independent position of the company's juristic person as well as the shareholders' limited responsibility, shirk debts, or harm

[34] *Id*., Article 75.
[35] *Id*., Article 22.
[36] *Id*., Article 16.
[37] *Id*., Article 116.
[38] *Id*., Article 20, 21.
[39] *Id*., Article 148. Since the very beginning of the planned economy, they have been the common words for state-owned enterprise or company operators and related officials to exculpate themselves from liabilities of negligence and being derelict of duty all along.
[40] *Id*., Article 150, 152-153.

the interests of the company's creditors, they should bear joint and several liability for the company's debts.[41]

Fourth, it tries to optimize the corporate governance. For example, the listed companies are asked to set independent directors and a board secretary[42]; the financial report of a company must be audited by the accountant firm according to law[43]; the State Council or local governments authorize the state-owned assets supervision and administration organs of the same level government to fulfill the duty and responsibility as the investor of wholly state-owned companies[44].

B. The anti-unfair competition law and anti-monopoly law catalyzed by market

The knowledge of market competition is accompanied by the emancipation of the mind. The Stalinist socialism regards competition as an "evil", for it is believed to be connected with capitalism that would set off a life-and-death social disaster. With the development of reform and opening-up, people have realized that market and competition are by no means the "patents" of private ownership and capitalism. China also needs fair competition to practice market economy which means the countering of both monopoly and unfair competition.

Concerning this, the government walked ahead of academic circles. As early as the year 1980, when the legal circle of China knew nothing about competition law and the college law students didn't have any courses of competition law, the State Council released the *Provisional Regulations on Promoting Economic Association*[45] and the *Provisional Regulations on Carrying out and Protecting Socialist Competition*[46]. The former noted that "the regional blockage and inter-departmental barriers should be broke", while the latter said: "in economic activities, except for the products that are specially dealt in by relevant departments and units designated by the state, all products can not be in monopolized operation"; in 1986, the State Council promulgated the *Several Regulations on Deepening Enterprise Reform and Intensifying Enterprise Vitality*[47], putting forth that "in the same industry,

[41] *Id*., Article 20.
[42] *Id*., Article 123, 124.
[43] *Id*., Article 165.
[44] *Id*., Article 65.
[45] See http://www.chinalaw.gov.cn/jsp/jalor/disptext.jsp?recno=1&&ttlrec=1 (China Legislative Information Network System), visited on October 4th, 2006.
[46] *Ibid*.
[47] See http://www.chinalaw.gov.cn/jsp/jalor/disptext.jsp?recno=1&&ttlrec=2 (China Legislative Information Network System), visited on October 5th, 2006.

only one monopolistic enterprise group is normally prohibited so as to facilitate competition and technology progress."

Local governments were also unwilling to fall behind. In 1985, Wuhan municipal government approved and promulgated the *Tentative Measures of Wuhan for Curbing Unfair Competition Activities* formulated by the local administration for industry and commerce; in 1987, Shanghai municipal government issued the *Provisional Regulations of Shanghai for Curbing Unfair Competitions* and in 1989, Jiangxi provincial government released such local regulations as *Tentative Measures of Jiangxi province for Curbing Unfair Competitions*.[48]

Against this backdrop, in 1987, the State Council organized a panel for drafting anti-monopoly statute called the *Draft of Provisional Regulations on Forbidding Monopoly and Unfair Competition*. As at that time, all the important industries were controlled by the government, the spontaneous monopoly in market was still not common and hence, it was unpractical to put anti-monopoly on the agenda. Therefore, the drafted statute was revised as *Law for Countering Unfair Competition*. It was said that once the condition was mature, the proposed anti-monopoly law would be prepared again. In order to coordinate the legislation, the legal circle began to do research work on competition law. So we can see that they had so lagged behind.

