

**University of Alberta**

Independent Directors in China

by

Lijun Ma

A thesis submitted to the Faculty of Graduate Studies and Research  
in partial fulfillment of the requirements for the degree of

Master of Laws

Faculty of Law

©Lijun Ma

Fall 2009

Edmonton, Alberta

Permission is hereby granted to the University of Alberta Libraries to reproduce single copies of this thesis and to lend or sell such copies for private, scholarly or scientific research purposes only. Where the thesis is converted to, or otherwise made available in digital form, the University of Alberta will advise potential users of the thesis of these terms.

The author reserves all other publication and other rights in association with the copyright in the thesis and, except as herein before provided, neither the thesis nor any substantial portion thereof may be printed or otherwise reproduced in any material form whatsoever without the author's prior written permission.

## **Examining Committee**

Richard Bauman, Faculty of Law

Moinuddin Yahya, Faculty of Law

Gregory Clarke, Centre of Constitutional Studies

## **ABSTRACT**

This thesis examines the development of the independent director system in China. The newly introduced independent director system is viewed as a revolutionary change to the Chinese corporate governance development. After analyzing the barriers in independent directors' practice in China, this thesis gives some suggestions on how to improve the independent director system in China. Finally the thesis concludes that the independent director system will certainly become effective in China, but only if China's policy makers can eventually solve the existing problems.

## **ACKNOWLEDGEMENT**

My thanks go to my supervisors, Professor Richard Bauman and Professor Moinuddin Yahya for their constructive criticisms and suggestions. I am grateful to Professor Gregory Clarke for accepting to sit in my thesis committee and to Professor Ted DeCoste for his direction in the course of my research. I am also thankful to the Faculty of Law, University of Alberta and the Alberta Law Foundation for their generous financial support. I am grateful to all staff of Faculty of Law, University of Alberta, especially Kim Wilson.

My sincere appreciation goes to my parents, Aihua Ma and Mingfang Gao for their love, encouragement and support. I also thank all my friends and my classmates for their help.

# TABLE OF CONTENTS

INDEPENDENT DIRECTORS IN CHINA .....	1
1 Introduction .....	1
1.1 The historical background of corporate development in China.....	1
1.1.1 The early practice .....	1
1.1.2 Developments after 1978.....	2
1.2 Legal framework for corporate governance .....	4
1.2.1 Major laws and regulations .....	4
1.2.2 Introduction to China's company law.....	6
2 Independent Directors in General.....	8
2.1 Introduction .....	8
2.2 Origin .....	8
2.2.1 Development of the Independent Directors in the United States.....	8
2.2.2 Inducements of the Independent Directors Issue.....	10
2.3 Concepts .....	12
2.3.1 Some terms .....	12
2.3.2 Outside Directors.....	13
2.4 Function.....	15
2.4.1 Functions of the independent directors.....	15
2.4.2 Approach .....	16
2.5 Major rules regarding the independent director system .....	18
2.5.1 Delaware General Corporation Law and Modern Business Corporation Act .....	18
2.5.2 American Law Institute's Principles of Corporate Governance (1994)..	18
2.5.3 Rules of the New York Stock Exchange .....	19
2.5.4 Rules of NASDAQ .....	19
2.5.5 Sarbanes-Oxley Act.....	20
3 The Independent Director Institution in China.....	22
3.1 Reasons for Introducing the Independent Director Institution .....	22
3.1.1 Background .....	22
3.1.2 Shareholding Structure of Chinese Listed Companies .....	23
3.1.3 Large Shareholder Exploitation of Small Shareholders .....	25
3.2 Process of Introducing the Independent Director Institution.....	35
3.2.1 The Early Practice .....	35
3.2.2 Continuous Lawmaking Effort .....	37
3.2.3 Some Important Documents .....	39
3.3 Provisions .....	44

3.3.1 Qualification.....	44
3.3.2 Nominations and Replacement Procedure.....	46
3.3.3 Rights .....	48
3.3.4 Obligations .....	50
4. Barriers in China’s Independent Directors Practice .....	52
4.1 Current Situation .....	52
4.1.1 The Positive Side.....	52
4.1.2 The Negative Side .....	53
4.2 Existing Problems.....	54
4.2.1 Appointment .....	54
4.2.2 Nominating Mechanism .....	55
4.2.3 Qualification and Participation.....	57
4.2.4 Replacement .....	62
4.2.5 Conflict of the Board System: Board of Supervisors and Independent Directors .....	62
4.2.6 Independence.....	63
4.2.7 Incentive Mechanism.....	64
4.2.8 Unsecured Right-to-know .....	66
4.2.9 Lack of a Sound Legal System.....	66
4.2.10 Confucianism Influence.....	67
4.3 Conclusion.....	68
5. Suggestions For China’s Independent Director System .....	70
5.1 Boad of supervisors or independent directors?.....	70
5.1.1 Chinese scholars’ disputes: proponents and opponents .....	70
5.1.2 My opinion .....	73
5.2 How to improve the independent directors system.....	74
5.2.1 To take a rational attitude toward the independent director system.....	74
5.2.2 Suggestions on how to improve China’s independent director system...	75
5.3 Conclusion.....	92
6. Conclusion.....	94
BIBLIOGRAPHY .....	97

# INDEPENDENT DIRECTORS IN CHINA

## 1 Introduction

### 1.1 The historical background of corporate development in China

The first Chinese company law was enacted during the late Qing Dynasty.<sup>1</sup> After 1949 when the new China was founded, a highly centralized economic model from the former Soviet Union was imported. As a result, business corporations gradually ceased to exist. In the late 1970s when China decided to introduce a market economy, state-owned enterprises were redefined as business corporations. At the same time, private businesses were incorporated.

#### 1.1.1 The early practice

The government of China promulgated the first Chinese Company Law, the *Da Qing Gong Si Lu*, in 1904.<sup>2</sup> From a legal perspective, that is the

---

<sup>1</sup> *Da Qing Gong Si Lu*, issued by the Ministry of Commerce, 21 January 1904.

<sup>2</sup> *Ibid.*

first time China had a concept of “company” or “corporation.”<sup>3</sup> When the Communist party took over the government in 1949, it demolished the old legal system and started the planned economic system in China.<sup>4</sup> Under the Communist regime, enterprises were not independent economic entities, but rather workshops and production units controlled entirely by the state.<sup>5</sup> Until 1956, all enterprises with private ownership were transformed into state-owned enterprises which were not as productive as the modern corporation system of western countries.<sup>6</sup> On the one hand, the state exercised macroeconomic functions such as social, regulatory and policy-making functions.<sup>7</sup> On the other hand, the state took part in the microeconomic activities as well.<sup>8</sup>

### **1.1.2 Developments after 1978**

The evolution of the corporate system in China has occurred in the context of economic reforms which started in the late 1970s. The Third Plenary Meeting of the Eleventh Communist Party of China Congress officially endorsed the “opening the door” policy and economic reform in China after 1978.<sup>9</sup> The year 1979 marked a new direction for China’s opening up to foreign

---

<sup>3</sup> Wang Baoshu & Cui Qingzhi, *the Principles of the Chinese Company Law (Zhongguo Gongsì Fa Yuanli)*, (Beijing: The Social Documents Press, 1998) at 7.

<sup>4</sup> Zhao Xudong, *Company Law* (Beijing: Higher Education Press, 2003) at 31.

<sup>5</sup> *Ibid.*

<sup>6</sup> *Ibid.*

<sup>7</sup> Gan Gongren & Shi Shulin, *On the Legal Systems of Corporate Governance* (Beijing: Peking University Press, 2007) at 96.

<sup>8</sup> *Ibid.*

<sup>9</sup> Zhao, *supra* note 4.

trade which rapidly restructured China's planned economy to a market economy.<sup>10</sup> The legal concept of the corporation was imported into China at the end of the nineteenth century.<sup>11</sup>

From 1990 to 1991, two stock exchanges were established in Shanghai and Shenzhen. In 1990, five Chinese companies became the first firms listed on the official Shanghai Stock Exchange. This was a result of China's determination to establish a market-oriented economic system through economic reform and open itself to the whole world.<sup>12</sup> China did not have any formal national company law until the National People's Congress promulgated the *Company Law of the People's Republic of China* in 1993.<sup>13</sup> This is the first formal national company law of China which only has a short history of sixteen years.

In 1997, the Fifteenth National Congress of the Communist Party of China decided to accelerate the reform of modern enterprise and transform large and medium size state-owned enterprises into corporations.<sup>14</sup> In 1999, the Fourth Plenum of the Fifteenth CPC Central Committee adopted a decision that calls for "strategic adjustment" of the state sector by "withdrawing what should

---

<sup>10</sup> Angus Young, Grace Li & Alex Lau, "Corporate Governance in China: The Role of the State and Ideology in Shaping Reforms" (2007) 28:7 *Company Lawyer* 204 at 207.

<sup>11</sup> Guan Xinrong, *Independent Director System and Corporate Governance* (Beijing: China Procurator Press, 2004) at 67.

<sup>12</sup> Jian Chen, *Corporate Governance in China* (London and New York : RoutledgeCurzon, 2005) at 31.

<sup>13</sup> *Company Law of the People's Republic of China* (Zhonghua Renmin Gongheguo Gongsifa). It was adopted on 29 December 1993 by the Fifth Session of the Standing Committee of the Eighth NPC and was effective from 1 July 1994. It was recently amended. The new law took effect on 1 January 2006. Online: <<http://www.cclaw.net/download/companylaw.asp>>

<sup>14</sup> Guan, *supra* note 11.

be withdrawn.”<sup>15</sup> It defined the major objectives and guiding principles for the reform and development of state-owned enterprises.<sup>16</sup>

## 1.2 Legal framework for corporate governance

### 1.2.1 Major laws and regulations

Currently, there are two major laws passed by the National People’s Congress (“NPC”) of China, which set the legal framework for corporate governance in China.<sup>17</sup> One is the *Company Law of the People’s Republic of China*<sup>18</sup> which was promulgated in 1993. The other one is the *Securities Law of the People’s Republic of China*<sup>19</sup> which was promulgated in 1999. On October 27, 2005, China announced major revisions to its company and securities law which became effective 1 January, 2006.<sup>20</sup> Reforms include lowering the threshold for domestic initial public offerings and strengthening corporate governance.<sup>21</sup>

These two major laws are supplemented by many different regulations and guidelines. In China, administrative regulations, bylaws and judicial

---

<sup>15</sup> *Ibid.*

<sup>16</sup> *Ibid.*

<sup>17</sup> Under Article 57 of the Constitution of the People’s Republic of China of 1982, the NPC is “the highest organ of state power.” Zhonghua Renmin Gongheguo Xianfa, art. 57 (1982). Pursuant to Article 62 (3) of the Constitution, the NPC has the power to enact and amend criminal laws, civil laws, state organ laws, and other basic laws. Article 62 (3). Article 67 (2) of the Constitution gives the Standing Committee of the NPC the power to enact and amend laws, other than those already enacted and amended by the NPC itself.

<sup>18</sup> See [www.gov.cn](http://www.gov.cn), the official website of Central People’s Government of People’s Republic of China.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

<sup>21</sup> Guan, *supra* note 11.

interpretations play an important role in the lawmaking and practice of company law.<sup>22</sup> For instance, the Chinese Securities Regulatory Commission (CSRC) was set up to monitor and regulate the stock market in 1992.<sup>23</sup> It incorporates new sets of rules for governance and disclosure to further protect investors' interests.<sup>24</sup> Regulations and interim rules affecting corporate governance arrangements are usually made in the name of the CSRC, sometimes in conjunction with other organizations such as the State Commission for the Reform of the Economic System.<sup>25</sup> At the same time, the stock exchanges in China made their own rules which govern the listed companies.<sup>26</sup> In addition to legal sources, a corporation's Memorandum of Association plays an active role in designing the corporation's governance structure.<sup>27</sup>

The most recent development in the legal framework of corporate governance in China is the promulgation by the CSRC of the corporate governance guidelines for listed companies.<sup>28</sup> These guidelines include the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies* introduced on 16 August 2001, and the *Code of Corporate*

---

<sup>22</sup> Zhao, *supra* note 4, at 50.

<sup>23</sup> Li Jianwei, *Corporate System, Corporate Governance and Corporate Management: The Role and Effectiveness of Law in Corporate Management* (Beijing: People's Court Press, 2005) at 91.

<sup>24</sup> *Ibid.*

<sup>25</sup> Ning Jincheng, *Corporate Governance Structure* (Beijing: Law Press, 2007) at 233.

<sup>26</sup> These rules are made by the stock exchanges in Shanghai, Shenzheng and Hongkong. For example, Shanghai Stock Exchange made *Rules governing the listing of stocks on Shanghai Stock Exchange* which was effective as of January 1998 and revised for the sixth time in September 2008. It can be found online at [http://www.sse.com.cn/sseportal/en\\_us/ps/support/en\\_sserule20090408.pdf](http://www.sse.com.cn/sseportal/en_us/ps/support/en_sserule20090408.pdf).

<sup>27</sup> The company law requires that the Memorandum of Associations shall be formulated when a company is incorporated, and provides that it shall be binding on the company, its shareholders, directors, supervisors and managers. Company law, *supra* note 13, art. 11, 22, 29.

<sup>28</sup> The Notice Concerning the Announcement of Corporate Governance Guidelines for Listed Companies, promulgated by the CSRC on 7 January 2002 and effective from that date.

*Governance for Listed Companies* of 7 January 2002.<sup>29</sup>

## 1.2.2 Introduction to China's company law

The company law requires China's companies to form three statutory and indispensable corporate governing bodies. The first are the shareholders who act as a body at the general meeting.<sup>30</sup> The rest are the board of directors and the board of supervisors.<sup>31</sup> It is formulated for the purposes of standardizing the organization and activities of companies, protecting the legal rights and interests of companies, shareholders and creditors, safeguarding social and economic order and promoting the development of socialist market economy.<sup>32</sup>

### *a. The governance structure*

The internal governance structure followed by China's company law is a combination of the Anglo-American and German systems.<sup>33</sup> China operates a two-tier board system which contains a board of directors and a supervisory

---

<sup>29</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies* (promulgated by China Securities Regulatory Committee, August 16, 2001) online: [http://211.154.210.238/en/depjsp/depsecond\\_en.jsp?path=ROOT%3EEN%3EDepartments%3EDept.%20of%20Listed%20Company%20Supervision%3EService%20Guide&level=5](http://211.154.210.238/en/depjsp/depsecond_en.jsp?path=ROOT%3EEN%3EDepartments%3EDept.%20of%20Listed%20Company%20Supervision%3EService%20Guide&level=5); *Code of Corporate Governance for Chinese Listed Companies* (promulgated by China Securities Regulatory Commission & State Economic and Trade Commission, Jan 7, 2002) online: [http://e.3edu.net/fl/E\\_4990\\_3.html](http://e.3edu.net/fl/E_4990_3.html).

<sup>30</sup> Company law, *supra* note 13, art. 99-108 for specific provisions regarding the general meeting of shareholders.

<sup>31</sup> *Ibid.*, art. 109-117 for provisions regarding the board of directors; see art. 118-120 for provisions regarding the board of supervisors.

<sup>32</sup> *Ibid.*, art. 1.

<sup>33</sup> Shi Tiantao, *Corporation Law* (Beijing: Law Press, 2007) at 304.

board under the German corporate governance model.<sup>34</sup> According to the company law, the board of directors is responsible for managing the affairs of the company.<sup>35</sup> It convenes shareholders' meetings, implements the resolutions of those meetings, decides the company's business and investment plans, and formulates its basic management system.<sup>36</sup>

*b. Corporation types*

Chinese company law recognizes only two types of corporations: closely held corporations and publicly held corporations.<sup>37</sup> The general meeting of shareholders and the existence of the board of directors and board of supervisors are mandatory for both types of corporations.<sup>38</sup> In both types of corporations, the board of directors and the board of supervisors function on an equal level and are independent of each other.<sup>39</sup> In both types, the general meeting of shareholders, as the supreme authority of the corporation, has indisputable power to hold the two boards accountable.<sup>40</sup>

---

<sup>34</sup> *Ibid.*

<sup>35</sup> *Ibid.*

<sup>36</sup> Company law, *supra* note 13 art. 113

<sup>37</sup> *Ibid.*, art. 2.

<sup>38</sup> *Ibid.*, art. 38-126.

<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

## **2 Independent Directors in General**

### **2.1 Introduction**

The independent director institution has been viewed as a solution to many corporate governance problems for a long time. Corporations in the United States usually have widely dispersed shareholders. Independent directors were introduced to monitor the integrity and performance of management. Therefore, public corporations can run more effectively, make more profit and be more responsible to the society.

However, why is it so popular in today's corporate governance debate? Why did so many countries introduce independent directors into their legal system? In order to explain these, we have to examine the basic factors of the independent directors such as the origin, the concepts, the function, and the contents of the institution.

### **2.2 Origin**

#### **2.2.1 Development of the Independent Directors in the United States**

Rome was not built in a day. The independent director institution did not have a clear concept or appellation in the early corporation law of the United States. In fact, the development of the system of independent directors is a

process of development and perfection. The development of the independent director system in the United States has experienced four landmark periods.

a. Germination Period

In the early 1930s, the Securities and Exchange Commission of the United States started to suggest that listed corporations have “non-employee directors.” In the Securities Exchange Act of 1934, it states that listed corporations should have “non-employee directors.”<sup>41</sup>

b. First Establishment

In 1940, the Investment Company Act required that at least 40 percent of the membership on the board of directors should be “disinterested.”<sup>42</sup> Later on, the Internal Revenue Code mentioned “outside directors” for the first time.<sup>43</sup> During that period of time, introducing outside directors to the board of directors was a prevalent way for the corporations.

c. Formal Adoption

The concept of independent directors in the United States can be tracked back to the early 1970s. It was aimed to cure corporate governance problems of that time. In 1972, the Securities and Exchange Commission of the

---

<sup>41</sup> See *Securities Exchange Act of 1934*, 17 CFR sec. 240.16b-3.

<sup>42</sup> See *Investment Company Act of 1940*, 15 USC. 80a-10(a); 15 USC sec. 80a-2(a) (18).

<sup>43</sup> See *Internal Revenue Code* 26 CFR sec. 1.162-27.

United States officially required publicly held corporations should have outside directors in the standing audit committee.<sup>44</sup> In 1977, the New York Stock Exchange officially required every listed corporation to establish and maintain an audit committee composed exclusively of independent directors.<sup>45</sup> This is the first time the word “independent director” appeared in a legal document in the United States as a special legal term. The independent directors system is considered to have officially originated during the 1970s.

#### d. Further Development

During the 1990s, an unprecedented number of investors entered the market. Their way and speed of acquiring stock information were strikingly developed. This challenged the independent directors system of the time. Among different American states, Michigan was the first to have the independent directors system in Article 450 of its Business Corporations Act.<sup>46</sup> It regulated the standard, nomination measure, and special power of independent directors.

