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Weighted Voting Rights Under China's New Company Law

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Abstract

This paper examines the revised voting regime under China's new Company Law, which creates different classes of shares, deviating from its enshrined law of one share-one vote. The accompanying safeguards and limitations on protecting minority shareholders are critically discussed with an aim to identify areas for the future reform.

Introduction

After three rounds of draft versions and public consultations since 2021, the sixth amendment to the Chinese Company Law is finally approved on 29 December 2023.¹ The newly amended company law (hereafter “new Company Law”) comes into force on 1 July 2024 and has 266 articles in total. This amendment is the largest-scale amendment since the Chinese Company Law was first promulgated in 1993. It has deleted 16 articles from the 2018 Company Law, added and modified 228 articles, among which 112 articles have undergone substantive modifications. Among changes on capitalisation requirements, directors' duties, shareholder rights, registration/deregistration, the new Company Law permits and introduces different classes of shares, which deviates from the enshrined law of one share-one vote in China.²

Together with the statutory introduction of different classes of shares in art.144, art.116, formerly art.103 of the 2018 Company Law,³ is also revised to provide an important exception by stating that shareholders' voting rights can be different from the one share-one vote basis when a company issues different classes of shares.⁴ In other words, apart from ordinary shares, companies can now issue preference shares with preferential rights to distributable profits or return of capital

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¹ Since the enactment of the first modern Company Law in China on 29 December 1993, it has been subsequently amended in December 1999, August 2004, October 2005, December 2013 and October 2018.

² Chinese Company Law 1993 art.106 clearly stipulated that every share has one vote at shareholder general meeting and remains largely unchanged in the subsequent company law amendments until 2023. For example, art.103 of the Chinese Company Law 2018 stipulated: A shareholder of a company present at a general meeting shall have one voting right for each share held, provided that the company shall have no voting right for the shares held by itself.

³ Chinese Company Law 1993 art.106.

⁴ Chinese Company Law 2023 art.116 states: When a shareholder attends the shareholders' meeting, he shall have one voting right for each share he holds, except for a classified shareholder.

on a winding-up,⁵ shares with more or less voting rights than those of ordinary shares,⁶ shares subjected to transfer and/or other restrictions,⁷ or any other class of shares as prescribed by the State Council.⁸ Such change is of course welcomed as it solves the potential conflict between the enshrined one share-one vote principle and weighted voting rights (also known as special voting power), which was first permitted by the revised listing rules of the Shanghai Stock Exchange in June 2019.⁹

It is noteworthy that among all these newly introduced classes of shares, only those shares with special voting power are the target of the recent controversies and criticism in terms of shareholder inequality, reduced corporate valuation and increased corporate governance risks and moral risks,¹⁰ this paper therefore focusses on para.1(2) of art.144 of the new Company Law, namely the introduction of the shares with weighted voting rights in addition to ordinary voting shares.

Not surprisingly, new challenges arise in relation to investor protection following the statutory introduction of different classes of shares. Articles 144–146 among other provisions under the new Company Law thereby impose safeguards to limit the exercise of the special voting power in the new regime. This paper is going to critically examine the role and impact of these safeguarding measures with reference to the measures taken under the listing rules as well as the practices under English company law, with an aim to identify the potential limitations relating to minority shareholder protection.

Considering this change would not only have a huge impact on over millions of companies in China, but also many foreign investors and their subsidiaries, the findings and recommendation for potential future reforms would be of both theoretical and practical importance. The remainder of the paper is divided into five parts. It would first examine the significant but not unexpected change from the traditional proportionate voting. It then analyses the safeguarding measures relating to the minority shareholder protection, in particular the holders of inferior voting shares or non-special voting shares. After that, the new issues brought by this statutory change as well as other limitations would be discussed. The fourth part considers possible solutions under existing laws and some lessons drawn from the listing rules and English company law. The final part concludes.

⁵ Chinese Company Law 2023 art.144 para.1(1). Though preference shares are used by both listed and non-listed companies since the State Council's *Guiding Opinions on Carrying out Preference Share Pilot Program* in November 2013, this is the first time that preference shares are explicitly recognised at the statutory level.

In addition to the preference shares, this clause also introduces deferred shares which have subordinated rights regarding dividend and capital rights.

⁶ Chinese Company Law 2023 art.144 para.1(2).

⁷ Chinese Company Law 2023 art.144 para.1(3).