At the end of 1991, "Law for Countering Unfair Competition" was listed into the legislative plan of the Standing Committee of National People's Congress. State Administration for Industry and Commerce drafted the *Anti-Unfair Competition Law* (draft for soliciting opinions) passed by the Standing Committee of National People's Congress in 1993 and was put into practice. Thus "freedom + order" or "vigour of market + ruly competition" had become a part of the tenet of the China's market and the rule of law, which started to integrate gradually with the international standards.

The *Anti-Unfair Competition Law* is in fact a "competition law" or "fair trade law" which not only counters unfair competition but also prescribes several monopolistic activities that had revealed themselves during the legislative process and detested by the people. In addition, as is specified in article 14 of *Price Law*, business operators are prohibited from cartel price behavior, improper sales at a lower-than-cost price as well as price discrimination; the *Invitation and Submission*

[48] See the three local provisions at http://www.chinacourt.org/flwk/ (the website of CHINACOURT), visited on October 4th, 2006.

of Bids Law in 1999 and *Government Procurement Law of the People's Republic of China* (short for *Government Procurement Law*) in 2002 made specifications on making tenders in collusion as well as the prejudice against and rejection of bidding competition. In order to standardize direct sales and ban pyramid sales — a detriment of market order and social stability, the State Council promulgated in 2005 the *Regulations on Direct Selling Administration* and *Regulation on the Prohibition of Pyramid Selling*. Along with the development of market-oriented reform and the legal system, *Anti-Monopoly Law* was incorporated into the legislative plan of the 9th Standing Committee of National People's Congress in 1999. The draft has been completed by the Legislative Affairs Office of the State Council and has been submitted to the Standing Committee of National People's Congress for discussion and review.

The *Anti-Unfair Competition Law* did have played some role over more than a decade. For example, before the implementation of it, the phenomenon of fake and imitating package or decoration ran rampant in China and couldn't be checked by any law, this law has reversed the picture[49]; people used to have furious disputes over whether the rebates of sales is good or bad while the stipulation of the law has appeased it, i.e., the offer of a rebate openly in account is "lawful" while the under-the-table offer of any rebate outside account is illegal[50]; there is still the problem of infringement of know-hows, however, the law has transformed the know-how protection from the state of vacancy of law into rule by law[51]; that the local governments and departments and public utility enterprises carried out market blockage and designated purchases (e.g., restricting consumers to purchase specific telephone devices, gas appliances etc. when they apply for correlative services) was ever a headache for consumers and enterprises, however, after the promulgation of the law, there appeared an upsurge of the sentiment against "administrative monopoly", and the administrations for industry and commerce have conducted a multitude of such cases, therefore, the problem is no longer as common and severe as before.[52]

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[49] See the *Anti-Unfair Competition Law*, item 2 of Article 5.

[50] *Id*., Article 8.

[51] *Id*., Article 10.

[52] The law has two famous provisions concerning anti-administrative monopoly and anti-abuse power of public utility enterprises. The article 7 prescribes: "Governments and their subordinate departments shall not abuse administrative powers to restrict people to purchasing commodities from the business operators designated by them and impose limitations on the rightful operation activities of other business operators. Governments and their subordinate departments shall not abuse administrative powers to restrict commodities originated in other places from entering the local markets or the local commodities from flowing into markets of other places";