### **2.2.2 Inducements of the Independent Directors Issue**

The origin of the independent directors system has its direct or indirect

---

<sup>44</sup> See R. I. Tricker, *Corporate Governance* (USA: Ashgate, 2000).

<sup>45</sup> See *New York Stock Exchange, Listed Company Manual*, November 03, 2004, ses. 303.00.

<sup>46</sup> Business Corporation Act, Mich. Stat. 1972 (Act 284, Eff. Jan. 1, 1973 ;-- Am. 1989, Act 121, Eff. Oct. 1, 1989 ;-- Am. 1993, Act 91, Eff. Oct. 1, 1993)

social, economic, political and legal aspects. We call these facts the inducements of the issue of independent directors. Specifically speaking, these inducements can be concluded to be corporate scandals, overpaid salary, and increasing shareholder litigation.

#### a. Corporation Scandals

The political chaos of the 1960s in the United States is the historical background of introducing independent directors. Vietnam War, Watergate scandal and stagflation made the public lose their faith in the development of the corporations. The exposure of several corporation scandals such as the Lockheed bribery scandals<sup>47</sup> even made the public feel unbearable.

#### b. Overpaid Salaries

Since the 1950s, people have long been unsatisfied with the high pay of the senior managers. In theory, salary is the shareholder's main way of monitoring and rewarding managers. The problem is how high the pay should be. The corporation's achievement does not have much to do with the salary of the managers. Even when the corporation is losing money, the salary of the

---

<sup>47</sup> The Lockheed bribery scandals were a series of illegal bribes and contributions made by Lockheed officials from the late 1950s to the 1970s. In late 1975 and early 1976, a sub-committee of the U.S. Senate led by Senator Frank Church concluded that members of the Lockheed board had paid members of friendly governments to guarantee contracts for military aircraft. In 1976, it was publicly revealed that Lockheed had paid \$22 million in bribes to foreign officials in the process of negotiating the sale of aircraft including the F-104 Starfighter, the so-called "Deal of the Century". The scandal caused considerable political controversy in West Germany, the Netherlands, Italy and Japan. In the U.S. the scandal led to passage of the Foreign Corrupt Practices Act, and nearly led to the ailing corporation's downfall (it was already struggling due to the poor sales of the L-1011 airliner). Daniel Haughton resigned his post as chairman of Lockheed.

managers is still increasing. Therefore, the fairness of the manager's remuneration became the core problem.

### c. Increasing Shareholder Litigations

During the 1970s, there were a lot of shareholder lawsuits. Shareholders brought the lawsuit to protect self-interest or the corporation's interest. Besides, the creditors of the corporations, rivals, and the government (such as the Securities and Exchange Commission) also brought up lawsuits. Faced with this increasing litigation aiming at corporate board of directors, the court required corporations improve their corporate governance structures by introducing outside directors into their boards of directors.

## **2.3 Concepts**

### **2.3.1 Some terms**

The concept of independent director has no clear meaning. There are several different terms such as "independent," "outside," "non-employee," "non-executive," and "disinterested." Although these terms have different meanings, they are always discussed together as if they were indicating the same

concept.<sup>48</sup>

Outside directors and non-executive directors are similar because they are not involved in the corporation's daily operations. Generally speaking, the term "non-executive directors" is more widely used in Britain while the term "outside directors" is prevalent in the United States.

Some individuals seem to be outsiders since they don't work in the corporation. However, some of them are not truly independent such as former employees, those who provide financial or legal services, or family members of senior management members. According to their relationship with management or controlling shareholders, outside directors can also be divided into affiliated directors and unaffiliated directors. Only the unaffiliated outside directors are independent directors.

### **2.3.2 Outside Directors**

An outside director means any director who is not a company employee.<sup>49</sup> The Cadbury Report states that "a board made up of a combination of executive directors, with their intimate knowledge of the business, and of outside, non-executive directors, who can bring a broader view to the company's

---

<sup>48</sup> Donald C. Clarke, "Three Concepts of the Independent Director" (2007) 32 Del. J. Corp. L. 73 at 78.

<sup>49</sup> Thomas J. Andre, Jr., "Cultural Hegemony: The Exploration of Anglo-Saxon Corporate Governance Ideologies to Germany" (1998) 73 Tul.L.Rev. 69at 152.

activities.”<sup>50</sup> Professor Cheffins thinks that one function of outside directors is to “provide full-time executives with support and assistance as they carry out their managerial tasks, which entails offering specialized advice and fostering links with other organizations.”<sup>51</sup>

At the same time, outside directors can be divided into “independent outside directors” and “non-independent outside directors.” “Independent outside directors” refers to those directors who are free from any interpersonal relationship or financial interest. By contrast, “non-independent outside directors” refers to those close friends or relatives of the shareholders and senior managers of the corporation, or they may have economic interest relationship with the corporation. Some scholars refer to these “non-independent outside directors” as “grey directors” or “nominal directors.”

Obviously, although independent directors are not inside directors, they are not equal to outside directors. They only belong to the “independent outside directors.” Since those “grey directors” are “non-independent outside directors,” they should not be called independent directors.

However, while independent directors and outside directors do not exactly have the same meaning, independent directors are actually derived from outside directors. During the history of American corporate governance, the term

---

<sup>50</sup> See Financial Reporting Council, London Stock Exchange, *Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report)*, December 1992, online at: [http://www.ecgi.org/codes/code.php?code\\_id=132](http://www.ecgi.org/codes/code.php?code_id=132)

<sup>51</sup> Brian R. Cheffins, *Company Law: Theory, Structure, and Operation* (Oxford: Clarendon Press, 1997) at 96.

“independent directors” appeared later than the term “outside directors.” This can explain why both in the academic research and corporate governance practice, most people do not seriously distinguish independent directors from outside directors.

## **2.4 Function**

There are two perspectives for independent directors: to protect shareholders’ interests against management and to protect broader social interests against the corporations as a whole.<sup>52</sup> The former eventually prevails in the United States corporations practice.<sup>53</sup> In the United States, most of the independent directors are exclusive members of the audit committee, nominating committee and compensation committee in large publicly held corporations.

### **2.4.1 Functions of the independent directors**

The Cadbury Report defines independence as “independent of management and free from any business or other relationship which could materially interfere with the exercise of their independent judgment.”<sup>54</sup>

---

<sup>52</sup> Chiwei Huang, “Worldwide Corporate Governance Convergence within A Pluralistic Business Legal Order: Company Law and Independent Director System in Contemporary China” (2007), online: <[http://works.bepress.com/chi\\_wei\\_huang/1](http://works.bepress.com/chi_wei_huang/1)>, at 51.

<sup>53</sup> *Ibid.*

<sup>54</sup> *Supra* note 48.

Independent directors are supposed to participate in decision-making and to monitor the management of the corporation. They are seen as a check on the management of companies, as an oversight mechanism, apart from the additional value that they bring to board deliberations. This is to ensure that action for wrongdoing by the majority stake holders who control the management by holding a majority of their own shares is not hampered. A director's fulfillment of fiduciary responsibilities requires more than the mere absence of bad faith or fraud. Representation of the financial interests of others imposes on a director an affirmative responsibility to protect those interests and to oversee with a critical eye.

#### **2.4.2 Approach**

The independent directors of the United States sit in the related committees of the board of directors in order to bring their functions into play. Generally speaking, there are several committees established by the board of directors such as the strategic development committee, audit committee, remuneration committee, and nomination committee. The strategic development committee is where independent directors participate in decision-making. At the same time, service on the other committees is considered to be a way independent directors can function as monitors.

#### a. Audit Committee

The audit committee is regarded as the most important committee. It is like the supervisory board of the civil law system. However, it is different from the supervisory board in that it only examines the financial issues of the corporation. Since independent directors are not main shareholders of the corporation and they don't manage the corporation, they do not have conflict of interest of the corporation's management and decision-making. Furthermore, they are usually financial experts. Therefore, independent directors can monitor the inside directors effectively.

#### b. Remuneration Committee

Independent directors normally only attend those important meetings of the corporation. They do not get fixed remuneration from the corporation. They usually do not have conflict of financial interest with the corporation. Thus, they are the suitable people to set the remuneration for the inside directors. Under such circumstances, inside directors can not abuse their power to unreasonably increase their salaries. In the remuneration committee, independent directors bring forward a specific remuneration plan based on the evaluation of the outstanding achievement of the managers of the corporation.

#### c. Nomination Committee

How the directors are nominated directly determines the independence of the board of directors. The nomination committee is established to ensure that the board of directors is not controlled by the chairman of the board of the directors. If a corporation does not have a nomination committee, the nomination power is very likely to be held in the hand of the chairman of the board of directors or CEO.

## **2.5 Major rules regarding the independent director system**

### **2.5.1 Delaware General Corporation Law and Modern Business Corporation Act**

The Delaware General Corporation Law and the Modern Business Corporation Act do not provide an absolute and general definition of “independence” or requirement of independent directors.

### **2.5.2 American Law Institute’s Principles of Corporate Governance (1994)**

The American Law Institute requires that every large publicly held corporation should have a majority of directors who are free of any significant

relationship with the senior executives on the board.<sup>55</sup> The article also suggests that the audit committee should consist of at least three members, and should be composed exclusively of directors who are neither employed by the corporation nor were so employed within the two preceding years, including at least a majority of members who have no significant relationship with the corporation's senior executives.<sup>56</sup>

### **2.5.3 Rules of the New York Stock Exchange**

The New York Stock Exchange (NYSE) traces its origins to 1792. It has now become one of the world's leading equities markets. The NYSE requires that each of its listed corporations set up and maintain an audit committee.<sup>57</sup> The committee shall consist of at least three directors who have no relationship to the corporation that may interfere with the exercise of their independence from management and the corporation.

### **2.5.4 Rules of NASDAQ**

NASDAQ is the largest electronic stock market in the United States. The corporations listed on NASDAQ are from all areas of business, including

---

<sup>55</sup> See Article 1.34, *American Law Institute's Principles of Corporate Governance*, May 13, 1992.

<sup>56</sup> *Ibid.*

<sup>57</sup> *New York Stock Exchange, Listed Company Manual*, *supra* note 45, article 303.01.

technology, retail, communications, financial services, transportation, media and biotechnology. According to the NASDAQ marketplace rules, the independent director's definition is "a person other than an officer or employee of the company or its subsidiaries or any other individual having a relationship which, in the opinion of the company's board of directors, would interfere with the exercise of independent judgment in carrying out the responsibilities of directors."<sup>58</sup>

## 2.5.5 Sarbanes-Oxley Act

### a. Introduction

The *Sarbanes-Oxley Act of 2002*<sup>59</sup>, which is also known as *The Public Company Accounting Reform and Investor Protection Act of 2002*, was signed into law by U.S. President George W. Bush on July 30, 2002. It was passed in response to corporate scandals, particularly Enron and WorldCom.<sup>60</sup> Its

---

<sup>58</sup> See article 4200(a) (15), *NASDAQ marketplace rules*. Following is a detailed description of a person who shall not be considered independent director: (1) a person was employed by the company or by any parent or subsidiary of the company at any time during the past three years; (2) a person or his or her family member who accepted any payments from the company or its parent or subsidiary in excess of U.S. \$60,000 during any period of twelve consecutive months within the three years preceding the judgment regarding independence, other than the following reasons: (a) compensation for board of directors or board committee service; (b) payments from investments in the company's securities; (c) compensation paid to a family member who is a non-executive employee of the company or its parent or subsidiary; (d) profits under a tax-qualified retirement plan, or non-discretionary compensation; (e) loans or payments from a financial institution, only if condition such as these loans or payments: (i) were made in the ordinary course of business or (ii) were made on substantially the same terms as those prevailing at the time for comparable transactions with the general public, or (iii) did not involve more than a normal degree of risk or other unfavorable factors, or (iv) were not otherwise subject to the specific disclosure requirements of SEC Regulation S-K, Item 404; or (v) not otherwise subject to the disclosure requirements of SEC Regulation S-K, Item 404; or (vi) permitted under Section 13(k) of the Act.

<sup>59</sup> See *Sarbanes-Oxley Act of 2002*, Pub. L. No. 107-204, 116 Stat. 745. (2002).

<sup>60</sup> Scott Harshbarger & Goutam U. Jois, "Looking Back and Looking Forward: Sarbanes-Oxley and the

intention is to restore public confidence in stock markets. It seeks to “restore the integrity of the audit process by strengthening oversight of the accounting profession.”<sup>61</sup>

#### b. Independence Directors on Audit Committees

The *Sarbanes-Oxley Act* followed the trendy reform advice by requiring that an audit committee be responsible for looking on a company’s accounting practices and be made up solely of independent directors.<sup>62</sup> In order to be considered as independent directors to serve on the audit committees, the *Sarbanes-Oxley Act* requires that a member of the audit committee may not receive “any consulting, advisory, or other compensatory fee” from the company, or affiliate to the company or any of its subsidiaries thereof.<sup>63</sup>

---

Future of Corporate Governance” (2007) 40:1 Akron Law Review 1 at 3.

<sup>61</sup> John Armour & Joseph A. McCahery, ed., *After Enron: Improving Corporate Law and Modernising Securities Regulation in Europe and the US* (Oxford and Portland: Hart, 2006) at 2.

<sup>62</sup> *Sarbanes-Oxley Act of 2002*, *supra* note 59 article 301 (3) (A),

<sup>63</sup> *Sarbanes-Oxley Act of 2002*, *supra* note 59 article 301 (B).

## **3 The Independent Director Institution in China**

### **3.1 Reasons for Introducing the Independent Director Institution**

#### **3.1.1 Background**

In 1978, China initiated an economic reform program which transformed the former planned economy to a market economy.<sup>64</sup> This program introduced some important laws, converted state-owned entities into companies and listed these companies on the stock exchanges.<sup>65</sup> The Third Plenary Meeting of the Eleventh Communist Party of China Congress officially endorsed the “opening the door” policy and economic reform in China after 1978. Since then, economic reform in the People’s Republic of China has significantly transformed Chinese society and the Chinese economy. China’s opening up to foreign trade and investment is a key factor in the transformation.

The legal concept of the corporation was imported into China at the end of the nineteenth century. During that time, the separation of state ownership and control was introduced to Chinese companies. Almost all the Chinese listed companies are restructured from a former State-Owned Enterprise (hereinafter

---

<sup>64</sup> Helen Wei Hu, “Independent Directors: A New Chapter of the Development of Corporate Governance in China” in *Proceedings of the 15th Annual Conference of the Association for Chinese Economics Studies Australia*, 2003 at 2.

<sup>65</sup> Iain MacNeil, “Adaptation and Convergence in Corporate Governance: The Case of Chinese Listed Companies” (2002) 2 *Journal of Corporate Law Studies* 289 at 289.

SOE).<sup>66</sup> Historically, the state has played an important role in corporate governance.<sup>67</sup> Those SOEs were generally regarded as branches of the government.<sup>68</sup> Some government agencies still use unreasonable administrative power to control today's companies. Controlling shareholders tightly control the listed companies through concentrated ownership, management friend boards, and low transparency in operations.<sup>69</sup> Such control includes requiring those government agencies' approvals of the board of directors' decisions, bypassing the general meeting of shareholders, appointing directors and executives directly, and interfering with the companies' daily operations.<sup>70</sup>

### 3.1.2 Shareholding Structure of Chinese Listed Companies

The most remarkable feature of the Chinese shareholding structure is one dominant shareholder control. A study of the Shanghai Stock Exchange described the high ownership control as "excessive."<sup>71</sup> According to empirical research, as at the end of 2001, the state controlled 81.6% of listed companies in China, and its average controlling stake in these companies amounted to just

---

<sup>66</sup> Cai Lei, "Phenomenon of Concentrated Shareholding and Resolution" (2006) *Economic Research Guide* 59 at 59; Lin Lefen, "Empirical Research on the Degree of Concentrated Shareholding" (2005) *Social Sciences in Nanjing* 53 at 57.

<sup>67</sup> Cindy A. Schipani and Junhai Liu, "Corporate Governance in China: Then and Now" (2002) 1:1 *Colum. Bus. L. Rev.* 1 at 28.

<sup>68</sup> *Ibid.* at 29.

<sup>69</sup> Qiao Liu, "Corporate Governance in China: Current Practices, Economic Effects, and Institutional Determinants" (2006) 52:2 *CESifo Economic Studies* 415 at 425.

<sup>70</sup> Schipani & Liu, *supra* note 67.

<sup>71</sup> Shanghai Stock Exchange Research Centre, "China Corporate Governance Report 2003" (Shanghai: Fudan University Press, 2003) at 46.

fewer than 50%.<sup>72</sup> However, this figure is just a conservative estimate because it is likely that the second and third largest shareholders are also under the state's influence or direction.<sup>73</sup> At the same time, the *China Corporate Governance Report 2003* stated that

data in the 2002 annual reports of 734 companies listed on the Shanghai Stock Exchange (released as of June 20, 2003) suggests that, in the end of 2002, in 40.9% of all the 300 companies, the largest shareholders owned more than 50% of the total shares. On average, in all 734 companies, each largest shareholder possessed 44.3% of its company's shares.<sup>74</sup>

Although the number of investors has largely increased in the last ten years, the state still holds approximately two-thirds of the total issued shares in China.<sup>75</sup>

Concentrated ownership is the root of the corporate governance problems of the Chinese listed companies. The controlling shareholders often hold unlisted state shares or legal person shares while those minority shareholders hold a small portion of listed shares.<sup>76</sup> Such typical concentrated ownership regime is different from the "agency problem" in the American corporate governance literature.<sup>77</sup> By holding the majority of a company's

---

<sup>72</sup> See Guy S. Liu & Pei Sun, "The Class of Shareholdings and Its Impact on Corporate Performance: Composition in Chinese Public Corporations" (2005) 13 *Corporate Governance: An International Review* at 46.

<sup>73</sup> *Ibid.*, at 50-51.

<sup>74</sup> Shanghai Stock Exchange Research Centre, *supra* note 71.

<sup>75</sup> OK Tam, "Ethical Issues in the Evolution of Corporate Governance in China" (2002) 37 *Journal of Business Ethics* 303 at 309.

<sup>76</sup> Huang, *supra* note 52, at 45.

<sup>77</sup> See Adolph A. Berle & Gardiner C. Means, *The Modern Corporation and Private Property* (New York: Macmillan 1933). In the Berle-and-Means corporation, powerful managers exploit dispersed and rationally apathetic shareholders. In China, such companies with widely dispersed public ownership where no individual owns a controlling block of shares do not exist at all.

shares, the state retains a not-so-visible hand in corporate affairs.<sup>78</sup> The state is actually playing two roles at the same time: controlling shareholders and regulators.<sup>79</sup>

### 3.1.3 Large Shareholder Exploitation of Small Shareholders

#### a. Abuse by Dominant Shareholders

In China, it is quite common for controlling shareholders to manipulate the shareholder meetings and boards of directors. Large shareholders abuse their power by handpicking board members and management personnel to operate the company in the interest of them.<sup>80</sup> The controlling shareholders appoint 70% of the directors.<sup>81</sup> At the same time, they are willing to ratify their conduct. When majority shareholders dominate the way companies run, it becomes very difficult to challenge their actions.<sup>82</sup> It is the state as a majority shareholder which prevents the various corporate mechanisms from operating effectively.