⁸ Chinese Company Law 2023 art.144 para.1(4), this is not different from the previous law. See fn.9.

⁹ Chinese Company Law 2018 art.103 states each shareholder present at general meeting shall have one vote per share, but art.131 provides that the State Council may formulate separate regulations for issuance of shares of types other than those provided for in the Company Law (emphasis added). For more discussion, see Min Yan, "Differentiated Voting Rights Arrangement under Dual-Class Share Structures in China: Expectation, Reality and Future" (2020) 28(2) *Asia Pacific Law Review* 337, 341–342.

¹⁰ See Junhai Liu, "To Maximize the Benefit and to Minimize the Cost of the Dual-Class Structure of Listed Companies" [2022] 5 *Journal of Comparative Law* 169. This is unsurprising at all. For example, although preferential rights are attached to preference shares regarding distributable profits or return of capital on a winding-up, they generally have restricted voting rights in general meetings, consequently they are not target of opponents of dual class share structures and weighted voting shares.

The journey to weighted voting rights

One share-one vote is enshrined in China since its first modern Company Law in 1993. The Chinese justification for granting shareholders voting rights commensurate with their shares of residual gains and losses is not materially different from the mainstream economic justification in the West.¹¹ Apart from the perspective of controlling agency costs,¹² shareholder equality is also argued as an important reason for proportionate voting.¹³

However, there was one often ignored statutory provision that provides a leeway to this bedrock principle of corporate voting in China. Article 135 of the 1993 Company law provided that the State Council may formulate separate regulations governing the issue of classes of shares not covered by the statute, which remains unchanged in the five amendments thereafter.¹⁴

The turning point started from the process of permitting companies to list with weighted voting rights amidst the increased popularity of dual class share structures.¹⁵ First, in September 2018, the State Council exercised its statutory power under the company law legislation¹⁶ to permit a class of shares with weighted voting rights that were disproportionate to their economic stakes in the company in its *Opinion on Promoting the High-Quality Development of Innovation and Entrepreneurship and Creating an Upgraded Version of Entrepreneurship and Innovation among all the People*.¹⁷ Then, the China Securities Regulatory Commission, the national securities watchdog, allowed high-tech and innovative companies to get listed on a new Science and Technology Innovation board in the Shanghai Stock Exchange in January 2019. Two months later, the revised Listing Rules of the Shanghai Stock Exchange explicitly permitted applicants with weighted voting rights to list in this newly created board.¹⁸

Here it is interesting to note the uniqueness of the Chinese reform regarding permitting companies to list with weighted voting rights compared with other leading financial centres. Take Singapore for example: before the Singapore Stock Exchange allowed companies to list with weighted voting rights in 2018, Singaporean company law was first amended by enacting a new provision permitting differentiated voting arrangements to replace the old provision on one

¹¹ Ciyun Zhu and Chaohui Shen, “Classified Shares and the Evolution of Chinese Corporate Law” (2019) 9 *Social Science in China* 147, 153.

¹² That is to say each element of the residual proprietary interest is supposed to carry an equal voting right on the ground that the degree to which shareholders would be affected as residual proprietary claimants is in proportion to their economic stakes in the company, shareholders are thereby expected to be appropriately incentivised into choosing, and wholeheartedly supporting, optimal decision-making for the success of the company. See, e.g. Frank H. Easterbrook and Daniel R. Fischel, “Voting in Corporate Law” (1983) 26(2) *Journal of Law & Economics* 395, 409.

¹³ Liu, “To Maximize the Benefit and to Minimize the Cost of the Dual-Class Structure of Listed Companies” (2022) 5 *Journal of Comparative Law* 169, 175–176.

¹⁴ For example, in the fifth amendment, the 2018 Company Law, its art.131 stipulated that State Council may formulate separate regulations for the issuance of shares of types other than those provided for in the Company Law.

¹⁵ Of course, another important usage of this leeway is the preference share under the State Council’s *Guiding Opinions*, which is defined as separate from ordinary shares prescribed under the Company Law legislation. The holders of this class of shares have priority in the distribution of the company’s profits and surplus assets on a winding-up before the ordinary shareholders, but their rights to participate in the company’s decision-making and management are restricted. There are also restrictions regarding the eligibility of companies who can issue preference shares. See *Guiding Opinions on Carrying Out Preference Share Pilot Programme*, No.32 [2018] of the State Council of the People’s Republic of China.