Nevertheless, for the economic and social development as well as the inadequate awareness of the legislators, there still remains some room for the improvement of the *Anti-Unfair Competition Law*. For example, there is no prescription on whether the behavioral persons of the sales at an under-the-cost price should possess any market power[53]. As a matter of fact, only when the subjects holding market power engage in constant and vicious sales at a lower price, the market competition and social interests would be imperiled, or else, no damage will be incurred on the part of the market and there are benefits rather than harms on the part of the consumers. However, when the administrations for industry and commerce deal with the cases, they don't consider whether or not a at lower-than-cost price seller hold any dominance in the market. And the prescription that the maximum sum of the award in lottery sales shouldn't exceed RMB 5,000[54] was reasonable at that time. I remember in the 1990s, people would win a car in the lottery for buying a small packet of sunflower seeds, which had drawn the competition between sellers and the interest of consumers on the prizes, then they wouldn't care about the quality of commodities or services. Nowadays, such a provision is irrational. For the purchase of a residential apartment, there would be a prize of a parking space worth RMB 80,000 which is too small a sum compared with the price of the home — RMB one or two million. So it should be learned from the experiences of developed countries to decide whether the value of a prize is reasonable or lawful according to the value of the commodities or services for sale. Moreover, there is no restriction on the popularity with relation to using others' name or enterprise appellation[55]. In real life, there are thousands of people with identical names. If I am not ill-intentioned and at the same time, you are no celebrity, I use the same name of person or enterprise as yours, which won't induce any misunderstandings, such act should be allowed. That is to say, with respect to this kind of case, there should be restriction based on the popularity. Meanwhile, the revision to *Anti-Unfair Competition Law* should echo the stipulation of the *Anti-Monopoly Law*. When the latter being promulgated, the clauses on anti-monopoly in the former should also be moved into the latter.

Anti-monopoly law is a foundation stone of the market economy. China has no

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While the article 6 says: "A public utility enterprise or any other business operator occupying monopoly status according to law shall not restrict people to purchasing commodities from the business operators designated by him, thereby precluding other business operators from fair competition."

[53] *Id*., Article 11.

[54] *Id*., Article 13.

[55] *Id*., item 3 of Article 5.

tradition of rule of law and has adopted the model of civil law system, thus the transformation to a market system has enjoyed considerable development, it is imperative to stipulate an *Anti-Monopoly Law*. The law shall popularize the concept and value of free market, making systematic regulation on cartel behaviors, the abuse of market power or dominance as well as the enterprise concentration. Hopefully, China's market economy and the law will probably make qualitative headway and scale a new height.

III. Further Problems and the Prospect

A. Fair and just and the rule of law: guarantee of healthy companies and an effective market economy

On surface, provisions of the new *Company Law* are sufficient to meet all issues, but still the expected effects may not be achieved. The problem is that Chinese society lacks a tradition and consciousness of the rule of law which is necessary to the operation of modern companies and corporate institutions.

Law is not equal to legal articles. But on the whole, the development of law in China still remains on the level at which law is considered equal to statutory provisions. Legislation is always falling behind practice or transcending it unrealistically; contradictions, careless omissions and mistakes in legal articles are unavoidable; the number of legal articles in modern society are too numerous to enumerate, multiple legislations may be targeted against the same thing, several provisions may be applicable to the same case, the applying of any one of them is lawful, but there is always only one most justifiable and rational rule on the thing or case; moreover, there are contradictions between procedure justice (legal truth) and substantial justice (objective truth). All of these require that the society should pursue the rule of law and make good use of laws; judges in particular should adhere to the stance and idea of fair and just, and make suitable choices from multitudes of proper or improper legal articles and give reasonable explanations, so that disputes can be solved in a fair way. However, the China society is lacking within the idea of rule of law as notions of honesty and credit, sacred property, liability of fault, no dislocation of roles and avoiding conflict of interests, etc. Due to the continental style legal system, the pursuit of law focuses on certain legislations or articles and their mechanical application to concrete cases; while the rule by man tradition causes people to evade laws by intentional formalist understanding of them, in order to

avoid duties or liabilities or to infringe on others' interests. Hence, judges are provided with chances of indiscriminate use of laws with selfish purposes; they may handle a case and give a verdict in any way they want as long as legal articles and procedures are abided by superficially and formally. If fair and just are not placed above any specific law or rule, regulation or provision, the rule of law will be an illusion. This is exactly the major problem of China's law circumstance. It makes no exception of enterprises and the company law.