At the same time, monitors of management are also appointed by the

---

<sup>78</sup> “A Critical Survey of the People’s Republic of China’s New Company Law” (1995-1996) 6:2 *Ind. Int’l & Comp. L. Rev.* 493 at 513.

<sup>79</sup> Liu, *supra* note 69, at 436.

<sup>80</sup> Jie Yuan, “Formal Convergence or Substantial Divergence: Evidence from Adoption of the Independent Director System in China” (2007) 9:1 *Asian-Pacific Law & Policy Journal* 71 at 77.

<sup>81</sup> Danhan Huang, “Problems Concerning Independent Directors Institution and Its Legal Environment” *Corporate Governance Reform: China and World* (2002) online: <[http://www.cipe.org/china/cg\\_book.htm](http://www.cipe.org/china/cg_book.htm)>.

<sup>82</sup> Lilian Miles & Zhong Zhang, “Improving Corporate Governance in State-owned Corporations in China: Which Way Forward?” (2006) 6:1 *J Corp. Law Stud.* 213 at 218.

majority shareholder. It is impossible to expect them to disregard its wishes when supervising management.<sup>83</sup> Such state involvement creates a conflict of interest between the state as controlling shareholders and other shareholders.<sup>84</sup>

The controlling shareholders of China's listed companies actually control all the operations and decisions which represent the interests of the large shareholders. According to a Shanghai lawyer, in practice, due to the director appointment system in China, many small shareholders could not do what they should do. Instead, they had to do what they were told by the majority shareholders who have appointed them.<sup>85</sup>

#### b. The Problem of Exploitation of Minority Shareholders' Rights

The unique corporate shareholding structure with Chinese characteristics results in the importance of protecting minority shareholders' rights.<sup>86</sup> A study conducted by the Shanghai Securities Exchange reveals the following problems existing in Chinese corporate governance: (1) irrational shareholding structure; (2) lack of independence of the board of directors; (3) inability of board of supervisors to play its role; (4) relative weakness of oversight role of creditors; (5) unlimited powers of key management personnel; (6) low level of transparency and professionalism in investment decisions; (7)

---

<sup>83</sup> *Ibid.*, at 222.

<sup>84</sup> Liu, *supra* note 69, at 436.

<sup>85</sup> Neil Andrews & Roman Tomasic, "Directing China's Top 100 Listed Companies: Corporate Governance in an Emerging Market Economy" (2006) 2:3 Corp. Governance Law Rev. 245 at 267.

<sup>86</sup> Huang, *supra* note 52, at 45 .

lack of a market for corporate control; (8) lack of a market for management services; (9) skewed system of incentives; (10) lack of protection of interests of minority shareholders; (11) lack of a system for accountability; and (12) lack of a shareholder culture and corporate governance culture.<sup>87</sup> According to the study, most of the problems are related to the powerlessness to protect the interests of small and medium shareholders.

Although the state wants to prevent dominant shareholder exploitation of minority shareholders when it is a passive shareholder, it may itself be guilty of some exploitation when it is the dominant shareholder.<sup>88</sup> Such exploitation is often at the expense of minority shareholders. For example, large shareholders misused their authority to empty company coffers, which caused small and medium-sized shareholders to suffer huge losses.<sup>89</sup> Sanli Huagong, one such large shareholder in China, gained 98.8 million RMB by treating the corporate assets as his own assets.<sup>90</sup>

### c. Related-Party Transactions

Large shareholders abuse their authority by making a large amount of related-party transactions with listed companies, which sacrifice or impair the

---

<sup>87</sup> See “First Guide to Corporate Governance Appears” *China Economic Times* (6 November, 2000)

<sup>88</sup> Donald C. Clarke, “The Independent Director in Chinese Corporate Governance” (2006) 31 *Del. J. Corp. L.* 125 at 148.

<sup>89</sup> *Ibid.*

<sup>90</sup> Yongqiang Yin, “Doubts on Return of Funds by Big Shareholder of ST Tong Jinma” *Securities Times* (12 May, 2004).

interests of the companies and the minority shareholders.

A related-party transaction is a business deal or arrangement between two parties who are joined by a special relationship prior to the deal. For example, large shareholders may buy materials from suppliers which are controlled by them.<sup>91</sup> According to a 2002 study, on the basis of self-reporting alone, 40% of listed companies involved in related-party transactions with their top ten shareholders.<sup>92</sup> A related-party transaction is not necessarily a transaction on unfair terms to the company. However, China does not have institutional safeguards which can ensure fair terms. To some extent, it is the system that provides legitimate grounds for those unfair related-party transactions.<sup>93</sup> One observer reported that every single transaction by a quoted enterprise in China has to be a related-party transaction as all assets are publicly owned and all enterprises report to the same government.<sup>94</sup> Furthermore, the 2002 study did find that the controlling shareholders of 676 listed companies misused their funds in the amount of almost US\$12 billion.<sup>95</sup> The well-known 999 Drug Group is an example of this. Its major shareholder and related parties expropriated from the firm RMB 2.5 billion representing about 96 percent of the

---

<sup>91</sup> He Jianliang, "Affiliated-dealings in Listed Corporation and Oversight" *Securities Market Herald* (Jan 2002) 50.

<sup>92</sup> See State Economic and Trade Committee Vice Chairman Qiangui Jiang, "Be a Sincere and Responsible Listed Company Controlling Shareholder" *Economic Daily* (30 January, 2003), online: <<http://www.chinainfobank.com>>

<sup>93</sup> One example of unfair related-party transactions is that large shareholders may sell the output of the company at below-market prices to their related-party.

<sup>94</sup> Andrews & Tomasic, *supra* note 85, at 265.

<sup>95</sup> Jiang, *supra* note 92.

firm's net assets.<sup>96</sup>

#### d. The Insider Control Problem

One of the prominent complaints about the current regime that governs the powers and responsibilities of enterprise managers is that there is too much “insider control.”<sup>97</sup>

During the economic transition period of the Soviet Union and countries in Eastern Europe, “insider control” is thought to have become prominent.<sup>98</sup> Professor Masahiko Aoki is considered to be the person who brought forward the term “insider control.” He defines insider control as

...the capture of substantial control rights by the manager or the workers of a formerly SOEs in the process of its corporatization or insider control as a majority or substantial block-holding by the insiders in the case of privatization, or strong assertion of insider interests in strategic enterprise decision-making when the enterprises remain owned by the state.<sup>99</sup>

The definitions generally describe the situation in the Soviet Union and countries in Eastern Europe. Nevertheless, it is not exactly the same in

---

<sup>96</sup> Simon S. M. Ho & Haigen Xu, “Corporate Governance in the People’s Republic of China” in Low Chee Koong, ed., *Corporate Governance: An Asia-Pacific Critique* (Hong Kong: Sweet and Maxwell, 2002) 269 at 274.

<sup>97</sup> See Yunpeng Liu, “Looking at Chinese Corporate Governance Issues from the Standpoint of the Theory of the Modern Firm and the Theory of Property Rights” in China Reform and Development Institute ed., *The Structure of Corporate Governance in China* (Hainan: Wanwen Press, 1999) When writing about the weakness in Chinese corporate governance, almost all the scholars mentioned the problem of “insider control.”

<sup>98</sup> On Kit Tam, *The Development of Corporate Governance in China* (Cheltenham, UK: E. Elgar, 1999) at 32.

<sup>99</sup> Masahiko Aoki, “Controlling the Insider Control: Issues of Corporate Governance in the Transition”, Mimeograph, “Corporate Governance in Transition Economics” Project, cited in On Kit Tam, *ibid*; See also Masahiko Aoki, “Controlling Insider Control: Issues of Corporate Governance in Transition Economics” in Masahiko Aoki & Hyung-Ki Kim eds, *Corporate Governance in Transitional Economies* (Washington, D.C. : The World Bank, 1995) at 3-29

China. According to Aoki's theory, the government's control of the manager is weakened because of the insider control problem. In fact, during China's SOE reform, the government can not only manipulate important decisions of the companies but also firmly control the power of appointment and dismissal. However, the phenomenon of insider control does exist in Chinese companies. Therefore, some scholar named China's situation as "insider control under the administrative intervention."<sup>100</sup>

In Chinese listed companies, the state does not have a physical presence within companies because it is not allowed to be involved in business operations as a non-natural person. To overcome this problem, the state appointed agents such as civil servants and government officials to play its role in companies. However, an absent shareholder cannot monitor the activities of the board. The interests of these agents are not always the same as the state. These state-appointed bureaucrats or representatives are not real owners of the companies. So they only have indirect interests in corporate profits.<sup>101</sup> Even if they do not perform well, their positions are secure.<sup>102</sup> Since the state lacks a clear, accountable party to enforce its wishes,<sup>103</sup> it is unable to prevent negligence or abuses of power from occurring.

---

<sup>100</sup> Chunlin Zhang, "Problems in State-Owned Enterprises Transformation" (1996) Chinese Book Review at 10.

<sup>101</sup> Ho & Xu, *supra* note 96 at 287.

<sup>102</sup> Pamela Mar & Michael N. Young, "Corporate Governance in Transition Economies: A Case Study of Two Chinese Airlines" (2001) 36:3 Journal of World Business 280 at 283.

<sup>103</sup> See Yingqi Qian, "Enterprise Reform in China: Agency Problems and Political Control" (1996) 4:2 Economics of Transitions at 427-447.

What is worse, the chairman of the board of directors and the president of a Chinese listed company are often performed by one person. Thus the board of directors is likely to be controlled by insiders. The insiders expropriate minority shareholders in different ways, such as installing unqualified family members in managerial positions or overpaying executives.<sup>104</sup> According to the Shanghai Stock Exchange report, insiders in Chinese listed companies have expropriated shareholders' property in the following ways:

1. Transferring and appropriating corporate profits and assets via various inappropriate related-party transactions;
2. Theft of corporate assets through self-dealing and acquisition of “perquisites” or private gains embodied in excessive personal consumption of corporate resources;
3. Fabricating financial documents and cheating on corporate profits in order to meet mandatory public offering requirements, and then conducting insider trading by manipulating the stock price in the initial public offering and secondary market;
4. Management “buy-outs” at undervalued prices; and
5. Developing personal connections by using company's resources.

For example, nepotism and appointing key corporate staff based on criteria in

---

<sup>104</sup> R La Porta, F Lopez-de-Silanes & A Shleifer, “Corporate Ownership Around the World” NBER Working Paper 6625 (June 1998) online: <<http://www.nber.org/paper/6625>>

the insider's personal interest rather than the company's best interest.<sup>105</sup>

#### e. Weak Supervisory Board

The supervisory board also plays a very limited role in Chinese listed companies in terms of ensuring proper conduct on the part of directors.

China's supervisory boards have very limited powers compared to those in Germany and France.<sup>106</sup> There are fundamental differences between the German and Chinese systems of corporate governance. In China, there is no hierarchical relationship between the board of directors and the board of supervisors. Neither is accountable to the other. They function on an equal level. At the same time, both directors and supervisors are appointed and may be dismissed by shareholder action.<sup>107</sup> In contrast, the German supervisory board oversees the board of directors, and the members of the board of directors are

---

<sup>105</sup> Shanghai Stock Exchange Research Centre, *supra* note 71, at 14-15.

<sup>106</sup> Minkang Gu, "Will an Independent Director Institution Perform Better than a Supervisor? Comments on the Newly Created Independent Director System in the People's Republic of China" (2003) 6 J. Chinese & Comp. L. 59 at 66-67; Article 54 of China's company law state the duties and powers of the supervisory board: a board of supervisors or a supervisor (in the case of companies which have not established a board of supervisors) shall exercise the following duties and powers: (1) inspect the company finances; (2) supervise the performance of duties by directors and senior management personnel and propose to remove a director or senior management personnel who violates the provision of the laws and administrative regulations and the articles of association of the company or the resolutions of the shareholders' meeting; (3) require a director or senior management personnel who act against the interests of the company to make correction; (4) propose to convene interim shareholders' meeting, convene and chair a shareholders' meeting when the board of directors fails to convene and chair a shareholders' meeting in accordance with the provisions of this Law; (5) make proposals at shareholders' meetings; (6) file a lawsuit against a director or senior management personnel in accordance with the provisions of Article 152; and (7) other duties and powers stipulated in the articles of association of the company. Supervisors may attend meetings of the board of directors and query resolutions of the board of directors or give suggestions. Article 55 of China's company law states that a board of supervisors or a supervisor (in the case of companies which have not established a board of supervisors) may conduct investigation upon discovering irregularities in the business operations and may appoint an accounting firm etc to assist in the investigation if necessary; such expenses shall be borne by the company.

<sup>107</sup> *Company Law of People's Republic of China*, *supra* note 13, article 38.

appointed and may be dismissed by the board of supervisors.<sup>108</sup>

Based on such mechanism in China, the board of supervisors does not have substantive powers. Although the supervisory board and the board of directors are designed to be parallel organs, the supervisory board actually has little power. For example, when directors or managers do harm to the company's interests, the supervisory board could only demand directors to remedy.<sup>109</sup> If their demand is declined, they could propose an interim shareholders' meeting and report the misconduct to shareholders. However, such a proposal may be rejected as well because the power to convene an interim shareholders' meeting is vested in the board of directors.<sup>110</sup> Chinese supervisory boards do not have the power to dismiss directors. Nor do they have the right to sue directors. The boards of supervisors are not subject to legal liability or external oversight for their actions or inactions.<sup>111</sup> Therefore, supervisors are likely to escape their responsibilities without any punishment.

Moreover, the members of the board of supervisors are selected at general shareholder meetings.<sup>112</sup> These large dominant shareholders appoint the supervisors. Many supervisory directors also have strong affiliations with the state. One danger in this is that the supervisory directors may be inclined to

---

<sup>108</sup> *German Stock Corporation Act*, 1965, article 84; Schipani & Liu, *supra* note 67 at 16.

<sup>109</sup> *Company Law of the People's Republic of China*, *supra* note 13 article 54.

<sup>110</sup> Jingyan Ba, "Modification of Monitoring Powers of Supervisory Board" (2004) 4 *Frontier* 130 at 131; Jianwei Li, "Modification of Supervisory Board in Listed Companies: Incidentally Discuss the Relationship between Independent Directors and Supervisory Board" (2004) 2 *Law Sci.* 75 at 76.

<sup>111</sup> Yuan, *supra* note 80 at 79.

<sup>112</sup> *Company Law of the People's Republic of China*, *supra* note 13 article 103.

promote and protect state interests rather than the interests of the company. In addition, many supervisory directors identify themselves as friends and associates of the board of directors. As a result, supervisors remain loyal to the interests of the large shareholders. This obviously limits their independence.

In practice, most members of the supervisory board are trade union presidents and employees' representatives.<sup>113</sup> In China, trade unions are not independent of corporations.<sup>114</sup> Instead, those trade union presidents are employees of corporations and they have low status in the corporations. At the same time, the employees' representatives are usually picked from junior managers.<sup>115</sup> Therefore, it is natural that the supervisory boards are reluctant to challenge the decisions made by the board of directors and senior management.<sup>116</sup>

Finally, few supervisory directors possess the necessary experience and expertise in matters of law, accounting and finance to carry out their responsibilities. In part, this is exacerbated by the fact that the pool of potential

---

<sup>113</sup> Sibao Shen & Jing Jia, "Will the Independent Directors Institution Work in China?" (2005) 27 *Loy. L.A. Int'l & Comp.L.Rev.* 223 at 245; Article 118 of China's company law states that companies limited by shares shall establish a board of supervisors comprising not less than three members. The board of supervisors shall include shareholders' representatives and an appropriate number of employees' representatives; the ratio of employees' representative therein shall not be less than one-third and such ratio shall be stipulated by the articles of association of the company. Employees' representatives sitting on the board of supervisors shall be appointed by company employees via an employees' representative congress or employees' congress or other forms of democratic election.

<sup>114</sup> See generally Lei Jiang, "Disputes Arise among Members of an Oil Trade Union: Plan for Accumulating Industrial Investment Fund Is Set Back" *Fin. & Econ. Times* (18 December, 2004) online: <[http://www.ce.cn/new\\_hgjj/guonei/cvjj/200412/18/t20041218\\_2610520.shtml](http://www.ce.cn/new_hgjj/guonei/cvjj/200412/18/t20041218_2610520.shtml)>.

<sup>115</sup> See generally "Re-election Notice of the Supervisory Committee of Donghu Gaoxin" *Negotiable Securities Times* (13 January, 2005) online: <<http://finance.sina.com.cn/stock/shannounce/20050113/09081291106.shtml>>.

<sup>116</sup> Sibao Shen & Jing Jia, *supra* note 113 at 246.

supervisory directors is small and underdeveloped.

According to a study conducted by the State Economic and Trade Committee, in the participating 100 Chinese listed companies, 78 of them set up a board of supervisors.<sup>117</sup> Among these companies, only 33 were effective and 24 of the companies were of limited effect or existed in name only.<sup>118</sup>

## **3.2 Process of Introducing the Independent Director Institution**

### **3.2.1 The Early Practice**

The earliest practice of introducing independent directors can be traced back to 1988. In that year, the H-share companies which were listed in the Hong Kong Stock Exchange introduced independent directors. In 1993, Qingsdao Brewery Co., Ltd listed on the Hong Kong Stock Exchange. According to the requirements of the Exchange, the company hired two independent non-executive directors. The term “independent directors” was strange to most companies of that time.<sup>119</sup>

The concept of the independent director appeared, for the first time, in

---

<sup>117</sup> State Economic and Trade Committee, *Reform of State-Owned Enterprise* (China: Law Press: 2000) at 483.

<sup>118</sup> *Ibid.*

<sup>119</sup> Junjie Li, “On Introducing Chinese Characteristic Independent Directors” *Theory and Practice* 9 (2002) 74.

the *Guidelines for the Articles of Association of Listed Companies*<sup>120</sup> issued by the Chinese Securities Regulatory Commission<sup>121</sup> (hereinafter CSRC) in December 16, 1997. According to article 112, a company, on the basis of its need, could introduce independent directors.<sup>122</sup> It is an optional article rather than a compulsory one. It states that independent directors shall not consist of the following persons: the shareholders or any employees of the shareholders' company; the company's internal staff (such as company managers or company employees); or people with self-interested relationship with affiliates or management levels of the company.<sup>123</sup> According to these guidelines, the institution of special committees is not required. At the same time, the proportion, qualifications, powers and duties of independent directors are not confirmed either.