¹⁶ Namely the power under art.131 of the Chinese Company Law 2018, which remained the same as art.135 of the Chinese Company Law 1993.

¹⁷ No.32 [2018] of the State Council of the People’s Republic of China.

¹⁸ More detail can be found in Min Yan, “The Myth of Dual Class Shares: Lessons from Asian Financial Centres” (2021) 21 *Journal of Corporate Law Studies* 397, 415–416.

vote per share.¹⁹ And for other jurisdictions which recently reformed their listing rules in order to permit listing applicants with weighted voting rights, like the Hong Kong or the United Kingdom (UK), there were no restrictions on differentiated voting arrangements for non-listed companies at the statutory level.²⁰ Nonetheless, China first reformed its listing rules to explicitly acknowledge and permit shares with weighted voting rights as distinct from the ordinary type of shares prescribed by the company law legislation, but left the law on one share—one vote untouched until now.

Although the traditional proportionate voting principle has been circumvented under the revised Listing Rules in March 2019 when permitting companies to list with weighted voting rights, the one share-one vote principle under Chinese Company Law remains unchanged. Such clashes certainly caused unnecessary confusion and uncertainty for both entrepreneurs and investors alike. As observed and argued elsewhere, the clash in the Chinese context can only be addressed by amendments of law by adding “unless otherwise stipulated in the articles of association of the company” after “shareholders present at a general meeting shall be entitled to one vote for each share held”.²¹

In other words, the statutory introduction of different classes of shares, particularly shares with weighted voting rights, is not completely unexpected. But that does not affect the significance of this change from the traditional one share-one vote regime. Under the new voting regime, companies can issue multiple classes of shares that differ from the single voting shares, namely some shares can have greater voting rights.²²

Safeguarding measures accompanying the change

This statutory change undoubtedly helps solve the clash and confusion caused by the permission of weighted voting rights by the listing rules since 2019. It also provides flexibility for firms, especially for the founders who wish to maintain the control of their firms when reducing their shareholdings to attract external investment.²³ Unsurprisingly, the main problem is minority shareholder protection as extensively discussed during the revival of listings with weighted voting shares.²⁴ When formally acknowledging and introducing different classes of shares, other classes of shares that differ from ordinary shares are collectively called “*Leibie Gu*” (namely, “classified shares”) under China’s new Company Law,²⁵ safeguarding

¹⁹ The newly enacted s.64A repeals s.64 and permits public companies to issue shares with differentiated voting rights, conferring special, limited, conditional or no voting rights. See Companies (Amendment) Act 2014 (No.36 of 2014) s.33.

²⁰ In fact, as observed by Dunlavy, weighted voting rights or voting arrangements other than one vote per share were actually the mainstream in many jurisdictions in the long history. Colleen Dunlavy, “Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights” (2006) 63 *Washington & Lee Law Review* 1347, 1359–1360.

²¹ Min Yan, “Differentiated Voting Rights Arrangement under Dual-Class Share Structures in China: Expectation, Reality and Future” (2020) 28(2) *Asia Pacific Law Review* 337, 341.

²² Chinese Company Law 2023 art.144 para.1(2). And unlike the listing rules that only allow tech and innovative firms to list with weighted voting shares, art.144 does not have similar restrictions.

²³ The arguments in favour of listings with weighted voting rights on the point that such flexible capital structures may provide more investment opportunities for investors may be equally applied here, as the founders will not be afraid of losing control via dual class shares when attracting external investment.

²⁴ See, e.g. Lucian Bebchuk and Kobi Kastiel, “The Perils of Small-Minority Controllers” (2019) 107 *Georgetown Law Journal* 1453; Min Yan, “Permitting Dual Class Shares in the UK Premium Listing Regime—A Path to Enhance rather than Compromise Investor Protection” (2022) 42(2) *Legal Studies* 335.

²⁵ Chinese Company Law 2023 art.144.

measures are adopted relating to these classified shares, which principally include additional disclosure requirements and restrictions imposed on exercising special voting power.

Disclosure in the company's constitution

Article 145 of the new Company Law, added at a fairly late stage,²⁶ requires companies adopted different classes of shares must include: (1) the order of classified shares in receiving distributable profits or surplus assets on a winding-up; (2) the number of voting rights attached to classified shares; (3) restrictions on the transfer of classified shares; (4) measures to protect the rights and interests of minority shareholders; and (5) other matters deemed necessary by the shareholders' meeting in the company's articles of association.