The following are worthy of mention. They will test the level of judicature and the rule of law during the implementation of the new *Company Law*:

The first is the problem of one-person companies. After the recent amendment of the *Company Law*, it is permitted that a natural person may establish a limited liability company. This signifies that more freedom is given to investment, operation and enterprises, and individuals have the same status with juristic persons and governments. However, China is hardly capable of supervising natural persons and law enforcement; moreover, the society has a low credibility and the credit system is distempered. The appearance of many one-person companies[56] may aggravate the phenomena of mixing the shareholder personality with that of the company, the company finance with the personal assets, which would no doubt harm the interests of obligees, thus posing a new test to the market supervision of governments, courts and the whole society.

The second aspect relates to unveiling corporations or corporate personality denial. The amended *Company Law* stipulates that: shareholders should not abuse their rights to impair the interests of the company or other shareholders, otherwise they shall be subject to compensation; shareholders who abusing the independent status of juristic person or their limited liabilities to shirk debts, and thus seriously damages the interests of any creditor, shall bear joint liabilities for the debts of the company; the shareholder of a one-person limited liability company unable to prove that the assets of the company is independent from his own property, shall bear joint liabilities for the debts of the company.[57] Such provisions are necessary since they are helpful to the security of transactions, the maintenance of market order and the

[56] The new *Company Law* has been implemented since January 1st, 2006. Within 8 months, 300 one-person companies have come into existence in Shishi, Fujian Province where the population is only 300 thousands. The number accounts for 34% of the total number of enterprises established in the period. See *Establishment of "one-person companies" is all the rage in Shishi, Fujian; 300 companies are registered in eight months*, http://www.fjcns.com/News/ShowInfo.aspx?ID=10534 (the website of Fujian Newsnet), September 7th, 2006.

[57] See the *Company Law* article 20, 64.

promotion of social credit. But their application, to a great extent, depends on the free ruling of judges. For example, what is the “abusing” and how to bear joint liability? If they are handled properly, judges’ awareness of fair and just can be cultivated, so that making progress towards the corporate law and the society’s rule of law; otherwise, a company’s personality may be denied at will and the basis of company law and the corporate institutions will be shook.

The third is about the issue of related transactions. Related transactions are neutral, beyond reproach per se. With reliable and stable credit, lower cost and strong duration, they are the inevitable outcome of trade relations; what is to be controlled by law is that companies use them to create profits or losses, transfer interests or risk, evade debts, dodge taxes and governmental business regulations. Some articles have been added to the *Company Law* that controlling shareholders, actual controllers, directors, supervisors and senior managers who taking advantage of its related relationships to impair the interests of the company and result in any losses to the company shall be subject to compensation; directors of listed companies having any relationship with the company involved in the matter to be discussed at the meeting of the board, shall stay out of voting on the resolutions.[58] The realization of these also relies on the social consciousness of rejecting contradictory interests and judges’ seeking for the balance between justice and the effectivity of a related transaction.

The fourth is concerned with duties and liabilities of directors. Directors are entrusted with the duty of managing the shareholders’ investment and operating the company. It is also not enough to enumerate their duties of loyalty and care in the law. When judges are hearing such cases, their behavior is rather rash. They do not distinguish the fault liability between executive directors and ordinary directors, and that between internal directors and external directors. Still the business judgment rule is yet to be introduced. Therefore, there is a long way to go. Once the issue of directors’ duties and liabilities is solved, the corporate governance in China will be accordant with requirements of modern enterprise system.

The final is related to the judicial remedy of minority shareholders. The protection of minority shareholders requires a series of suit rights, e.g., suits concerning shareholder’s right to know (including auditing), the withdraw right, the request of dismissing a company because of deadlock, direct or representative actions. After the amendment of the *Company Law*, courts formerly reluctant to

[58] *Id*., Article 21, 125 and item 4 of Article 217.

accept such cases will have no excuse of declining them legally and morally. However, how these suits will be carried on is still unknown. Courts have to accumulate experience through practice to gain knowledge on what kind of violations of company interests can lead to a derivative action, the procedure of such actions as well as the position of litigants, etc. Derivative suits may have some disadvantages in disturbing the normal operation of companies even the economy. The task of reducing any side effect of it will be weighed upon the inexperience of the courts as well as the judges.