The 1993 *Company Law of the People's Republic of China*<sup>124</sup> does not specially address independent directors. Before the guiding opinion was published, provisions concerning independent directors were scattered in various rules and regulations.

---

<sup>120</sup> *Guidelines for the Articles of Association of Listed Companies* (promulgated by China Securities Regulatory Commission, December 16, 1997) online: <[http://www.robroad.com/data/2006/0720/article\\_82924.htm](http://www.robroad.com/data/2006/0720/article_82924.htm)>.

<sup>121</sup> The Chinese Securities Regulatory Commission was set up to monitor and regulate the stock market in 1992. It incorporates new sets of rules for governance and disclosure to further protect investors' interests.

<sup>122</sup> *Guidelines for the Articles of Association of Listed Companies*, *supra* note 120, art. 112.

<sup>123</sup> *Ibid.*

<sup>124</sup> *Company Law of the People's Republic of China*, *supra* note 13.

### 3.2.2 Continuous Lawmaking Effort

On March 29, 1999, the CSRC together with the State Economic and Trade Committee jointly issued *Further Standardizing Operations and Intensifying Reform of Companies Listed outside China Opinion*.<sup>125</sup> It requires that

companies shall increase the ratio of external directors. When the board of directors is changed at the end of its term, the external directors shall comprise one half or more of the board and there shall be two or more independent directors. “Independent directors” refers to directors who are independent from the shareholders of the company and do not hold a position within the company. The opinions expressed by an independent director shall be clearly recorded in the board's resolutions. The company's transactions with its affiliates must be endorsed by an independent director before they can become effective. Two or more independent directors may propose the convening of an interim shareholders' general meeting. Independent directors may directly report circumstances to the shareholders' general meeting, the CSRC and other relevant authorities.<sup>126</sup>

Although this is aimed at companies listed outside China, it marks the beginning of independent directors as a compulsory regulation for companies. However, its regulations are too simplified to be maneuverable. After this, related legislation departments and stock exchanges continuously made efforts to improve the lawmaking.

A draft set of rules for companies seeking listing on a secondary board (operating and defined as “NASDAQ”) were reported on August 23, 2000 in the

---

<sup>125</sup> *Further Standardizing Operations and Intensifying Reform of Companies Listed Outside China Opinion* (promulgated by China Securities Regulatory Commission & State Economic and Trade Commission, March 7, 1999) online: <<http://www.enread.com/job/law/29582.html>>.

<sup>126</sup> *Ibid*, art. 6.

People's Daily.<sup>127</sup> The goal of these rules is to regulate those companies which seek to be listed on a secondary board. These rules state a relatively clear definition of the qualifications of independent directors. The rules require that independent directors are not: (1) shareholders; (2) directly related, or collaterally related within three generations to company directors, supervisors, or officers; (3) directors, supervisors, or officers of affiliated enterprises; or (4) any person who was manipulated by the company.<sup>128</sup> The draft rules do not contemplate any special function for independent directors other than to attend board meetings and vote as directors.<sup>129</sup>

On November 3, 2000, the Shanghai Stock Exchange issued a set of draft guidelines on corporate governance for its listed companies.<sup>130</sup> These guidelines were believed to provide a more refined version of independent director system.<sup>131</sup> It suggests that there should be at least two independent directors, and that the number of independent directors should account for at least 20% of the entire board membership.<sup>132</sup> These guidelines also stipulate that all subcommittees of the board of directors have to be composed (principally) of and (chaired) by independent directors.<sup>133</sup> However, there is no description of

---

<sup>127</sup> See Wu Li, "Trends in the Establishment of the Secondary Board Market" *People's Daily* (23 August, 2000) 3

<sup>128</sup> *Ibid.*

<sup>129</sup> Clarke, *supra* note 88 at 186.

<sup>130</sup> *Supra* note 87.

<sup>131</sup> Huiling Luo, "Comments on Independent Directors" *Chinese Macro Economy News Net* (18 May 2001).

<sup>132</sup> *Supra* note 87.

<sup>133</sup> *Ibid.*

the independence or disinterestedness requirement of independent directors in these guidelines.

The CSRC issued *Measures on the Administration of Securities Companies* which is a draft for comments on June 20, 2001.<sup>134</sup> The significance of these draft measures is that they introduced a concrete independent director system.<sup>135</sup> These draft measures are followed by the release on December 28, 2001 of the final version: *Securities Companies Measures*.<sup>136</sup> It requires all the securities companies should introduce the independent director institution.<sup>137</sup> At the same time, it states that independent directors constitute no less than one quarter of the board of directors in the following circumstances: (1) the chairman of the board and the chief executive officer are the same person; (2) internal directors constitute at least one-fifth of the board; or (3) the department in charge of the company, its shareholders' general meeting, or the CSRC deems it necessary.<sup>138</sup> Therefore, the China Securities Regulatory Committee finished its job of establishing independent director institution in securities companies.

### 3.2.3 Some Important Documents

On August 16, 2001, the CSRC released the *Guidelines for*

---

<sup>134</sup> *Measures on Administration of Securities Companies Draft for Comment* (promulgated by China Securities Regulatory Commission, June 20, 2001)

<sup>135</sup> Huang, *supra* note 52 at 89.

<sup>136</sup> *Securities Companies Measures* (promulgated by China Securities Regulatory Commission, December 28, 2001), online: <<http://www.csrc.gov.cn/n575458/n870297/n4240488/n8639654/8663029.html>>.

<sup>137</sup> *Ibid.*, art. 27.

<sup>138</sup> *Ibid.*

*Introducing Independent Directors to the Board of Directors of Listed Companies*,<sup>139</sup> indicating that the independent director system has been formally set up. This landmark document first institutionalized the independent director system in China.<sup>140</sup> It includes the most comprehensive regulatory measures of independent directors suggested by any Chinese governmental agency.<sup>141</sup> It recommended that all domestic listed companies revise their articles of association, hire qualified independent directors by June 30, 2002, and ensure a board of directors comprising at least one-third independent directors by June 30, 2003.<sup>142</sup> Even though this is not compulsory, most listed corporations adhere to this regulation.

On January 7, 2002, the CSRC and the State Economic and Trade Commission reaffirmed the independent director system when it promulgated the *Code of Corporate Governance for Chinese Listed Companies*.<sup>143</sup> This code is a set of comprehensive rules that supplements the existing laws. It covers basic principles for corporate governance of Chinese listed companies, the means for the protection of investors' interests, and the ethical requirements for directors, supervisors, managers and other senior management members.<sup>144</sup> The code elevates requirements on accounting procedures and information disclosure,

---

<sup>139</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, *supra* note 29.

<sup>140</sup> Sibao & Jia, *supra* note 113 at 223.

<sup>141</sup> Clarke, *supra* note 88 at 190.

<sup>142</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, *supra* note 29, art. 1(3).

<sup>143</sup> *Code of Corporate Governance for Chinese Listed Companies*, *supra* note 29.

<sup>144</sup> Julian Roche, *Corporate Governance in Asia* (London: Routledge, 2005) at 200

introduces an independent director system and tightens the supervision of corporate management in order to introduce solid corporate governance in Chinese listed companies.<sup>145</sup>

The code states that a listed company shall introduce independent directors to its board of directors in accordance with relevant regulations. Independent directors shall be independent from the listed company that employs them and the company's major shareholders. Moreover, an independent director may not hold any other position apart from independent director in the listed company.<sup>146</sup> It is worth noting that this code requires that the independent directors shall bear the duties of good faith and due diligence toward the listed company and all the shareholders. They shall earnestly perform their duties in accordance with laws, regulations and the company's articles of association; shall protect the overall interests of the company; and shall be especially concerned with protecting the interests of minority shareholders from being infringed. It stipulates that independent directors shall carry out their duties independently and shall not subject themselves to the influence of the company's major shareholders, actual controllers, or other entities or persons who are interested parties of the listed company.<sup>147</sup>

The code is formulated to promote the establishment and improvement

---

<sup>145</sup> *Ibid.*

<sup>146</sup> *Code of Corporate Governance for Chinese Listed Companies, supra* note 29, article 49.

<sup>147</sup> *Ibid.*, art. 50.

of a modern enterprise system by listed companies; to standardize the operation of listed companies; and to bring forward the healthy development of the securities market of China.<sup>148</sup> It is the major measuring standard for evaluating whether a listed company has a good corporate governance structure, and if major problems exist with the corporate governance structure of a listed company, the securities supervision and regulation authorities may instruct the company to make corrections in accordance with the code.

On June 4, 2002, People's Bank of China issued *Guidance on Independent Directors and External Supervisors of Joint-Stock Commercial Banks*.<sup>149</sup> It systematically regulates the independent director institution of joint-stock banks. Its content includes the qualifications, election, appointment, dismissal, rights, obligations, duties, remuneration and expenses of independent directors.<sup>150</sup> Commercial banks are important in the modern capital market. If the corporate governance of the joint-stock commercial banks improves, more competition will be boosted. At the same time, the entire financial and economic system will develop favorably. Therefore, the establishment of independent director institution in China's commercial banks is very important for the independent director institution of listed companies and even the whole independent director institution in China.

---

<sup>148</sup> *Ibid.*, the preface of the code.

<sup>149</sup> *Guidance on Independent Directors and External Supervisors of Joint-Stock Commercial Banks* (promulgated by People's Bank of China, June 4, 2002) online: <<http://www.pbc.gov.cn/english/detail.asp?col=6800&ID=41>>.

<sup>150</sup> *Ibid.*

On January 1, 2006, China's new *Company Law*<sup>151</sup> was promulgated. According to article 123, listed companies shall appoint independent directors and the specific measures shall be provided by the State Council.<sup>152</sup> As with the *Code of Corporate Governance for Chinese Listed Companies*, the *Company Law* defers to the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies* for detailed requirements. Thus, while the *Code of Corporate Governance for Chinese Listed Companies* and the *Company Law* formally institutionalize the requirement for independent directors, the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies* is the most important document regulating the independent director system in China.

Nowadays, almost all the Chinese companies which list on foreign stock exchanges have introduced the independent director institution. In the domestic A-share listed companies, some companies also have hired famous professionals to act as the independent directors. Moreover, many listed companies convene shareholder meetings to vote independent directors onto a board of directors; to prepare to reelect board of directors; or to add further

---

<sup>151</sup> *Company Law of People's Republic of China*, *supra* note 13. The new law replaces the old Company Law, which had been adopted in 1993. Changes included registered capital requirements, corporate governance and protection for shareholders, and the introduction of one-person companies. The 2005 Company Law also introduced the principle of piercing the corporate veil.

<sup>152</sup> *Ibid.*, art. 123. The detailed rules are understood as *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*. The third draft of Company Law initially stated that listed corporations "may" have independent directors, but the final version, adopted on October 27, 2005, changed the word to "should." Thus, independent director system effectively ended up being compulsory under the 2005 Company Law.

independent directors.

### 3.3 Provisions

Until now, China has basically finished the legislation of the independent director institution. To some extent, the *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*<sup>153</sup> formulate the main content of the current Chinese independent director institution. Although the *Code of Corporate Governance for Chinese Listed Companies* and the *Company Law* addresses many of the existing problems in China's financial sector, its effectiveness depends on company managers' honesty to implement the code's provisions.<sup>154</sup>

#### 3.3.1 Qualification

##### a. Positive Qualification

Article 2 of the guidelines states that a person holding the position of Independent Director should fulfill the basic conditions set forth below:

(1) having the qualifications to hold the position of Independent Director in a listed company in accordance with laws, administrative regulations

---

<sup>153</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, *supra* note 29.

<sup>154</sup> Roche, *supra* note 144.

and other relevant regulations;

(2) being independent as required herein;

(3) having a basic knowledge of the operation of listed companies and being familiar with related laws, administrative regulations and rules;

(4) having not less than five years' experience in the law or economics or other work experience required for performing the duties and responsibilities of an Independent Director; and

(5) meeting the other conditions specified in the company's articles of association.

b. Negative Qualification

Article 3 of the guidelines stipulates that the following persons may not hold the position of Independent Director:

(1) persons holding a position in the listed company or a subsidiary thereof and their lineal relatives and major social relations (the term "lineal relatives" meaning spouses, parents, children, etc.; and the term "major social relations" meaning siblings, parents-in-law, children-in-law, siblings' spouses, spouse's siblings, etc.);

(2) natural person shareholders who directly or indirectly hold not less than 1% of the issued shares of the listed company or who rank in the top ten shareholders of the listed company, and their lineal relatives;

(3) persons who hold positions in entities that directly or indirectly hold not less than 5% of the issued shares of the listed company or that rank in the top five shareholders of the listed company, and their lineal relatives;

(4) persons who, at some time in the previous year, have fallen into one of the three categories listed above;

(5) persons who provide financial, legal, consultancy or other such services to the listed company or its subsidiaries;

(6) other persons specified in the company's articles of association;

(7) other persons determined by the CSRC.

According to these requirements, Chinese independent directors should be independent from the company's managers, employees, large shareholders and professionals. However, natural person shareholders who directly or indirectly hold less than 1% of the issued shares of the listed company or persons who hold positions in entities that directly or indirectly hold less than 5% of the issued shares of the listed company can be an independent director. This is consistent with China's wish to protect the benefit of small and medium shareholders by introducing the independent director institution.

### **3.3.2 Nominations and Replacement Procedure**

#### **a. Nomination**

Article 4 of the guidelines clarifies that a listed company's board of directors, supervisory board and shareholders who individually or together hold not less than 1% of the shares in the listed company may nominate candidates for independent director. Such directors will be decided through election by the shareholders' general meeting. Obviously, the right of nominating an independent director is in the hands of a listed company's board of directors, supervisory board and shareholders who individually or together hold not less than 1% of the shares in the listed company.

#### b. Replacement and Removal

The same article also requires that an independent director may not be removed without cause before the expiration of his term, unless the circumstance mentioned above or a circumstance under which a person may not hold the position of director specified in the Company Law arises.<sup>155</sup>

---

<sup>155</sup> *Company Law of People's Republic of China, supra* note 13. Article 147 states that the following persons shall not act as a director, supervisor or senior management personnel:

- (1) a person who has no civil capacity or who has limited civil capacity;
- (2) a person who has been convicted for corruption, bribery, conversion of property or disruption of the order of socialist market economy and a five-year period has not lapsed since expiry of the execution period or a person who has been stripped of political rights for being convicted of a crime and a five-year period has not lapsed since expiry of the execution period;
- (3) a person who acted as a director, factory manager, manager in a company which has been declared bankrupt or liquidated and who is personally accountable for the bankruptcy or liquidation of the company; and a three-year period has not lapsed since the completion of bankruptcy or liquidation of such company;
- (4) a person who has acted as a legal representative of a company which has its business license revoked or being ordered to close down for a breach of law and who is personally accountable, and a three-year period has not lapsed since the revocation of the business license of such company; and
- (5) a person who is unable to repay a relatively large amount of personal debts. Where the election or appointment of a director, supervisor or senior management personnel is in violation of the aforesaid provisions, such election or appointment shall be void. In the event of the circumstances stipulated in (1) above during the term of appointment of a director, supervisor or senior management personnel, the company shall remove the director, supervisor or senior management personnel.

### c. Remuneration

In order to prompt the independent directors to work more effectively, article 7 of the guidelines stipulates that listed companies should provide an appropriate allowance to their independent directors. The proposed rate for such allowance should be formulated by the board of directors, deliberated and adopted by the shareholders' general meeting and disclosed in the company's annual report. At the same time, the guidelines state that independent directors should not receive any extra, undisclosed benefits from the listed company, its principal shareholders or organizations or individuals with a material interest in the listed company other than the afore-mentioned allowance. Therefore, the guidelines do not stipulate the specific form or standard of the allowance.

### **3.3.3 Rights**

Article 7 of the guidelines states that listed companies should provide the necessary conditions to ensure that the independent directors effectively exercise their functions and powers. For example, listed companies should ensure that their independent directors enjoy the same right-to-know as other directors. For any matters that require the decision of the board of directors, listed companies must give independent directors prior notice by the statutory deadline and provide them sufficient information.

Article 5 of the guidelines stipulates that listed companies should grant independent directors the following special functions and powers:

(1) major connected transactions (namely proposed connected transactions between the listed company and a connected person with a total value of more than Rmb 3 million or more than 5% of the listed company's most recently audited net asset value) should be submitted to the board of directors for deliberation after the approval of the independent directors;

1) before rendering their judgment, independent directors may engage an intermediary organization to issue an independent financial consultant report for use as a basis for rendering their judgment;

2) proposing the engagement or dismissal of an accounting firm to the board of directors;

3) proposing to the board of directors the convening of an extraordinary shareholders' general meeting;

4) proposing the convening of a meeting of the board of directors;

5) independently engaging external auditing institutions and consultancies; and

6) openly soliciting shareholders' voting rights before the holding of a shareholders' general meeting.

In addition, independent directors should obtain the consent of at least half of all the independent directors before exercising the afore-mentioned

functions and powers. If a listed company establishes a remuneration committee, audit committee, nomination committee or other such committees under the board of directors, independent directors should account for at least one-half of the members thereof.

### **3.3.4 Obligations**

As article 1 of the guidelines states, an independent director has a fiduciary duty and a duty of diligence toward the listed company and all the shareholders. An independent director should, pursuant to the requirements of the relevant laws and regulations, these Guiding Opinions and the company's articles of association, conscientiously perform his duties and responsibilities, safeguard the company's overall interests and, in particular, pay attention that the lawful rights and interests of small and medium shareholders are not prejudiced. An independent director should perform his duties and responsibilities independently, without the interference of the principal shareholders or the persons in actual control of, or other entities or individuals that have a material interest in, the listed company. In principle, an independent director should not simultaneously hold the position of independent director in more than five listed companies and he should ensure that he has sufficient time and energy to effectively perform his duties and responsibilities as an independent director.

At the same time, article 4 of the guidelines states that if an independent director fails to attend in person three consecutive board meetings, the board of directors should invite the shareholders' general meeting to replace him.

## 4. Barriers in China's Independent Directors Practice

### 4.1 Current Situation

#### 4.1.1 The Positive Side

##### a. The Independent Directors Institution Has Turned Out To Be Effective

In 1999, Guangzhou Baiyunshan Pharmaceutical Co., LTD. hired two independent directors. After the company adjusted its industry structure according to the opinion of the independent directors, it successfully made up the deficits and ensured surpluses.<sup>156</sup> The company regarded the independent director institution as an antenna which helped to receive more information, to supervise the company, and to lessen mistakes.<sup>157</sup> This is a well-known example for Chinese to show how effective independent directors are.