The above measures are designed to promote transparency, but clearly classified shares with weighted voting rights is not the focus of art.145.²⁷ If protecting minority shareholders against controlling shareholders with special voting power is a priority, then the additional disclosure requirement should also be designed to reduce the cost and difficulty for investors to obtain information and facilitate supervision. A good reference is the enhanced disclosure obligation imposed by the listing rules when stock exchanges permitting differentiated voting arrangements. For example, when China permitted companies to list with weighted voting rights in 2019, the revised listing rules imposed enhanced disclosure obligations regarding the corporate governance risks associated with special voting power, the details of the shareholders holding special voting shares as well as the quantity of these shares among others.²⁸ Although it may be an onerous requirement for those non-listed companies to include all this information, not mentioning a single word except the number of voting rights attached to special voting shares undoubtedly disadvantages the protection of minority shareholders.

While it may be argued that the new Company Law does require disclosure of measures relating to minority shareholder protection, which can potentially include those holders of non-special voting shares or inferior voting shares, but compared to requirements under the listing rules, the implementation of these measures and supervisory board's independent view on compliance of shareholder protection mechanisms and abuse of special voting power among others are not required to be disclosed in companies' annual or periodic reports.²⁹ This will lead to less checks on the controllers.

²⁶The additional disclosure requirement was only added into the Bill since the second draft version that published on 30 December 2022.

²⁷For example, the priority order in receiving distributable profits or return of capital on a winding-up is primarily relevant to preference shares *versus* ordinary shares.

²⁸Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange art.4.5.1. Furthermore, specific opinions of the supervisory board of companies with weighted voting rights on compliance of shareholder protection mechanisms and abuse of special voting rights among others is solicited and required to publish in the company's annual reports, which also aims to provide more check on the controllers. See Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange art.4.5.12. Similar disclosure requirements can also be found in the Hong Kong and Singapore Stock Exchanges' revised listings rules when permitting listing with weighted voting rights, see HKEx Main Board Listing Rules rr.8A.32 and 8A.37–41; SGX Mainboard Rules, rr.610 and 1207.

²⁹Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange art.4.5.1.

Restrictions on special voting power

For the weighted voting rights, apart from the additional disclosure requirement, safeguarding measures are essential to check the exercise of the special voting power. For listed companies with weighted voting rights, there are mechanisms limiting controllers' disproportional voting rights on matters involving fundamental corporate changes or potential conflicts of interest, where their weighted voting shares would temporarily convert to ordinary voting shares.³⁰ However, the new Company Law only touches upon the potential conflicts of interest in relation to the election and replacement of supervisory board members and members of the audit committee, where weighted voting shares temporarily have the same voting rights as ordinary voting shares.³¹ There are no similar restrictions on the exercise of special voting power on matters involving fundamental corporate changes such as the amendment of company's constitution, increase or reduction of the registered capital, merger, division, dissolution, or change of the company form.

Under Chinese Company Law, a special resolution is required to make fundamental corporate changes, namely shareholders representing two-thirds or more of the voting rights of the shareholders in presence are in favour of the resolution.³² When the above fundamental corporate matters, among others, come to affect the rights of shareholders holding non-ordinary shares, for example preference shareholders, art.146 mandates that companies also need to obtain an approval of more than two-thirds of the voting rights at a separate meeting of the holders of that class of shares.³³

Such double supermajority rule, like the requirement for variation of class rights under the s.630(4) of the Companies Act 2006 in the UK, is designed to protect class rights and make it more onerous for controllers to make these changes that may affect class rights, e.g. preferential rights attached to preference shares.³⁴ Although this can also apply to the context of inferior voting rights, the reality is that the difference between weighted voting shares and single voting shares under art.144 para.1(2) is the number of votes they have while all other rights are same.³⁵

³⁰ In listed companies with weighted voting rights, according to art.4.5.10 of the Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange, shares with weighted voting rights will temporarily have the same voting rights as ordinary voting shares in cases like (1) amendments to the company's articles of association; (2) change of number of voting rights for superior voting shares; (3) the appointment or dismissal of independent directors; (4) the engagement or dismissal of an accounting firm which issues audit opinions on the periodic reports of the company; and (5) the merger, division, dissolution or change of legal form of the company.