B. Problems encountered during the formulation of the *Anti-Monopoly Law*

The *Anti-Monopoly Law* is still in draft form. It remains unknown what it at last looks like and when it will be formally promulgated. However, its framework is decided and will not be changed. After its promulgation, China's competition law will more closely follow international practice. According to my personal experience as a member of the Expert Consultants of the Legislative Committee on Chinese Antimonopoly Law appointed by the Legislative Affairs Office of the State Council in 2005, major issues involved of the proposed law are as follows.

1) How to specify the tenet of the *Anti-Monopoly Law* and the definition of monopoly

In line with the continental legal system, the tenet or purposes should be made clear at the very beginning of a legislation; moreover, the policy function of the law and its flexibility also require a certain tenet so as to facilitate application in future. The tendency of the legislators is to generalize and blur the tenet of the law and add descriptions like maintaining the order of market competition, protecting the interests of consumers and the public. The purpose may be to give sufficient freedom to the intended anti-monopoly law enforcement authority. In my opinion, such ideas are too general to reflect the character of the anti-monopoly law. Preferably, the aim of the law should be clarified, i.e., protecting fair, effective competition and the interests of consumers. If necessary, the law enforcement authorities and courts may judge by the tenet whether or not a particular behavior should be taken. The concept of effective competition includes the meanings of sufficiency and order.

Related is the definition of a monopoly activity. According to my own experience, its denotation should not relate to too many aspects, such as "injuring the interests of

consumers", "harming public interests" etc. Unlike the tenet in a legislation used as a kind of idea or guidelines, the definition of monopoly will be used in concrete cases. In 2003, I participated in an investigation organized by the Ministry of Communications et al into the concerted conduct of several liner conferences and freight stabilization agreement organizations in collecting the terminal handling charge (THC). In this case, the liner companies defended themselves and asserted that their behavior did not cause any damage on "the legitimate rights and interests of other operators or consumers", because the article 14 of the *Price Law* mainly applied in the case stipulates that operators shall not act in price collusion to the detriment of such "rights and interests". Since it is difficult and unnecessary to prove that their conspired conduct harmed other operators or consumers, much time had been wasted in wrangling. Their obvious illegal conduct went almost unchecked. After debates, the present draft only enumerates monopoly activities and deleted the superfluous general definitions.

2) The tendency of strengthening administrative power during the legislation

Legislations and laws are drafted mostly by government departments. Governments have a natural tendency towards strengthening their administrative power. In the anti-monopoly legislation, the government in charge of drafting once required that any cartel and enterprise concentration should be examined and approved by relevant governmental department, and administrative punishment should be taken as the precondition or the sole remedy for anti-monopoly civil cases. I agree with neither of them. This is actually using methods applicable to controlled economy to treat matters in market economy, which is not only unfeasible but detrimental to market economy. The experience of Germany and Europe is that the cartel censoring system would result in the accumulation of applications; those who intend for unfair restraint of competition do not apply to the government at all while the applications of honest applicants are delayed. Thus the normal operation and development of economy is affected. The side effects will be more enormous if approval should be got for any stated M&A cases. It is gratifying that now there are no provisions on cartel approval in the draft and any cartel conduct may be dealt with by anti-trust authorities, or any stakeholder has right to bring lawsuits against it. The enterprise concentration approval has been changed into the record-filing system popular in developed countries, which indicates the enlightenment and progress of the legislators.