##### b. The Independent Directors Institution Has Been Widely Accepted

According to a survey in 2002, the independent director institution was widely accepted by Chinese listed companies.<sup>158</sup> In the questionnaire, when answering the question of whether or not there is a need to set up independent directors institution, 67.5% of the participating companies chose the option of “very necessary” and 32.5% of them chose the option of “necessary.”<sup>159</sup>

---

<sup>156</sup> “Independent Directors Institution Makes Enterprises Feel Better” Renmin Daily May 22, 2000

<sup>157</sup> *Ibid.*

<sup>158</sup> Shuyuan Zhao & Wenfeng Li, “Independent Directors Turned Out To Be Effective: The Importance of Keeping Their Independence” Securities Times ( December 18, 2002)

<sup>159</sup> *Ibid.*

Although those who chose “necessary” also chose “unobvious effect in practice”, none of the companies chose the options of “not very necessary” or “not necessary at all.” This shows that Chinese listed companies are in favor of the independent director institution. The independent director institution has been widely accepted.

#### c. Independent Director Institution has been Implemented

According to the Shanghai Securities News in 2004, by the end of June 2003, among the 1,250 companies listed on the Shanghai and Shenzhen Stock Exchanges, 1,244 had introduced independent directors, and for 800 companies independent directors comprised more than one-third of board members, accounting for 65 percent of all the companies. There were 1,023 companies in which independent directors comprised more than one-fourth of board members, accounting for 82 percent of all the companies. In terms of the number of persons, most listed companies had introduced independent directors as required. The independent director institution has been implemented as expected.

#### **4.1.2 The Negative Side**

However, independent directors have had a minimal positive effect on corporate performance as measured by share values and rate of return. A 2002

study conducted by Gao and Ma reveals that the performance of companies with independent directors is not significantly different from those without independent directors.<sup>160</sup> The study also states that the performance of Chinese listed companies does not have a direct relation to independent directors.<sup>161</sup>

## **4.2 Existing Problems**

While introducing the independent director institution seems to be a positive step in the development of China's corporate governance, the question remains, "Will companies perform better by having independent directors on the board?" Although there are numerous rules, regulations, and guidelines emphasizing the importance and significance of independent director institution, the pursuit of the independent director institution in China does not seem to be successful in the following aspects.

### **4.2.1 Appointment**

In order to meet the requirements of the Guidelines, most of China's listed companies appointed independent directors to their boards. By the end of 2005, there were 4,640 independent directors on the boards of China's 1,377

---

<sup>160</sup> Minghua Gao & Shouli Ma, "A Positive Study of the Relationship between Independent Director Institution and Achievement of a Corporation: Correspondingly Discussing Institutional Environment for Effective Operation of Independent Director System", 2 Nankai Economic Studies, (2002) 64 at 66.

<sup>161</sup> *Ibid.*

listed companies.<sup>162</sup> For 93.3 percent of listed companies, independent directors constituted more than one-third of board members.<sup>163</sup> As the law only requires that listed companies should have one-third independent directors on their boards,<sup>164</sup> only 0.66 percent of listed companies have a majority of independent directors on their boards and more than 80 percent of listed company boards are comprised of 30-40 percent independent directors.<sup>165</sup> Moreover, listed companies are not willing to take on more independent directors than necessary.

#### 4.2.2 Nominating Mechanism

In a country like China where the relationship is strongly emphasized, it is difficult for the selection process of independent directors to avoid influence by controlling shareholders or management. There is no independent nomination committee drawn from board members in listed companies. Neither cumulative voting nor withdrawal mechanisms have been adopted by Chinese listed companies. Article 4 of the Opinion provides that directors, supervisors or the shareholders jointly or individually owning a one percent equity interest may all nominate independent director candidates. However, in reality independent directors are merely selected by controlling shareholders.<sup>166</sup> In many listed

---

<sup>162</sup> Qing Pan, Shangshi Gongsu Duli Dongshi Buzai “Chenmo” [Independent Directors of Listed Companies Will Be No Longer “Silent”], Guoji Jinrong Bao [International Financial News], December 13, 2006, online: <[http://paper.people.com.cn/gjrb/html/2006-12/13/content\\_12106333.htm](http://paper.people.com.cn/gjrb/html/2006-12/13/content_12106333.htm)>.

<sup>163</sup> *Ibid.*

<sup>164</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies, supra* note 29, article 1(3).

<sup>165</sup> Huifa Chen, WoGuo Shangshi Gongsu Duli Dongshi Zhidu Yu Gongsu Yeji De Shizheng Yanjiu [Empirical Research on Independent Director System and Corporate Performance in the Listed Company], October 8, 2005.

<sup>166</sup> Betty M. Ho, “Restructuring the Boards of Directors of Public Companies in Hongkong: Barking Up the Wrong Tree” (1997) 1 *Sing. J. Int’l & Comp. L.* 507 at 520.

companies, only the large shareholders or managers can recommend and nominate independent director candidates to the board of directors. Studies show that boards of directors nominate approximately 63 percent of independent director candidates, among which 36 percent are directly nominated by major shareholders.<sup>167</sup> The remaining 37 percent of the candidates are nominated by the supervisory board and by shareholders who independently or jointly hold more than one percent of company shares.<sup>168</sup> Ironically, most independent directors are appointed by the very majority shareholders who are supposed to be monitored by them.

The fact that large shareholders nominate a majority of the independent directors tends to discourage true independence at board meetings. Controlling shareholders and management tend to select those who have some connection to them and who are on the same side with them. Under such a nominating mechanism, it is difficult to guarantee the independence of the independent directors. Each year, the CSRC rejects some appointments of independent directors because of various “behind the curtain” connections with controlling shareholders or management.<sup>169</sup> A Chinese scholar points out that,

Chinese regulators face a dilemma: if they give any stockholder the independent director nomination right without a minimum requirement of shareholdings, then a profusion of nominated candidates could give excessive power to controlling shareholders through a scattering of the votes of small shareholders. However, if

---

<sup>167</sup> Yuan, *supra* note 80 at 87.

<sup>168</sup> Tong Ying, Zhongguo Dudong Shengcun Xianzhuang [The Status quo of Independent Directors in China], Shanghai Zhengquan Bao [Shanghai Securities News], May 27, 2004. online: <[http://www.cnstock.com/ssnews/2004-5-27/liuban/t20040527\\_571548.htm](http://www.cnstock.com/ssnews/2004-5-27/liuban/t20040527_571548.htm)>.

<sup>169</sup> Zhang Jizhong Jia Pingwa Yao Kechuan Mou Gongsi Duli Dongshi [Jizhong Zhang and Pingwa Jia Will Be Independent Directors of a Company] (May 13, 2003) online: <<http://cn.ent.yahoo.com/030513/127/1lx6q.html>> In this case, Jizhong Zhang is a famous film director in China while Pingwa Jia is a famous writer in China. Both of them admitted that they were selected because they were friends of the company’s manager.

only controlling shareholders are granted the nomination powers, then it does not seem to be possible for those controlling shareholders to take care of the minority shareholders' rights.<sup>170</sup>

Needless to say, independent directors' true ability to prevent abuse by majority shareholders and protect the interests of medium-sized and small shareholders is problematic. These independent directors are inclined to represent those who selected them instead of those who are supposed to be protected.

#### **4.2.3 Qualification and Participation**

##### *a. The Lu Jiahao Case*

The Lu Jiahao Case represents both the first time that an independent director was fined by the CSRC and the first time that an independent director sued the CSRC.<sup>171</sup> This case emphasizes the passive role of independent directors and at the same time proves that those academic directors lack the required qualifications to serve as an independent director.

Lu Jiahao was an independent director in Zhengbaiwen which is a Shanghai-listed plastic manufacturer and dealer. In 2002, Lu Jiahao was fined RMB 100,000 (about US\$12,091) by the CSRC for failing to take any action when the company submitted a false accounting report.<sup>172</sup> Lu subsequently protested the punishment and brought an action against the CSRC.<sup>173</sup> Beijing's First Intermediate People's Court dismissed the lawsuit.<sup>174</sup> Lu is a retired

---

<sup>170</sup> Huang, *supra* note 52 at 126.

<sup>171</sup> Sun Min, "Director First To Sue Securities Watchdog" *China Daily* (21 June, 2002).

<sup>172</sup> *Ibid.*

<sup>173</sup> *Ibid.*

<sup>174</sup> *Ibid.*

professor whose monthly income is only RMB1, 500(about US\$181). He had not received any compensation from Zhengbaiwen. Lu argued that he always regarded the independent director as an honorary title and did not take part in any decision-making.<sup>175</sup> He said he was only a teacher who taught foreign language and knew nothing about the operation of companies. He also pointed out that he did not directly compile any false accounting documents.<sup>176</sup> He agreed with the annual reports based on the accounting firm's audit opinion.<sup>177</sup> What is more, he did not attend the meetings that approved such documents.<sup>178</sup> He claimed that he should not be punished in the same way as those who involved in the fraudulent financial practices.<sup>179</sup>

#### *b. Qualification*

In China's listed companies, most independent directors are academics and civil servants. Currently, the most popular way for Chinese listed companies to select independent directors is to invite scholars from universities and research institutes. The CSRC reported in 2004 that 44 percent of all independent directors in Chinese listed companies were professors or scholars.<sup>180</sup> Another 24 percent of independent directors were from accounting, law, or consulting firms or other similar organizations.<sup>181</sup> Only 13 percent of

---

<sup>175</sup> *Ibid.*

<sup>176</sup> *Ibid.*

<sup>177</sup> *Ibid.*

<sup>178</sup> *Ibid.*

<sup>179</sup> *Ibid.*

<sup>180</sup> See Jixu Tuidong Wanshan Duli Dongshi Zhidu: Zhongguo Zhengjianhui Youguan Bumen Fuzeren Da Jizhe Wen [Continue to Perfect the Independent Director System in China: China Securities Regulatory Commission Officials' Response to the Questions Rose by Reporters], Zhongguo Zhengquan Bao [China Securities Journal], February 6, 2004, at 1.

<sup>181</sup> *Ibid.*

them were current or previous corporate executives.<sup>182</sup> However, such a method is being questioned nationwide by economists, business insiders and other critics. On the one hand, those academics and civil servants do not have enough time or energy to carry out their duties because they have their other full-time positions. On the other hand, academics and civil servants often lack sufficient knowledge in operating real corporations effectively, although they may be excellent in their own fields. It is difficult for them to provide critical judgment for a firm's decisions since they rarely have been personally involved in actual corporate operations and lack experience with complex transactions and financial reports. Moreover, in order to avoid losing face, scholars may be reluctant to ask questions about things they do not understand. That is why the insiders prefer scholars, because these people tend to be neutral and not so familiar with corporate operations.

Nevertheless, the trouble here is the lack of experienced talent to serve as independent directors. One of the common challenges facing developing countries is the shortage of experts who have the relevant qualifications and technical knowledge to fulfill their duties. The independent directors system is a recent innovation in China. China does not have a readily available, experienced applicant pool. According to the requirements of the CSRC, in the coming years the demand for independent directors will be higher and higher. In order to address this problem, the CSRC required independent directors to undergo a training course organized by the CSRC in conjunction with Tsinghua

---

<sup>182</sup> *Ibid.*

University.<sup>183</sup> As of June 2003, the CSRC had already organized more than thirty training courses for more than 8,000 independent directors.<sup>184</sup> However, such training is hardly a substitute for experience. Ultimately, if independent directors do not have the ability to supervise management, their presence has little value. Additionally, the lack of qualified candidates makes it difficult to require a majority of independent directors.

### *c. Participation*

According to a study conducted by Shanghai Securities News, more than one-third of independent directors admitted that they never cast an abstaining or opposing ballot in a board meeting.<sup>185</sup> The study shows that over 70 percent of independent directors did not use or intend to use the special powers authorized by the CSRC such as proposing an interim shareholders' meeting or appointing an outside auditing or consulting organization. Another survey shows that 60 percent of independent directors at listed companies never express their independent opinions during board meetings.<sup>186</sup> The independent directors in China view themselves as corporate advisors rather than corporate monitors.<sup>187</sup> It has been reported that independent directors used their position to draft technical plans for the company instead of actually monitoring the

---

<sup>183</sup> *Shangshi Gongsi Duli Dongshi Peixun Shishi Xize* [Detailed Implementation Rules for Training of Independent Director in Listed Companies] article 3 (promulgated by the China Securities Regulatory Commission on December 22, 2005, effective on December 22, 2005) online: <[www.lawinfochina.com](http://www.lawinfochina.com)>.

<sup>184</sup> Continue to Perfect the Independent Director System in China: China Securities Regulatory Commission Officials' Response to the Questions Rose by Reporters, *supra* note 180 at 1.

<sup>185</sup> Tong, *supra* note 168.

<sup>186</sup> Chaobin Xie, *Research on Legal Regime of Independent Directors* (Beijing: Law Press, 2004) at 315.

<sup>187</sup> Tong, *supra* note 168.

company.<sup>188</sup>

Independent directors in China have come to be known colloquially as “vase directors.” Directors who have failed to diligently perform their duties may be described as a “vase director.” The Dean of the Changjiang School of Business, who serves as an independent director, said at the Chinese Enterprise Head Annual Conference, “I am an independent director. I am only decorative like a vase.”<sup>189</sup> He said under current circumstances in China, an independent director could hardly function.<sup>190</sup> A vase director metaphorically characterizes a director who has no real function and is nothing more than a decoration. Research shows that 2 percent of independent directors admit that they are “vase directors.”<sup>191</sup>

These independent directors are not willing to faithfully execute their duties. They regard their position as an easy job and do not want to spend too much time diligently fulfilling the role. At the same time, they may fear that disclosing real problems may lead to dismissal or losing promotion opportunities. Thirdly, the low ratio of independent directors and the absence of subcommittees on most boards limit independent director influence. Even though independent directors are empowered to raise objections or cast

---

<sup>188</sup> Yang Xianfeng, Zhongguo Shangshi Gongsu Duli Dongshi Zhidu de Xiangzhuang Fenxi [Status quo of Independent Director System in China], 34 (8) Anhui Nongye Kexue [Journal of Anhui Agriculture Science] 1675 at 1675-77 (2006).

<sup>189</sup> Xiang Bing, Duli Dongshi Xiang Huaping? [Are Independent Directors Just Decorative?], Gang-Ao Xinxi Ribao [Hongkong-Macao News Daily], January 1, 2003.

<sup>190</sup> *Ibid.*

<sup>191</sup> Yang, *supra* note 188.

opposing ballots, they rarely do so. What is worse, as a matter of fact, they do not have enough votes to overcome an opposing majority as well. There is no mention in the regulations whether independent directors have the right to vote against board decisions and whether they can appeal when they are not able to exercise their voting rights. It seems that independent directors serve no real function but merely window-dressing.

#### **4.2.4 Replacement**

Another interesting aspect of the independent director system in China is that independent directors are dismissed or resign frequently. Independent directors can be fired by the shareholders easily. Such lack of legal protection means that independent directors are often unwilling to challenge the board's decisions. By the end of November 2003, independent directors had been dismissed or had resigned in approximately 24 percent of the 1,249 listed companies that had independent directors.<sup>192</sup>

#### **4.2.5 Conflict of the Board System: Board of Supervisors and Independent Directors**

The existence of the supervisory board in China complicates the adoption of the independent director system. Introducing independent directors

---

<sup>192</sup> Li Kang, Ye ya & Zhang Mingkun, Duli Dongshi Tuichu Xianxiang Yanjiu [Study on Resignation Phenomenon of Independent Directors], 1048 Zhengquan Shichang Zhoukan [Securities Market Weekly] (2004) 65 at 67.

into a system where there is already a supervisory board may be problematic. Both the supervisory board and independent directors are supposed to be insider monitoring mechanisms. The powers and duties vested with board of supervisors and independent directors significantly overlap.<sup>193</sup> The guidelines do not clarify the relationship between the supervisory board and the independent directors.

The coexistence of two monitors can lead to free-riding problems. Independent directors may rely on the supervisory board to be responsible for the monitoring function. These two mechanisms are likely to interfere with, rather than to cooperate with, each other. What is more, the cost of corporate governance is higher for companies with both a supervisory board and independent directors.

#### **4.2.6 Independence**

Independent directors will only be able to enhance board efficiency if they are truly independent.<sup>194</sup> A certain cooling off period is required for a company's ex-employee to become an independent director according to the world's prevalent Corporate Governance Codes.<sup>195</sup> For instance, in the United States, the NYSE and the CalPERS requires a period of five years to have

---

<sup>193</sup> See *Company Law of the People's Republic of China*, *supra* note 13 , article 55, 119.

<sup>194</sup> Hu, *supra* note 64 at 8.

<sup>195</sup> *Ibid.*

passed.<sup>196</sup> However, in the guidelines the CSRC only requires a one-year period for the ex-employee, before he or she can become an independent director. This is too short a period as the ex-employee may still have some sort of loyalty with the company. This may make it difficult for him to rise against the management. Obviously, such a period is unreasonably short for an ex-employee to be truly independent from the company.

#### **4.2.7 Incentive Mechanism**

##### *a. Financial Incentive*

There is also the problem of ensuring fair and transparent remuneration to the independent directors. Article 103 of China's Company Law states that the shareholders' general meetings should determine the remuneration of all the directors. The remuneration of independent directors in China is not linked to the performance of the director or the company. In the world's leading countries, directors' remuneration is divided into two parts: one is a fixed fee and the other is linked with the firm's performance.<sup>197</sup> Currently, China's directors are paid fixed compensation fees which are low compared to western standards.<sup>198</sup> The average annual pay ranges from RMB 1,000 (US\$121) to

---

<sup>196</sup> *Ibid.*

<sup>197</sup> *Ibid.*, at 10.

<sup>198</sup> Layhong Tan & Jiangyu Wang, "Modelling an Effective Corporate Governance System for China's Listed State-Owned Enterprises: Issues and Challenges in a Transnational Economy" (2007) *J Corp Law Stud* 7 143 at 158.

more than RMB 80,000 (US\$9,674).<sup>199</sup> Most independent directors earn between RMB 40,000(US\$4,838) and RMB 50,000(US\$6,046) a year.<sup>200</sup> Some are only paid traveling allowance and a small salary.<sup>201</sup> This may explain the fact that many independent directors are always reluctant to carry out their duties such as attending board meetings. If the compensation is too low, independent directors lack economic incentives. Nevertheless, if the independent director is paid too much, independence is hard to ensure either. The independent director may hardly say no to the company's management.<sup>202</sup>

*b. Reputation Motivational Mechanism*

The absence of a reputation motivational mechanism is another problem for China's independent directors. In those countries which have a mature independent director institution, independent directors usually operate under the reputation motivation mechanism.<sup>203</sup> In such countries, if an independent director is truly independent and objective in his performance on the board of directors, his reputation will be protected and even enhanced, his price in the market will increase and he will be given more opportunities.<sup>204</sup> Therefore, independent directors in those countries are likely to work impartially

---

<sup>199</sup> *Ibid.*

<sup>200</sup> *Ibid.*

<sup>201</sup> *Ibid.*

<sup>202</sup> Hu, *supra* note 64 at 10.

<sup>203</sup> Tan & Wan, *supra* note 198.

<sup>204</sup> *Ibid.*

and professionally as expected.<sup>205</sup> However, in China, such a mechanism does not exist at all. That is another reason why independent directors in China do not act as independently and objectively as they should.<sup>206</sup>

#### **4.2.8 Unsecured Right-to-know**

The listed company may try to hide materials that are unfavorable for the company. The company may intentionally prevent the independent directors from participating in a board meeting. That makes it more difficult for the independent directors to acquire information. The rights of independent directors lack sufficient procedural guarantees and necessary judicial support

#### **4.2.9 Lack of a Sound Legal System**

In western countries, the position and role of independent directors are clearly laid down in the Company Law or the Stock Exchange Law, and implemented in the rules for listing in stock exchanges.<sup>207</sup> However, the CSRC rules and regulations do not have the same position in the Chinese legal system.<sup>208</sup> Apparently, these rules and opinions lack enforcement power.

Because China has introduced numerous rules and guideline opinions

---

<sup>205</sup> *Ibid.*

<sup>206</sup> *Ibid.*

<sup>207</sup> Tong Lu, "Development of System of Independent Directors and the Chinese Experience" online :<  
<http://old.iwep.org.cn/cccc/pdf/Development%20of%20System%20of%20Independent%20Directors%20and%20the%20Ch%20A1%AD.pdf>> at 13.

<sup>208</sup> *Ibid.*

regarding independent directors, it is clear that Chinese regulators are determined to build a corporate governance model that includes the independent director institution.<sup>209</sup> However, all the names such as opinions, rules, and measures suggest that these are not as strictly enforced as those which have been enacted into “Law” by the State Council.<sup>210</sup> China does not have any kind of legal institution that could make the independent director institution meaningful.<sup>211</sup> The rules at present, which do not contemplate a significant role for legal institutions, only contemplate a role for the CSRC.<sup>212</sup>

#### **4.2.10 Confucianism Influence**

Apart from the institutional impediments, the key reason why both the insider and outsider models of corporate governance fail to take root in China is the politico-cultural traditions of contemporary China.<sup>213</sup> It is generally accepted that an independent director should be outspoken and dare to ask straightforward and probing questions. He must act autonomously and avoid the influence of controlling shareholders and other interested parties.<sup>214</sup> However, all of these may be regarded as assertive and even hostile in Chinese traditional culture.<sup>215</sup> Confucius’ philosophical influence has been deeply rooted in the Chinese

---

<sup>209</sup> Huang *supra* note 52 at 126.

<sup>210</sup> *Ibid.*

<sup>211</sup> Clarke, *supra* note 88 at 210.

<sup>212</sup> *Ibid.*

<sup>213</sup> Tan and Wang, *supra* note 198 at 167.

<sup>214</sup> Miles & Zhang, *supra* note 82 at 228.

<sup>215</sup> *Ibid.*

culture. There is a gap between western corporate experience and the traditional culture of the Chinese.<sup>216</sup> In Chinese culture, which is deeply influenced by Confucian values, conformity, tolerance, humility and respect for others are encouraged.<sup>217</sup> Confucius focuses on the concepts of Li (rituals) and Ren (benevolence).<sup>218</sup> Confucian classics are still central to China's legal traditions as well as in everyday Chinese language and culture today.<sup>219</sup> According to Confucianism, the purpose of law is to serve the state, not to protect personal rights. For this reason, the existence of an independent director is unacceptable to some extent. The company executives are hostile to an outsider. The corporation will respond more to the CEO rather than to its independent directors. Many Chinese companies may feel strange and unfamiliar working with independent directors.<sup>220</sup> Thus, it is unrealistic to expect independent directors to fulfill their duties. At the same time, people may not be willing to serve as an independent director under such conditions.

### 4.3 Conclusion

In conclusion, China's introduction of independent directors does not

---

<sup>216</sup> Yuwa Wei, "An Overview of Corporate Governance in China" (2003) 30:23 *Syracuse J. Int'l L. & Com.* 23 at 27.

<sup>217</sup> J Dahya, Y Karbhari & JZZ Xia, "The Supervisory Board in Chinese Listed Companies: Problems, Causes, Consequences and Remedies" (2002) 9 *Asia Pacific Business Review* 118 at 229.

<sup>218</sup> Tan and Wang, *supra* note 198 at 167.

<sup>219</sup> Daniel H Rosen, *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace* (Washington, D.C.: Institute for International Economics, 1999) at 199.

<sup>220</sup> Miles & Zhang, *supra* note 82 at 229.

guarantee the effective operation of boards. There remains much to be done to ensure the proper functioning of the independent director institution. While China is implementing the independent director institution, the cultural, economic and legal environment will certainly limit the effectiveness of this foreign system. China has developed several thousand years' culture, and it has made not only achieved noble accomplishments, but it has also left behind formidable barriers such as bureaucratism and the culture of hierarchical interpersonal relationships. At the same time, a history of more than thirty years state-planned economy brought both glory and pain. After more than twenty years' revolution, Chinese listed companies still have to face the controlling shareholding situation. This is an economic environment which is inevitable for China's corporate governance revolution. When it comes to legal environment, China's company law is largely a succession of Japan company law and the company law made by the former Kuomintang government. China's civil commercial law and even the whole legal system belong to the civil law tradition. However, China's securities law and the establishment, cultivation and development of its securities market were transplanted from the American legal system. As a result of the incompatibility of these different legal and cultural influences, China has such a long way to go regarding the success of its corporate governance development.

## 5. Suggestions For China's Independent Director System

### 5.1 Board of supervisors or independent directors?

#### 5.1.1 Chinese scholars' disputes: proponents and opponents

As a matter of fact, the supervisory board institution in China's listed companies is ineffective in playing its supervisory function. Thus, policy makers face two choices: to improve the supervisory board institution so that it can really take on its monitoring responsibilities or to formally introduce the independent director institution into China's corporate governance structure so that the independent directors can do the monitoring job. There are some typical views regarding the relationship between these two systems.

##### *(1). To abandon the board of supervisors*

The first view is that corporate governance may be improved in those listed companies with the presence of independent directors.<sup>221</sup> Some scholars argue that the board of supervisors should be abandoned since it is powerless in monitoring the company.<sup>222</sup> They believe the independent director institution is

---

<sup>221</sup> Li Yu & Jun Feng, "New Thoughts on the Innovation of China's State-Owned Enterprises and the Corporate Governance Structure" in Neng Liang, *Corporate Governance Structure: China's Practice and America's Experiences* (Beijing: China People's University, 2000) at 159.

<sup>222</sup> See Yu Mengguo, "Independent Directors in Foreign Countries" (2001) 16:5 Journal of Beijing Industrial and Commercial University.

a better tool to monitor the company.<sup>223</sup>

(2). *To improve the supervisory board instead of introducing independent directors*

The second view is that China should improve its supervisory board institution. There are quite a few scholars who regard the supervisory board as a necessary monitoring organ.<sup>224</sup> They believe it is the weakness of the current law and the whole corporate environment in China that lead to the failure of the supervisory board institution.<sup>225</sup> Therefore, if China can solve these problems, its supervisory board will eventually work well. In terms of the independent director institution, some of them further point out that it may be appropriate to reconstruct the board of supervisors instead of introducing a brand new system.<sup>226</sup> These scholars believe that the independent director system cannot really play its role in raising the quality of listed companies if the ownership structure cannot be fundamentally challenged.<sup>227</sup> This is because the ownership structure leads to insider control problems and ineffectiveness of the board of

---

<sup>223</sup> *Ibid.*

<sup>224</sup> See Fen Ouyang, "On the Comparison between the Independent Director Institution and the Supervisory Board Institution" (2003) *Modern Management Science*; See also Feng Guo, "On the Improvement and Innovation of Corporate Governance Structure" (2000) *China Securities*; Tianxi Wang, *A Research on Corporate Governance and Independent Directors* (Beijing: China Law Press, 2005) at 244-265; Shenshi Mei, *On the Standardization of Modern Corporate Governance Structure* (Beijing: China Law Press, 2002) at 723-808; See also Qinshi Cui, "Analysis on China's Corporate Governance Structure" (1999) 2 *Law and Society* 58; See also Xinhua Qiu, "Rethink and Reconstruct the Monitoring System of China's Companies" (2003) 3 *Dezhou Academic Journal*.

<sup>225</sup> *Ibid.*

<sup>226</sup> See Jiao Jian, "A Monitoring Mechanism of Modern Companies: the Independent Director System or the Supervisory Board" (2002) 2 *Modern Law Review*.

<sup>227</sup> Wan Cuiying, "Skepticism the Introduction of Independent Director System: Perfecting the Supervisory Board in Chinese Listed Companies" (2002) 23:2 *Journal of Hebei University of Economics and Trade* at 56-58.

directors. Meanwhile, they believe the independent director institution is originated in the unitary board system and may not function properly in China with a dual board.<sup>228</sup>

*(3) To have the supervisory board and the independent directors at the same time*

The third view is that these two systems may coexist.<sup>229</sup> Some scholars believe that the coexistence of these two systems is the best choice for China.<sup>230</sup> They point out that the independent director institution can co-exist with the supervisory board institution well if some improvements are made.<sup>231</sup> For example, it is practical that the supervisory board performs a monitoring function internally and independent directors perform monitoring function externally.<sup>232</sup> On the one hand, internal monitoring exercised by the supervisory board focuses on supervising management's implementation of resolutions from both shareholders' meeting and the board.<sup>233</sup> On the other hand, external

---

<sup>228</sup> See Lixia Chen & Libo Wang, "On Introducing Outside Directors Institution into China's Listed Companies" (2002) 3 *Law and Society* 37.

<sup>229</sup> Jianlin Ni, *Corporate Governance Structure: Law and Practice* (Beijing: Law Press, 2001) at 204.

<sup>230</sup> Wang Wenqin, *Corporate Governance* (Beijing: China People's University Press, 2005) at 261; Minkang Gu, *supra* note 106 at 59.

<sup>231</sup> *Ibid.*

<sup>232</sup> Li Liao, *Corporate Governance and Independent Directors* (Beijing: China Plan Press, 2001) at 204; see Yihe Zhang, "On the Functions of the Supervisory Board and Independent Directors" (2003) *Modern Law*; see also Zhenming Peng & Jing Li, "Independent Directors and China's Corporate Governance" (2003) 2 *Hubei Economics Academic Journal*.

<sup>233</sup> Cao Yuankun, "On Transplanting Systems" (1997) 1 *Jianghai Academic Journal*; Jin Yonghong & Xi Yuqin, *The Independent Directors System and Corporate Governance of Chinese Listed Companies* (Beijing: Lixin Accounting Press, 2003) at 204; Xiaoxing He, "A Comparative Analysis on Advantages and Disadvantages between the Independent Director System and the Supervisory Board" (2001) 8 *Economics Trends*.

monitoring exercised by independent directors concentrates on the process of decision-making.<sup>234</sup> Therefore, independent directors play their roles during the decision-making process while supervisors function after the decisions have been made.

*(4). To let the company choose its monitoring system*

The fourth view is that China should let its companies choose which works better for them based on the company's scale and type.<sup>235</sup> Professor Zhu Ciwen believes that when developing its inner monitoring system, China should not focus on only one system.<sup>236</sup> In order to bring the advantages of these two systems into full play, China should let its companies choose which works better for them based on the company's scale and type.<sup>237</sup>

### **5.1.2 My opinion**

I think we cannot say which is better between these two systems. Each system has its own advantages and disadvantages. It would be difficult for China to abandon the supervisory board because of its long statutory history as a monitor. At the same time, recent revisions of Chinese regulations indicate no

---

<sup>234</sup> *Ibid.*

<sup>235</sup> Zhu Ciwen, *Inner Supervision Mechanism of Corporations* (Beijing: Law Press, 2007) at 334.

<sup>236</sup> *Ibid.*

<sup>237</sup> *Ibid.*

trend toward a one-tier board system.<sup>238</sup> Thus, I agree with the third view that independent directors and supervisors can coexist in a company. However, these two institutions' roles and responsibilities in corporate governance need a clear boundary.

## **5.2 How to improve the independent directors system**

China has begun to establish its own system of independent directors, but it needs to work in the following fields to turn it into an instrument for optimizing the governance structures of listed companies.

### **5.2.1 To take a rational attitude toward the independent director system**

To establish the independent director system in listed companies is an important systematic innovation in China's corporate governance structure. It is also a meaningful step to perfect China's corporate governance structure. It has been proved by western countries' practice that independent directors can help solve many problems such as reducing insider control problems and protecting shareholders' interest. However, a perfect system does not exist. Every system

---

<sup>238</sup> When the Company Law was significantly revised in 2005, the supervisory board's authority was strengthened and it was vested with broad new authority.

has its drawbacks. So does the independent director system. It has some limitations such as independent directors' information limitation, time limitation, energy limitation, professional knowledge structure limitation and so on. Moreover, China has a totally different social, economic, cultural and legal environment from those western developed countries. It is inevitable that difficulties occur during the process of designing and implementing the system. Nevertheless, we can not blame the system for its ineffectiveness. It is unrealistic and impossible for China to rely only on some independent directors to solve all the problems that exist in the entire corporate governance structure. On the contrary, we should take a more rational attitude toward such a system by analyzing its advantages and disadvantages objectively. In this way, the system can be improved and finally take effect in China. However, the system still has a long way to go to full maturity in China. It is an arduous and complicated task which requires endeavor and patience of all the people who are working on it.

### **5.2.2 Suggestions on how to improve China's independent director system**

#### *a. To regulate the qualifications of independent directors strictly*

The qualifications of independent directors have much to do with the effectiveness of the independent directors system. According to the CSRC, an

independent director shall meet five basic requirements in order to be qualified.<sup>239</sup> However, these are not enough for defining employable independent directors. To the requirements the guidelines have stated, I think China's lawmakers can make some additions.

*(1). To add more restrictions to the qualifications of independent directors*

It is necessary for China's lawmakers to add more restrictions to the qualifications of independent directors. For example, an independent director should not have a close interpersonal relationship such as teacher and student, classmates or former co-workers with any of the firm's directors or managers. At the same time, an independent director should not be an important supplier or consumer of the firm. An important supplier or consumer may directly or indirectly have a deal of more than RMB200, 000 (US\$ 34,000) with the firm.

*(2). To require related work experience*

An independent director should have three to five years' related work

---

<sup>239</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, supra note 29, article 2. Article 2 of the guidelines states that a person holding the position of Independent Director should fulfill the basic conditions set forth below:

- (1) having the qualifications to hold the position of Independent Director in a listed company in accordance with laws, administrative regulations and other relevant regulations;
- (2) being independent as required herein;
- (3) having a basic knowledge of the operation of listed companies and being familiar with related laws, administrative regulations and rules;
- (4) having not less than five years' experience in the law or economics or other work experience required for performing the duties and responsibilities of an Independent Director; and
- (5) meeting the other conditions specified in the company's articles of association.

experience. Lack of related work experience is one of the biggest problems leading to the ineffectiveness of the independent director system.<sup>240</sup> Only by having enough knowledge and experience can an independent director function well. It is more appropriate for companies to choose those professionals whose majors are management (including accounting), economics or law.<sup>241</sup> These professionals should be equipped with both theories and practice.<sup>242</sup> Although some details such as project technical problems can be solved afterwards, three to five years' related work experience should be necessary.<sup>243</sup> Since independent directors should make judgments about their companies' decisions, their abilities should equal the managers'.

*(3). To shorten the term of office of independent directors*

The duration of an independent director in China should be shortened. The CSRC regulates that “The term of office of independent directors will be the same as that of the other directors of the listed company. At the expiration of their terms, they may continue to serve if re-elected, but the additional time in office may not exceed six years.”<sup>244</sup> This duration is too long according to China's current situation. If an independent director works in a company for six

---

<sup>240</sup> Jiao, *supra* note 226.

<sup>241</sup> Mei Shenshi, *On the Structure of Modern Company's Organ Power* (Beijing: China University of Politics and Law Press, 2000) at 209.

<sup>242</sup> *Ibid.*

<sup>243</sup> *Ibid.*

<sup>244</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies, supra* note 29, art. 4 (4).

years, his independence will definitely be affected since he may be too familiar with other directors. For instance, the Corporate Law of Michigan regulates that an independent director's duration is no more than three years.<sup>245</sup> After three years, he can still work in the company but not as an independent director.<sup>246</sup> This is a good example for Chinese regulators to follow.

*(4). To reduce the number of companies an independent director can work for*

The guidelines stipulate that “in principle, an independent director should not simultaneously hold the position of independent director in more than five listed companies.”<sup>247</sup> However, if an independent director works for five companies at the same time, how can he ensure that he has sufficient time and energy to effectively perform his duties and responsibilities as an independent director? In order to avoid the phenomenon such as “vase directors,” it is suggested that the number should be cut down to three.

*b. To improve the selection mechanism of independent directors*

True independence is the core and soul of the independent directors system. If independence cannot be ensured at the beginning, how can we expect

---

<sup>245</sup> *Business Corporation Act*, *supra* note 46, 284 Mich. Stat. sec. 107 (f) (1972).

<sup>246</sup> *Ibid.*

<sup>247</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, *supra* note 29, art. 1 (2).

any independence afterwards? Therefore, reform should be made on the headstream, which is the procedure of selection and election of independent directors.<sup>248</sup>

*(1) To establish a reasonable election and selection procedure*

In order to let independent directors take effect, an independent nomination committee consisting of entirely independent directors is required. Since the purpose of the independent director institution is to safeguard the whole interests of the corporation, controlling shareholders should not be allowed to vote for the independent director, nor should they be allowed to vote for the independent director candidates they nominated. In electing independent directors, cumulative voting and withdrawal institutions could also be adopted.

*(2). To increase the ratio of independent directors on the board*

In Professor Walter J. Salmon's article "How to gear up your board," he listed "twenty-two questions for diagnosing your board."<sup>249</sup> Among those questions, the first one is "are there three or more outside directors for every insider?"<sup>250</sup> He claims that if the answer is yes, then the independent director system of the corporation is likely to be effective. However, if the answer is no,

---

<sup>248</sup> Jiao Jian, "Independent Directors, Supervisory Board and Modern Corporations' Choices" (2002) 2 Modern Law

<sup>249</sup> Walter J. Salmon, "How to Gear Up Your Board" 1993 in *Harvard Business Review on Corporate Governance* (Boston: Harvard Business School Press, 2000) at 10.

<sup>250</sup> *Ibid.*

the effectiveness of the corporation's independent director system is limited. Therefore, the proportion of independent directors on a corporate board is important because it significantly and directly influences the actual power of independent directors. A board with a higher ratio of independent directors is more likely to be hospitable to independent directors and less likely to be dominated by insiders.