Due to the focus on governmental (anti-trust law enforcement) power and the professionalism of the anti-trust as well as the disbelief in litigants and courts, the problem is still under discussion as to whether enterprises and individuals can file an anti-trust suit directly. The tendency of the draft is still that anti-trust cases should be handled by anti-trust law enforcement authorities. A doer, who refuses to accept the decision made by the enforcement authority, may then bring an administrative suit before a court. This is similar to taking administrative punishment as a precondition for shareholders to file a compensation suit. In this way, the fair competition order and the rule can not be maintained through ordinary judicial examination of monopoly conducts; moreover, the suit right of citizens, enterprises and any juristic persons is overridden. Therefore, China is in an urgent need of a democratic judicature advocated in the Anglo-American legal system, e.g., citizens enjoy the same status with governments, any governmental behavior should be examined to see not only whether the government has such power or rights but also whether it is justifiable according to relevant substantive laws, such as the competition law. Of cause citizens and juristic persons should have rights to bring suits directly to seek judicial remedies when their rights and interests have been infringed upon by any anti-competition behaviors.

The *Anti-Monopoly Law* will be a driving force and an index by which to assess the degree of judicial advancement in China.

3) Whether or not special provisions should be drawn up for administrative monopoly

In China, monopoly is largely the governmental behaviors; in other words, it relies on governments, for example, purchases designated by governmental departments, commodity or service circulation restricted by local governments, and the monopoly of public utilities and important industries approved and supported by governments. Such monopoly has become an object of public condemnation. Moreover, there is a tradition of clear distinction between public and private areas according to the continental legal system. Therefore, a question arises as to whether or not special provisions about administrative monopoly should be drawn up in the *Anti-Monopoly Law*. As to this question, there are two extreme points of view: the first asserts that the conducts of administrative monopoly should be enumerated in a detailed way, thus damage to competition and consumer interests caused by illegal administrative monopoly will be checked; the second contends that administrative

monopoly should not be included in the *Anti-Monopoly Law*, because such problem can only be solved via reforms of the political system rather than any laws.

With reference to the practice of developed countries mainly in the US, I have been advocating for years that the *Anti-Monopoly Law* should equally apply to both public and private sectors, so as to intensify efforts to prohibit administrative monopoly. Thus, there is no need to add special provisions about administrative monopoly in the *Anti-Monopoly Law*.[59] My points are as follows:

Firstly, the legitimacy of administrative monopoly is not always the same thing and such cases cannot be listed one by one. For example, railway passenger transportation in China is both administrative monopoly and a legal one. Meanwhile, efforts should be made to guard against illegal monopoly by abusing its dominant status. Anti-trust law enforcement, to a certain extent, depends on free judging of courts and governmental enforcement authorities, and on their understanding of the spirit of market competition and the actual competition situation.

Secondly, the government enjoys no privileges before competition law. If the government improperly affects market competition and violates the *Anti-Monopoly Law*, not relating to any affairs of sovereign, it should bear legal liabilities as if it was a citizen or a juristic person, including compensation. If this is the case, there is no need to draw up special provisions on administrative monopoly; otherwise it would be necessary to think up particular liability forms and remedy procedures for the government which are different to those for private monopoly. In this way, the control of administrative monopoly will be weakened; mostly we have to let it go.

Thirdly, anti-trust law in Europe and Japan historically did only oppose private monopoly rather than the monopoly done by states or state-owned enterprises. The reason is that, in the past, state-owned enterprises or state economy were largely engaged in infrastructure projects or public utilities and people considered such (administrative) monopoly necessary. Furthermore, because of the arrogance and stereotyped superiority of public power over private rights, the two cannot enjoy the same status in the anti-trust law. However, things have been changed: on one hand, in accordance with the requirements of market economy and the need of reform, many state-owned enterprises have been reorganized into competitive shareholding enterprises controlled by government. Business company law or register company

[59] See SHI Jichun, *On the Concepts and Objects of China's Anti-Monopoly Law*, the *Frontiers of Law*, Volume , Law Press (Beijing, 1999).

law even applies to these enterprises directly. With support from government, as the government would still probably be a controlling shareholder or the largest shareholder of such former state-owned enterprises, they are at an advantaged place in competition, if anti-trust law did not apply to them, it would be unfair to private companies. On the other hand, the trend of globalization aggravates economic competition among various countries. It is easy to see shadows of government behind private enterprises as well as state-owned enterprises in international market competition. According to the requirements of market rule, governments should never distort market relations and make unfair competition when they participate in market in a direct or indirect way. So anti-trust law and competition laws should be applicable to state-owned enterprises, governments and any other public organizations.