Currently, the Opinion only requires that one third of the board members be independent directors.<sup>251</sup> But how can we expect two or three independent directors, a minority on the board, to fight against insiders? Even if the independent directors have sufficient time and skills, they will find it very hard to play their role in a board controlled by a single dominating shareholder since insiders still dominate the other two thirds of the board seats. Therefore, I think the CSRC should require each listed corporation have a majority of independent directors.

*c. To improve the incentive mechanism of independent directors*

Generally speaking, a sound incentive mechanism can make employees work better for the company and contribute more. However, Chinese regulators have not provided enough incentives for independent directors. In order to make up this deficiency, China should start with the following changes.

---

<sup>251</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, supra note 29 art. 1(3).

*(1). To make a sensible remuneration standard for independent directors*

Pay could be one of the most important factors which determine whether independent directors have enough desire to get involved in board activities.<sup>252</sup> The proposed Guidelines of the CSRC require that listed companies pay independent directors appropriately.<sup>253</sup> In reality, however, most independent directors are mainly paid by a fixed compensation for commuting and travel expenses. As discussed in chapter four, this compensation fee is generally low compared to western standards. It is believed that the best way to make independent directors really perform their responsibilities is to link their own interests and honor with the companies. In many countries, directors' remuneration is often paid in two parts: one is a fixed fee and the other is linked with firm performance, such as shares or stock options.<sup>254</sup> In fact, stock option might seem to be appropriate because it not only directly aligns directors' interests to their shareholders, but also indirectly aligns directors' share return in according to firm performance.<sup>255</sup> Certain stocks or stock options virtually become a major variant in the total sum of payment for them. This will provide a greater incentive for independent directors to work hard and achieve better

---

<sup>252</sup> Luo Peixin, "Since the Independent Director System has Drawbacks, Company Law Should not Transplant It." *Nanfang Zhoumo (South Weekend)* (4 August 2005).

<sup>253</sup> *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, *supra* note 29 art. 7(5).

<sup>254</sup> Li Jianwei, *A Research on the Independent Director System: From Bilateral Perspective of Jurisprudence and Management* (Beijing: China People's University Press, 2004) at 257.

<sup>255</sup> Li Yulong & Zhu Xiaolei, *Legal Practice of Corporate Governance* (Beijing: Law Press, 2006) at 167.

performance. Nevertheless, for maintaining independence, the stock-option arrangement should differ from that for executive directors and senior managerial personnel.<sup>256</sup> For example, the stock-option arrangement should be received after the person stops working as an independent director. This can prevent an independent director's remuneration from having too much link with the firm's interests.

In addition, an entirely independent compensation committee should be established under the board to decide the compensation of both directors and management. It does not make sense for controlling shareholders and management to decide the compensation of the very independent directors who monitor their performance.

*(2). To strengthen the reputation incentive for independent directors*

Since most of the independent directors are famous people from the academic or business areas, reputation is much more important to them than pay.<sup>257</sup> Therefore, it is suggested that the CSRC investigate and evaluate the independent directors of the listed companies in order to honor those who have the best records.<sup>258</sup> At the same time, for those who jeopardize their companies'

---

<sup>256</sup> Kong Xiang, "An Comparative Research on the World's Independent Directors Systems" (2002) 8 Management World.

<sup>257</sup> Yan hai & Chen Liang, "Research on Independent Directors" (2001) 4 Academic Journal of East China University of Politics and Law; Li Jianwei, *supra* note 23 at 255.

<sup>258</sup> Xu Ming, *Theory and Practice of Independent Director System* (Beijing: Peking University Press, 2007) at 313.

interests, the CSRC should criticize them openly or suggest dismissals.<sup>259</sup> I believe this can build a sense of occupational honor for an independent director.

*d. To ensure the exertion of independent directors' authorities*

In China, the first thing to do is to provide legal and systematic guarantees for the system of independent directors. Otherwise, independent directors are in for a lot of obstacles in exercising their power.

*(1). To ensure the independent director's right to know*

Currently, one of the worst problems in China's listed companies is the untruth, inaccuracy and delay of information. Management has a monopoly on information and selectively reveals information to independent directors. It is very likely that the independent director is the last to know about the actual business situation of their corporations. Therefore, the independent director's right to acquire information should be ensured. The right to know is the premise of the exertion of independent directors' rights. However, the guidelines' provisions on the independent directors' right to know are not detailed enough for independent directors to implement.<sup>260</sup> In order to solve such problems, changes should be focused on the following. On the one hand, China's company

---

<sup>259</sup> *Ibid.*

<sup>260</sup> See *Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies*, supra note 29 art. 7(1). The guideline's regulation on the independent director's right to know is very general and simple. Those regulations need to be in detail.

law and security law should have provisions to protect the independent directors' right to know.<sup>261</sup> At the same time, the guidelines and rules of the CSRC should have more details to require that management communicate information with the independent directors faithfully and exactly.<sup>262</sup> Also, the independent directors should attend board meetings and shareholder meetings actively. When important decisions need to be made by the board of directors, the company should provide the independent directors as well as other directors with enough materials within the legal time.<sup>263</sup> In addition, the company should ensure necessary work conditions for independent directors. For example, it is important for the company to ensure the power for the independent directors to hire outside consultants when necessary and to pay for the expenses. On the other hand, the department managers and the team leaders should explain their work in detail to independent directors.<sup>264</sup> They should discuss together and give the board of directors suggestions. Moreover, since the independent directors are not involved in the company's daily work, their information is mostly second-hand. Therefore, it is necessary for them to acquire information by showing up at the company and investigating by themselves.

*(2). To build a professional committees system*

---

<sup>261</sup> Xie Chaobin, *supra* note 186 at 620.

<sup>262</sup> *Ibid.*

<sup>263</sup> Zhu, *supra* note 235 at 200.

<sup>264</sup> *Ibid.*

Currently, most listed companies of China do not have subordinate, specialized committees in their boards, which deprive the independent directors of a clear position and specific tasks. Chinese regulators should encourage their listed companies to operate several different professional committees to make a definite division and coordination within the board of directors.<sup>265</sup> By having a professional committee system in the boards of China's listed companies, independent directors will find it easier to express dissents without the presence of controlling shareholders and insiders whom they are supposed to monitor.<sup>266</sup> Additionally, if an independent director is a member of a special committee, he can develop a solid base of knowledge by studying specialized topics.<sup>267</sup>

*(3). To strengthen the professional training of the independent directors*

When introducing the independent director system, one of the biggest challenges confronted by developing countries is the lack of qualified independent director candidates. In China, most of the independent directors are either academics or government civil servants. Since these people usually lack sufficient knowledge and experience of running a company, it is hard for the independent directors in China to provide sensible judgment on firm's critical decisions, such as related party transactions or mergers and acquisitions.

---

<sup>265</sup> *Ibid.*

<sup>266</sup> Wan, *supra* note 227.

<sup>267</sup> Yin Bocheng & Liu Xiaohua, "On Independent Directors" (2002) 4 Social Science 25 at 27.

Therefore, the independent directors' training and examination should be encouraged.<sup>268</sup> The CSRC has already cooperated with institutions of higher learning in offering training courses to independent directors.<sup>269</sup> For example, Tsinghua University Economic School held a training class for independent directors of the first group of listed companies on July 16, 2001, and 102 thus obtained an independent director's accreditation certificate issued by CSRC.<sup>270</sup> Only those who have received training can fill the posts of independent directors.<sup>271</sup> The first college-run official training class with government entrustment for independent directors drew wide attention of the press and society. This might be a feasible way to improve the qualifications problem of independent directors. It is necessary to take advantages from all areas, such as universities, research institutes, trades societies, intermediary institutions, etc., and develop multiform and multilayer training.

*e. To establish constraints on independent directors*

Until 2006, more than a hundred independent directors have been criticized by the stock exchanges in China.<sup>272</sup> However, except for Lu Jiahao, who has been fined RMB 100,000, none of these independent directors have

---

<sup>268</sup> Xu, *supra* note 258 at 315.

<sup>269</sup> Bei Hu, *Independents Shunned by China Firms*, S. China Morn. Post, Feb. 7, 2004.

<sup>270</sup> *Ibid.*

<sup>271</sup> *Ibid.*

<sup>272</sup> Zhang Wenjun, *Shanghai and Shenzheng Stock Exchanges Criticized Many Independent Directors* Xinmin Net, Dec. 12, 2006, online at <http://biz.xinmin.cn/guancha/2006/12/12/109764.html>

received any related administrative punishment.<sup>273</sup> Nor have they taken any civil or criminal responsibilities for their malfeasance.<sup>274</sup> The fact is that Chinese regulators haven't established any particular provisions of independent directors' liabilities. Therefore, it is necessary to establish constraints on independent directors since an independent director may abuse power for personal gain, or use his right irresponsibly.<sup>275</sup> A sound constraint mechanism may include three aspects: legal liability constraints, reputation mechanism constraints and market constraints.

#### (1) *Legal liability constraints*

Chinese regulators should work on details for legal liability constraint since it is a necessary constraint for independent directors.<sup>276</sup> For example, there should be detailed records on how board proposals are voted, which need to be available at any time.<sup>277</sup> When losses are inflicted on shareholders due to malfeasance, all the directors, including independent directors, should take responsibility for this.<sup>278</sup>

#### (2) *Reputation mechanism constraints*

---

<sup>273</sup> *Ibid.*

<sup>274</sup> *Ibid.*

<sup>275</sup> Li, *supra* note 254 at 261; Li & Zhu, *supra* note 255 at 168

<sup>276</sup> *Ibid.*

<sup>277</sup> *Ibid.*

<sup>278</sup> *Ibid.*

The second one is reputation mechanism constraints. Since most of the independent directors in China are famous professors or business elite, their professional reputations are more valuable to them than money.<sup>279</sup> A non-executive will want to keep his track record intact in order to get future board appointments and lucrative consultancy contracts.<sup>280</sup> Thus, reputation constraints are important for restricting independent directors.

### (3) *Market Constraint*

The third one is market constraints. In developed countries, there are specialized institutions which evaluate the management performance of the corporate officers independently. For example, in order to standardize the independent directors' behavior, China could establish an independent directors guild.<sup>281</sup> Currently, there are more than 5,000 people who work as independent directors in China.<sup>282</sup> However, the business reputation system of the independent directors in China is still underdeveloped. Therefore, an independent directors' guild can be established in order to standardize the conduct of the independent directors.<sup>283</sup> The guild is a civilian self-discipline organization. It may offer trainings, assessment, supervision and restrictions to

---

<sup>279</sup> Wang, *supra* note 224 at 175.

<sup>280</sup> Cheffins, *supra* note 51 at 104.

<sup>281</sup> See Gu Gongyun & Luo Peixin, "On some Legal Problems of Establishing Independent Director System in China" (2001) 6 China Law 65 at 74.

<sup>282</sup> Guo Chunlin, "Let the Independent Directors Enhance Corporate Governance" (2009) 19:1 Journal of Xinyang Agricultural College 69 at 100.

<sup>283</sup> Gu Gongyun & Luo Peixin, *supra* note 281.

independent directors.<sup>284</sup> By offering training and assessment, the guild can enhance the professional moral culture, the knowledge structure, the operation ability and eventually the overall competence of the independent directors. The guild can also build archives for the independent directors by overseeing their daily work. Therefore, when a company wants to hire an independent director, these archives can provide important records which help the company to choose an independent director with a good reputation. This places a market constraint on independent directors. An independent director with a good reputation tends to enjoy a buyer's market; those with a bad reputation are rejected by the market. Such a market selection and competition mechanism can certainly spur independent directors to carry out their duties loyally and discreetly.<sup>285</sup>

*f. To introduce Director and Officer Liability Insurance*

Compared to inside directors, independent directors are faced with higher and more complicated risks. It is unfair and unrealistic to let independent directors assume all the financial loss for the company. This may cause too much pressure to the independent directors. In order to solve this problem, independent directors in western countries mainly rely on director and officer (D & O) liability insurance to lower their risk.<sup>286</sup> D & O liability insurance is a type

---

<sup>284</sup> Deng Li, "The Problems of the Independent Director System in China and Some Suggestions" in Zhang Zongyi, *Corporate Governance: Hot Issues and Positive Analysis* (Beijing: Law Press, 2006) at 163.

<sup>285</sup> Li & Zhu, *supra* note 255 at 168.

<sup>286</sup> Guan, *supra* note 11 at 261.

of property and casualty coverage.<sup>287</sup> Although this insurance is not particularly designed for independent directors, it can provide insurance for independent directors during their job implementation.<sup>288</sup> The D & O policy has two purposes: one is that it protects the corporation from some of the sizable losses it could incur due to its indemnification of its officials against liability, and the other is that it protects the insured officers and directors directly for certain losses against which the corporation does not or cannot indemnify them.<sup>289</sup> D & O insurance provides coverage for directors and officers against the consequences only if their mistakes are honest.<sup>290</sup> Those acts or omissions which compose reckless, willful, or criminal misconduct are usually not insurable.<sup>291</sup>

In China, the guideline and the code suggest that a listed company may purchase liability insurance for their directors. In January 2002, Ping An Insurance of China collaborated with Chubb Insurance Group on the first Director and officer liability insurance in China.<sup>292</sup> China Vanke Co., Ltd. purchased the first D & O from Ping An Insurance of China.<sup>293</sup> That is a profound step for the establishment of China's D & O insurance. In order to let

---

<sup>287</sup> John F. Olson & Josiah O. Hatch, III, *Director & Officer Liability: Indemnification and Insurance* (New York: Clark Boardman Company, Ltd., 1990) at 10-2.

<sup>288</sup> Wang, *supra* note 279 at 183.

<sup>289</sup> *Ibid.*

<sup>290</sup> *Ibid.*

<sup>291</sup> *Ibid.*

<sup>292</sup> Xiaomeng & Duan Chunhua, "Chubb and Safety first introduced Director and officer liability insurance" *Whole View of Net Security Times* (24 January 2002), online: Sina <<http://finance.sina.com.cn>>.

<sup>293</sup> *Ibid.*

the independent directors act effectively as an internal monitoring mechanism, D&O insurance should be compulsory.

*g. To optimize the corporate governance environment for independent directors*

*(1). To build a sound legal system*

In 2005, both China's company law and securities law were revised. Article 123 of the new company law states that listed companies should establish independent directors. However, neither of them has any article which states the rights or obligations of independent directors. At the same time, those independent directors rules and regulations issued by the CSRC do not have enough enforcement power in the Chinese legal system.<sup>294</sup> To solve this problem, China should provide a set of well-defined enforceable and applicable laws. If independent directors are formally and systematically written into China's business laws, the rights and obligations of independent directors can finally be clarified. As a result, the role of independent director in China will eventually have a sound legal foundation.

*(2) To strengthen the cultivation of a favorable corporate governance culture for independent directors*

To cultivate a favorable environment for a system is of great

---

<sup>294</sup> Deng, *supra* 284 at 161.

importance after introducing it.<sup>295</sup> Therefore, it is necessary to foster a favorable corporate governance environment for independent directors.<sup>296</sup> Generally speaking, China does not have a mature corporate governance culture now. Chinese regulators have to realize that whether independent directors can play an active and effective role depends not only on their own initiatives but also to large degree on the internal and external corporate environment. A favorable corporate governance culture is beneficial for the external supervision to be consciously accepted.<sup>297</sup>

### **5.3 Conclusion**

As an important institution in modern corporate governance system, the independent director institution has been practiced in China for nine years. During the process, the independent director institution has not realized CSRC's goal to improve the corporate governance structure and standardize the functioning of listed companies due to China's special situation. On the contrary, many problems are exposed during the nine years. However, it is more important to find solutions to improve the system, rather than to blame it. For China, to improve the independent director institution is a systematic project. In

---

<sup>295</sup> Zhang Li, "On the Cultivation of the Environment of Independent Director System in China" (2004) 11 the Economist

<sup>296</sup> See Liu Xiaojing & Wen Hongzhang, "On the Independence of Independent directors" (2002) 7 Finance Science.

<sup>297</sup> *Ibid.*

addition to perfecting the institution itself, China should also improve its market mechanism, related policies and so on. Chinese regulators have to realize that whether independent directors can play an active and effective role depends not only on their own initiatives but also to large degree on the internal and external corporate environment. I believe if necessary changes are made to China's independent director system, it will take effect eventually.

## 6. Conclusion

As an important measure to improve China's corporate governance, the independent director system has been introduced to more and more listed companies in China. Currently, the independent director system has become the focus of how to perfect China's corporate governance structure. However, since the independent director system is a legal transplant, it is inevitable that there will be many barriers in its practice. Thus, its function of improving China's corporate governance has been largely restricted. Therefore, China's policy makers realized that the introduction of independent director system cannot guarantee the effective operation of the board of directors. However, since China's company law has already introduced the independent director system officially, what China's policy makers should consider is how to improve the system rather than whether or not the system should exist. The independent director system has developed in western countries for a long time. Practice has already proved that the system can obviously improve the corporate governance in listed companies. Since China's situation is different from those western countries, it is inappropriate to simply transplant monitoring mechanisms without considering the unique social-political, legal, and economic environment of China's listed companies. Therefore, what China's policy makers should do is to draw lessons selectively from western countries and to

make innovations of China's own characteristics. At the same time, in order to bring the independent director system into play, China's policy makers have to analyze and research the historical background, features and functions of it carefully and rationally.

This thesis has explored the issue of the independent director system and assessed its recent development in China. The main objectives of this thesis are to identify the problems existing in China's independent director system and to examine the possibilities for solving these problems.

We must be fully aware of the urgency and difficulty in the reform of corporate governance in China. To improve corporate governance in China, the independent director system is only the first step. It is unrealistic to expect the independent director institution alone to solve all the corporate governance problems in China. The improvement of corporate governance structure is a systematic project which contains many factors such as a country's shareholding structure, the current situation of a country's securities market and legal environment. At present, the concentrated shareholding structure in listed companies is one of the major causes of China's corporate governance problem. Any monitoring mechanisms, either internal or external, cannot solve the problems caused by the concentrated state ownership without fundamentally challenging state ownership. In order to solve this problem, China should decrease state ownership of listed companies. Chinese regulators should change

the imbalanced shareholding structure and proscribe insiders from exerting disproportionate influences on the business of listed companies. They should also impose fiduciary duties on those people in control. Another important issue is the lack of efficient and effective judicial intervention. It is necessary to formulate a sound legal institution for the independent director institution to work. Moreover, it is also necessary for China to build a fully developed market economy, a sound legal institution, and a fair judiciary, as well as a fine cultural environment for corporate governance.

The fact that the introduction of independent director system has brought attention and attempt to improve the monitoring mechanisms in China's companies will lead the development of China's corporate governance structure to the right direction. If China's policy makers can eventually solve the existing problems, the independent director system has a better chance of becoming effective in China.

# BIBLIOGRAPHY

## LEGISLATION

*American Law Institute's principles of Corporate Governance.*

*Business Corporation Act, Mich. Stat. 1972 (Act 284, Eff. Jan. 1, 1973; -- Am. 1989, Act 121, Eff. Oct. 1, 1989; -- Am. 1993, Act 91, Eff. Oct. 1, 1993).*

*Code of Corporate Governance for Listed Companies (2002).*

*Company Law of the People's Republic of China (1993).*

*Da Qing Gong Si Lu, 21 January 1904.*

*Detailed Implementation Rules for Training of Independent Director in Listed Companies (2005).*

*German Stock Corporation Act, 1965.*

*Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies (2001).*

*Guidelines for the Articles of Association of Listed Companies (promulgated by China Securities Regulatory Commission, December 16, 1997).*

*Guidance on Independent Directors and External Supervisors of Joint-Stock Commercial Banks (promulgated by People's Bank of China, June 4, 2002).*

*Internal Revenue Code 26 CFR sec. 1. 162-27.*

*Investment Company Act of 1940, 15 U.S.C. 80a-10(a); 15 USC sec. 80a-2(a) (18).*

*Measures on Administration of Securities Companies Draft for Comment*  
(promulgated by China Securities Regulatory Commission, June 20, 2001).

*NASDAQ marketplace rules.*

*NYSE Listed Company Manual, ses. 303.00.*

*Report of the Committee on the Financial Aspects of Corporate Governance*  
(Cadbury Report), December 1992.

*Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. (2002).*

*Securities Companies Measures (promulgated by China Securities Regulatory*  
*Commission, December 28, 2001).*

*Securities Exchange Act of 1934, 17 CFR sec. 240. 16b-3.*

### **SECONDARY MATERIAL: MONOGRAPHS**

Aoki, Masahiko & Kim, Hyung-Ki. eds, *Corporate Governance in Transitional*  
*Economies* (Washington, D.C.: The World Bank, 1995).

Armour, John & McCahery, Joseph A. ed., *After Enron: Improving Corporate*  
*Law and Modernizing Securities Regulation in Europe and the US* (Oxford and  
Portland: Hart, 2006).

Berle, Adolph A. & Means, Gardiner C. *The Modern Corporation and Private*  
*Property* (New York: Macmillan, 1933).

Cheffins, Brian R. *Company Law: Theory, Structure, and Operation* (Oxford:  
Clarendon Press, 1997).

China Reform and Development Institute ed., *The Structure of Corporate Governance in China* (Hainan: Wanwen Press, 1999)

Gan Gongren & Shi Shulin, *On the Legal Systems of Corporate Governance* (Beijing: Peking University Press, 2007).

Guan Xinrong, *Independent Director System and Corporate Governance* (Beijing: China Procurator Press, 2004).

Jian Chen, *Corporate Governance in China* (London and New York: RoutledgeCurzon, 2005).

Jin Yonghong & Xi Yuqin, *The Independent Directors System and Corporate Governance of Chinese Listed Companies* (Beijing: Lixin Accounting Press, 2003).

Koong, Low Chee. ed., *Corporate Governance: An Asia-Pacific Critique* (Hong Kong: Sweet and Maxwell, 2002).

Li Jianwei, *A Research on the Independent Director System: From Bilateral Perspective of Jurisprudence and Management* (Beijing: China People' s University Press, 2004).

Li Jianwei, *Corporate System, Corporate Governance and Corporate Management: The Role and Effectiveness of Law in Corporate Management* (Beijing: People' s Court Press, 2005).

Li Liao, *Corporate Governance and Independent Directors* (Beijing: China Plan Press, 2001).

Li Yulong & Zhu Xiaolei, *Legal Practice of Corporate Governance* (Beijing: Law Press, 2006).

Liang Neng, *Corporate Governance Structure: China's Practice and America's Experiences* (Beijing: China People's University, 2000).

Mei Shenshi, *On the Standardization of Modern Corporate Governance Structure* (Beijing: China Law Press, 2002).

Mei Shenshi, *On the Structure of Modern Company's Organ Power* (Beijing: China University of Politics and Law Press, 2000).

Ni Jianlin, *Corporate Governance Structure: Law and Practice* (Beijing: Law Press, 2001).

Wang Wenqin, *Corporate Governance* (Beijing: China People's University Press, 2005).

Ning Jincheng, *Corporate Governance Structure* (Beijing: Law Press, 2007).

Olson, John F. & Hatch, Josiah O. *Director & Officer Liability: Indemnification and Insurance* (New York: Clark Boardman Company, Ltd., 1990).

Roche, Julian. *Corporate Governance in Asia* (London: Routledge, 2005).

Rosen, Daniel H. *Behind the Open Door: Foreign Enterprises in the Chinese Marketplace* (Washington, D.C.: Institute for International Economics, 1999).

Shanghai Stock Exchange Research Centre, *China Corporate Governance Report 2003* (Shanghai: Fudan University Press, 2003).

Shi Tiantao, *Corporation Law* (Beijing: Law Press, 2007).

State Economic and Trade Committee, *Reform of State-Owned Enterprise* (China: Law Press: 2000).

Tam, On Kit. *The Development of Corporate Governance in China* (Cheltenham, UK: E. Elgar, 1999).

Tricker, R.I. *Corporate Governance* (USA: Ashgate, 2000).

Wang Baoshu & Cui Qingzhi, *the Principles of the Chinese Company Law*, (Beijing: the Social Documents Press, 1998).

Wang Tianxi, *A Research on Corporate Governance and Independent Directors* (Beijing: China Law Press, 2005).

Xie Chaobin, *Research on Legal Regime of Independent Directors* (Beijing: Law Press, 2004).

Xu Ming, *Theory and Practice of Independent Director System* (Beijing: Peking University Press, 2007).

Zhang Zongyi, *Corporate Governance: Hot Issues and Positive Analysis* (Beijing: Law Press, 2006).

Zhao Xudong, *Company Law* (Beijing: higher education press, 2003).

Zhu Ciwen, *Inner Supervision Mechanism of Corporations* (Beijing: Law Press, 2007).

## **SECONDARY MATERIAL: ARTICLES**

### **ARTICLES IN JOURNALS:**

“A Critical Survey of the People’s Republic of China’s New Company Law”  
(1995-1996) 6:2 Ind. Int’l & Comp. L. Rev. 493.

Andre, Thomas J. Jr., “Cultural Hegemony: The Exploration of Anglo-Saxon  
Corporate Governance Ideologies to Germany” (1998) 73 Tul.L.Rev. 69.

Andrews, Neil. & Tomasic, Roman. “Directing China’s Top 100 Listed  
Companies: Corporate Governance in an Emerging Market Economy” (2006)  
2:3 Corp. Governance Law Rev. 245.

Ba Jingyan, “Modification of Monitoring Powers of Supervisory Board” (2004)  
4 Frontier 130.

Cai Lei, “Phenomenon of Concentrated Shareholding and Resolution” (2006)  
Economic Research Guide 59.

Cao Yuankun, “On Transplanting Systems” (1997) 1 Jianghai Academic Journal.

Chen Lixia & Wang Libo, “On Introducing Outside Directors Institution into  
China’s Lised Companies” (2002) 3 Law and Society 37.

Clarke, Donald C. Clarke, “The Independent Director in Chinese Corporate  
Governance” (2006) 31 Del. J. Corp. L. 125.

Clarke, Donald C. “Three Concepts of the Independent Director” (2007) 32 Del.  
J. Corp. L. 73.

Cui Qinzhi, “Analysis on China’s Corporate Governance Structure” (1999) 2  
Law and Society 58.

Dahya J, Karbhari Y & Xia JZZ, “The Supervisory Board in Chinese Listed

Companies: Problems, Causes, Consequences and Remedies” (2002) 9 Asia Pacific Business Review 118.

Gao Minghua Gao & Ma Shouli, “Empirical Analysis on the Relationship between Independent Director System and Corporate Performance: Correspondingly Discussing Institutional Environment for Effective Operation of Independent Director System” 2 Nankai Economic Studies, (2002) 64.

Gu Gongyun & Luo Peixin, “On some Legal Problems of Establishing Independent Director System in China” (2001) 6 China Law 65.

Gu Minkang, “Will an Independent Director Institution Perform Better than a Supervisor? Comments on the Newly Created Independent Director System in the People’s Republic of China” (2003) 6:1 J. Chinese & Comp. L. 59.

Guo Chunlin, “Let the Independent Directors Enhance Corporate Governance” (2009) 19:1 Journal of Xinyang Agricultural College 69.

Guo Feng, “On the Improvement and Innovation of Corporate Governance Structure” (2000) China Securities.

Harshbarger, Scott. & Jois, Goutam U. “Looking Back and Looking Forward: Sarbanes-Oxley and the Future of Corporate Governance” (2007) 40:1 Akron Law Review 1.

He Jianliang, “Affiliated-dealings in Listed Corporation and Oversight” Securities Market Herald (Jan 2002) 50.

He Xiaoxing, “A Comparative Analysis on Advantages and Disadvantages

between the Independent Director System and the Supervisory Board” (2001) 8  
Economics Trends.

Ho, Betty M. “Restructuring the Boards of Directors of Public Companies in  
Hongkong: Barking Up the Wrong Tree” (1997) 1 Sing. J. Int’l & Comp. L. 507.

Jiao Jian, “A Monitoring Mechanism of Modern Companies: the Independent  
Director System or the Supervisory Board” (2002) 2 Modern Law Review.

Jiao Jian, “Independent Directors, Supervisory Board and Modern  
Corporations’ Choices” (2002) 2 Modern Law.

Kong Xiang, “An Comparative Research on the World’s Independent Directors  
Systems” (2002) 8 Management World.

Li Jianwei, “Modification of Supervisory Board in Listed Companies:  
Incidentally Discuss the Relationship between Independent Directors and  
Supervisory Board” (2004) 2 Law Sci. 75.

Li Junjie, “On Introducing Chinese Characteristic Independent Directors”  
Theory and Practice 9 (2002) 74.

Li Kang, Ye ya & Zhang Mingkun, “Study on Resignation Phenomenon of  
Independent Directors”, 1048 Securities Market Weekly (2004) 65.

Lin Lefen, “Empirical Research on the Degree of Concentrated Shareholding”  
(2005) Social Sciences in Nanjing 53.

Liu, Guy S. & Sun Pei, “The Class of Shareholdings and Its Impact on  
Corporate Performance: Composition in Chinese Public Corporations” (2005)

13 Corporate Governance: An International Review 46-51.

Liu Qiao, "Corporate Governance in China: Current Practices, Economic Effects, and Institutional Determinants" (2006) 52:2 CESifo Economic Studies 415.

Liu Xiaojing & Wen Hongzhang, "On the Independence of Independent directors" (2002) 7 Finance Science.

MacNeil, Iain. "Adaptation and Convergence in Corporate Governance: The Case of Chinese Listed Companies" (2002) 2 Journal of Corporate Law Studies 289.

Mar, Pamela. & Young, Michael N. "Corporate Governance in Transition Economies: A Case Study of Two Chinese Airlines" (2001) 36:3 Journal of World Business 280.

Miles, Lilian. & Zhang Zhong, "Improving Corporate Governance in State-owned Corporations in China: Which Way Forward?" (2006) 6:1 J Corp. Law Stud. 213.

Ouyang fen, "On the Comparison between the Independent Director Institution and the Supervisory Board Institution" (2003) Modern Management Science.

Peng Zhenming & Li Jing, "Independent Directors and China's Corporate Governance" (2003) 2 Hubei Economics Academic Journal.

Qian Yingqi Qian, "Enterprise Reform in China: Agency Problems and Political Control" (1996) 4:2 Economics of Transitions.

Qiu Xinhua, "Rethink and Reconstruct the Monitoring System of China's

Companies” (2003) 3 Dezhou Academic Journal.

Salmon, Water J. “How to Gear Up Your Board” 1993 in Harvard Business Review on Corporate Governance (Boston: Harvard Business School Press, 2000).

Schipani, Cindy A. and Liu Junhai, “Corporate Governance in China: Then and Now” (2002) 1:1 Colum. Bus. L. Rev. 1.

Shen Sibao Shen& Jia Jing, “Will the Independent Directors Institution Work in China?” (2005) 27 Loy. L.A. Int’ l & Comp.L.Rev. 223.

Tam, OK. “Ethical Issues in the Evolution of Corporate Governance in China” (2002) 37 Journal of Business Ethics 303.

Tan Layhong & Wang Jiangyu, “Modeling an Effective Corporate Governance System for China’s Listed State-Owned Enterprises: Issues and Challenges in a Transnational Economy” (2007) J Corp Law Stud 7 143.

Wan Cuiying, “Skepticism the Introduction of Independent Director System: Perfecting the Supervisory Board in Chinese Listed Companies” (2002) 23:2 Journal of Hebei University of Economics and Trade.

Wei Yuwa, “An Overview of Corporate Governance in China” (2003) 30:23 Syracuse J. Int’l L. & Com. 23.

Yan hai & Chen Liang, “Research on Independent Directors” (2001) 4 Academic Journal of East China University of Politics and Law.

Yang Xianfeng, “Status quo of Independent Director System in China” (2006)

34:8 Journal of Anhui Agriculture Science 1675.

Yin Bocheng & Liu Xiaohua, “On Independent Directors” (2002) 4 Social Science 25.

Yuan Jie, “Formal Convergence or Substantial Divergence: Evidence from Adoption of the Independent Director System in China” (2007) 9:1 Asian-Pacific Law & Policy Journal 71.

Young, Angus. Li, Grace. & Lau, Alex. “Corporate Governance in China: the Role of the State and Ideology in Shaping Reforms” (2007) 28:7 Company Lawyer 204.

Yu Mengguo, “Independent Directors in Foreign Countries”(2001) 16:5 Journal of Beijing Industrial and Commercial University.

Zhang Chunlin, “Problems in State-Owned Enterprises Transformation “(1996) Chinese Book Review.

Zhang Li, “On the Cultivation of the Environment of Independent Director System in China” (2004) 11 the Economist

Zhang Yihe, “On the Functions of the Supervisory Board and Independent Directors” (2003) Modern Law.

#### **ARTICLES IN NEWSPAPERS AND WEBSITES:**

Chen Huifa, “Empirical Research on Independent Director System and Corporate Performance in the Listed Company”, October 8, 2005.

“Continue to Perfect the Independent Director System in China: China Securities Regulatory Commission Officials’ Response to the Questions Rose by Reporters”, China Securities Journal, February 6, 2004.

“First Guide to Corporate Governance Appears” China Economic Times (6 November, 2000).

Hu Bei, “Independents Shunned by China Firms”, S. China Morn. Post, Feb. 7, 2004.

Hu Helen Wei, “Independent Directors: A New Chapter of the Development of Corporate Governance in China” in Proceedings of the 15th Annual Conference of the Association for Chinese Economics Studies Australia, 2003 at 2.

Huang Chiwei, “Worldwide Corporate Governance Convergence within A Pluralistic Business Legal Order: Company Law and Independent Director System in Contemporary China” (2007), online: <[http://works.bepress.com/chi\\_wei\\_huang/1](http://works.bepress.com/chi_wei_huang/1)>.

Huang Danhan, “Problems Concerning Independent Directors Institution and Its Legal Environment” Corporate Governance Reform: China and World (2002) online: <[http://www.cipe.org/china/cg\\_book.htm](http://www.cipe.org/china/cg_book.htm)>.

“Independent Directors Institution Makes Enterprises Feel Better” Renmin Daily May 22, 2000.

Jiang Lei, “Disputes Arise among Members of an Oil Trade Union: Plan for Accumulating Industrial Investment Fund Is Set Back” Fin. & Econ. Times (18

December, 2004) online:

<[http://www.ce.cn/new\\_hgjj/guonei/cyjj/200412/18/t20041218\\_2610520.shtml](http://www.ce.cn/new_hgjj/guonei/cyjj/200412/18/t20041218_2610520.shtml)>

Jiang Qianguai, “Be a Sincere and Responsible Listed Company Controlling Shareholder” Economic Daily (30 January, 2003), online:

<<http://www.chinainfobank.com>>

Luo Huiling, “Comments on Independent Directors” Chinese Macro Economy News Net (18 May, 2001).

Luo Peixin, “Since the Independent Director System has Drawbacks, Company Law Should not Transplant It.” Nanfang Zhoumo (South Weekend) (4 August 2005).

Pan Qing, “Independent Directors of Listed Companies Will Be No Longer Silent”, International Financial News, December 13, 2006, online:

<[http://paper.people.com.cn/gjjrb/html/2006-12/13/content\\_12106333.htm](http://paper.people.com.cn/gjjrb/html/2006-12/13/content_12106333.htm)>.

Porta, R La. Lopez-de-Silanes, F. & Shleifer, A. “Corporate Ownership Around the World” NBER Working Paper 6625 (June 1998) online:

<<http://www.nber.org/paper/6625>>

“Re-election Notice of the Supervisory Committee of Donghu Gaoxin” Negotiable Securities Times (13 January, 2005) online:

<<http://finance.sina.com.cn/stock/shannounce/20050113/09081291106.shtml>>.

Sun Min, “Director First To Sue Securities Watchdog” China Daily (21 June,

2002)

Tong Lu, “Development of System of Independent Directors and the Chinese Experience” online :<  
<http://old.iwep.org.cn/cccg/pdf/Development%20of%20System%20of%20Independent%20Directors%20and%20the%20Ch%20A1%AD.pdf>>.

Tong Ying, “The Status quo of Independent Directors in China” , Shanghai Securities News, May 27, 2004. online:  
<[http://www.cnstock.com/ssnews/2004-5-27/liuban/t20040527\\_571548.htm](http://www.cnstock.com/ssnews/2004-5-27/liuban/t20040527_571548.htm)>.

Wu Li, “Trends in the Establishment of the Secondary Board Market” People’s Daily (23 August, 2000) 3

Xiang Bing, “Are Independent Directors Just Decorative?”, Hongkong-Macao News Daily, January 1, 2003.

Xiaomeng & Duan Chunhua, “Chubb and Safety first introduced Director and officer liability insurance” Whole View of Net Security Times (24 January 2002), online: Sina <<http://finance.sina.com.cn> >.

Yin Yongqiang, “Doubts on Return of Funds by Big Shareholder of ST Tong Jinma” Securities Times (12 May, 2004).

“Zhang Jizhong and Jia Pingwa Will Be Independent Directors of a Company” (May 13, 2003) online: < <http://cn.ent.yahoo.com/030513/127/1lx6q.html> >.

Zhang Wenjun, “Shanghai and Shenzheng Stock Exchanges Criticized Many Independent Directors” Xinmin Net, Dec. 12, 2006, online at

<http://biz.xinmin.cn/guancha/2006/12/12/109764.html>.

Zhao Shuyuan & Li Wenfeng, “Independent Directors Turned Out To Be Effective: The Importance of Keeping Their Independence” Securities Times  
( December 18, 2002)