Fourthly, illegal administrative monopoly should be opposed by law. Since the *Anti-Unfair Competition Law* put into enforcement, administrations for industry and commerce have dealt with a great many cases concerning market barriers and designated purchases done by county or city governments. Therefore, it is necessary to let the *Anti-Monopoly Law* have the function of anti-administrative monopoly.

Presently, the problem remains unsolved. The latest draft edition gives a general article on prohibiting administrative monopoly, rather than enumerating such behaviors. However, the draft still reflects no clear attitude on whether the same liabilities and remedies can be applicable to both governments and private subjects.

4) About the relationship between the anti-trust law and monopoly industry supervision laws and that between anti-trust law enforcement authorities and other relevant supervision agencies

The making of the *Anti-Monopoly Law* has caused widespread anticipation in society. Ordinary people cherish a different feeling compared to that of the experts. Restrictions or barriers enforced by local governments on commodity and service circulation are exceptional and local phenomenon and their influences occurred only in a short period of time, the public shows no strong reactions to it. The understanding of administrative monopoly of ordinary people is through their personal experience of bureaucratic business practices in monopoly industries such as oil, railway, telecom, water supply, electric power, banking etc. The public wishes that the promulgation of the *Anti-Monopoly Law* can fundamentally solve the

problem. This relates to the relationship between the anti-trust law and monopoly industry supervision laws and that between anti-trust law enforcement authorities and other relevant supervision agencies.[60]

Generally speaking, the relationship between anti-trust law and special industrial laws (e.g., electricity law, railway law, telecommunication law, postal law, civil aviation law, banking law etc.) is same as the relationship between general law and special law: the *Anti-Monopoly Law* targets at any kind of market competition, while anti-trust articles in special laws aim at particular monopoly conducts of particular industries, such as articles about market structures of specific areas, essential facilities monopoly, universal service and relevant price regulation. If such matters are under discussion, supervision laws for particular industries will be applicable first, even if they are somewhat unreasonable. In other words, if anti-trust law enforcement authorities think an act of a monopoly enterprise (maybe supported by any other government authorities) is not in accordance with the *Anti-Monopoly Law*, they can not interfere directly in deciding whether the laws are rational nor whether the established procedure is lawful as long as the act is done in line with regulations of relevant industrial laws. Naturally, if monopoly enterprises are not engaged in special monopoly conducts specified by industrial regulations and laws, the *Anti-Monopoly Law* will be applicable and the anti-trust law enforcement authorities have the power to deal with them, for example, when any monopoly enterprises abuse their market power or take an act which is not (or not clearly) specified in special laws.

As stated above, it could be seen that the public and consumers may be disappointed at the actual effects after the promulgation of the *Anti-Monopoly Law*. The reason is that, in China, reforms of public utilities rely on privatization and the introducing of various kinds of competition mechanism rather than anti-trust laws; the same holds true for other countries. In China, almost all monopoly industries have their own responsible departments or supervision agencies, such as the State Electricity Regulatory Commission, the Ministry of Railways, the Ministry of Information Industry, China Banking Regulatory Commission and China Insurance

[60] During the drafting of the *Anti-Monopoly Law*, the Legislative Affairs Office of the State Council put forward about ten proposals for experts to do some specific research. I was just responsible for the project of "Comparative Studies of the Relationship between the Anti-trust Law and Relevant Laws and that between Anti-trust Law Enforcement Authorities and Relevant Supervision Agencies and Some Legislation Suggestions" and other two subjects, i.e., "Comparative Studies of the Application Range of Anti-Trust Law" and "Comparative Studies of Legal Responsibilities and Liabilities of Anti-Trust Law and the Legislation Suggestion".

Regulatory Commission. So the anti-trust affairs of such industries and the effects are to a great extent rested with whether or not the anti-trust law enforcement authorities can proper handle the relationship with these departments or agencies. On one hand, institutional, non-institutional or informal communication cooperation and coordination are needed; on the other hand, it must be clearly stated in the *Anti-Monopoly Law* that the law enforcement authority shoulders more and final responsibilities for anti-trust affairs than the special industrial supervision agencies. When they notice that any special law of a particular industry conflicts with the needs of competition and the *Anti-Monopoly Law*, or when any special industrial supervision agencies ineffectively or improperly enforce the anti-trust articles in special laws or the *Anti-Monopoly Law*, the *Anti-Monopoly Law* enforcement authorities should enjoy the power to ask legislative organs for the examination of such special laws, put forward suggestions to other supervision agencies, request for consultation and apply to superordinate departments for coordination or dealing with. In this way, it is expected that anti-trust law enforcement authorities can bring their roles into full play, realizing the connection and mutual complementarity between the anti-trust law and relevant laws and that between anti-trust law enforcement authorities and relevant supervision agencies.

5) In what kind of structure should China's anti-trust law enforcement authorities be established?

Basically it is not a legal issue, but it has aroused heated discussions during the legislation and attracted the wide attention of the public. The major problem is that, the *Anti-Unfair Competition Law* has mainly been enforced by the administrations for industry and commerce for years, and any such an administration — from central government to each county and city — has established a "fair trade bureau" for this purpose. While the National Development and Reform Commission is the major enforcer of the *Price Law*, the Ministry of Finance is responsible for the enforcement of the *Government Procurement Law*. After its establishment in 2003, the Ministry of Commerce (come from the Ministry of Foreign Trade and Economic Cooperation) not only keeps its authority over foreign trade, investment and economic cooperation, but also possesses increasing power of supervising the domestic market; moreover, responsible departments or supervision agencies of special industries have the power of law enforcement in relevant fields. Therefore, after the promulgation of the *Anti-Monopoly Law*, is it necessary to choose a current

agency or to establish a new one to enforce the law? If an agency is to be chosen, which agency shall it be, the Ministry of Commerce or the Administration for Industry and Commerce? If a new agency is to be established, what its rank, position and the relationship be with other supervision agencies? Obviously the dispute is caused by power allocation and the relocation of vested power.

Now the discussion has come to its temporary end. The finding is that a compromise should be reached for between centralized and decentralized law enforcement to maintain the current situation of separated enforcement. On this basis, an "anti-monopoly committee of the State Council" shall be established whose members will be heads of relevant departments of the State Council, law experts and economists. Its major responsibilities will be to lead and organize anti-trust affairs, carry out researches on national anti-trust policies, put forward suggestions to the State Council, coordinate the handling of serious anti-trust cases and the cooperation between anti-trust law enforcement authorities.[61] This is a "debating and coordinating institution" rather than a substantial working organ, undertaking the functions of decision-making and coordination. As to its actual effects, we can give suitable remarks only after the implementation of the *Anti-Monopoly Law*.

An Epilogue

In recent years, China seems like a child who grows too fast to change clothes. It is hoped that there will be no serious disruption during the process and that the child will grow healthy and strong.

[61] It was mentioned when the government explained the first draft to the legislature, and will not probably be changed. See *The Draft of the Anti-Monopoly Law Submitted for Deliberation; the "Economic Constitution" is Being Made a Law*, http://www.gov.cn/jrzg/2006-06/25/content_319537.htm (the official website of the Central People's Government of PRC), June 25th, 2006.