³¹ Chinese Company Law 2023 art.144 para.2 states: "Where a company issues classified shares as specified in paragraph 1(2) of this article, each classified share shall have the same number of voting rights as common shares on the election and replacement of supervisors or members of the audit committee".

³² Chinese Company Law 2023 art.116 para.3.

³³ Chinese Company Law 2023 art.146 states: "Where a company issuing classified shares has any matter specified in paragraph 3 of Article 116 of this Law, among others, that may affect the rights of classified shareholders, the matter shall be subject to the approval of more than two-thirds of the voting rights held by shareholders present at the classified shareholders' meeting, in addition to the resolution of the shareholders' meeting according to paragraph 3 of Article 116". The second paragraph of this article continues to specify that individual companies can decide what other matters need to be subject to the resolution of the classified shareholders' meeting.

³⁴ However, unlike the protection provided under the UK Companies Act 2006 s.630(5), classified shareholders do not have the right to object to a variation even if it would unfairly prejudice the shareholders of that particular class under the Chinese law.

³⁵ To this extent, shares with weighted voting rights are regarded as another class of ordinary shares. That is why companies issuing shares with weighted voting rights are commonly rereferred to as companies having dual class share structures. Additionally, conferring or altering weighted voting rights on one class of shareholders does not necessarily constitute a variation of the class rights of other classes of shareholders.

Unless it concerns the alteration of voting rights, such double supermajority rule would not be applicable.³⁶

Moreover, like art.145, the double supermajority requirement for variation of class rights under art.146 is not targeting the special voting power, thus intrinsically different from safeguarding measures under those listing rules, which are designed to control the exercise of the special voting power as discussed above.

Extension of fiduciary duty

Last but not least, the new Company Law imposes the duty of loyalty to the company upon controlling shareholders who are de facto directors³⁷ or shadow directors.³⁸ While the extension of the duty of loyalty to controlling shareholders is not directly related to the introduction of *classified shares*, for shareholders who want to maintain the control by holding weighted voting shares, they will be subject to the duty of loyalty to avoid conflicts between their own interests and the interests of the company, and not use their powers to seek improper interests. When such controlling shareholders breach this duty of loyalty and use their special voting power to seek self-interests at the expense of the interests of the company when dealing with corporate affairs, minority shareholders can initiate a derivative action on behalf of the company.³⁹ This can to some extent hold controlling shareholders with weighted voting shares more accountable.

Limitation of minority shareholder protection

Deviating from one share-one vote essentially means granting shareholders voting rights not commensurate with their shares of residual gains and losses, leading to a separation between voting rights and ownership rights, which is considered by many as a significant corporate governance problem.⁴⁰ Accordingly, safeguards are needed to control the increased agency costs and moral risks due to such separation.

However, as exhibited above, disclosure obligation on classified shares, double supermajority requirement and controlling shareholders' fiduciary duties under the new Company Law are not specifically targeting the separation between voting rights and ownership rights. Besides these measures, there are no other safeguards

³⁶ Furthermore, the classic scenario for companies with dual class share structures is that Class A shares have ordinary voting rights while Class B shares have multiple voting rights, which means holders of superior voting shares can simply choose to change rights attached to Class B shares circumvent the double supermajority rule on minority protection.

³⁷ Chinese Company Law 2023 art.180 revised the previous art.147 of the Chinese Company Law 2018 on directors' duty of loyalty, adds that the duty of loyalty for directors, supervisors, and senior executives shall be applied to a controlling shareholder if they are involved in the company's affairs.

³⁸ Chinese Company Law 2023 art.192, which is a newly added provision, states where the controlling shareholder or actual controller of a company instructs a director or officer to engage in an act against the interests of the company or shareholders, the controlling shareholder or actual controller shall be jointly and severally liable with the director or officer.

³⁹ Shareholders holding 1% or more of the total shares of the company for 180 consecutive days or more may request in writing the board of supervisors to initiate a lawsuit against wrongdoing directors or officers. If the board of supervisors refuses to lodge a lawsuit after receiving the written request, or if they fail to initiate a lawsuit within 30 days after receiving the request, or if, in an emergency, the failure to lodge an action immediately will cause unrecoverable damages to the interests of the company, the shareholders may, on their own behalf, directly lodge a lawsuit in the court. See Chinese Company Law 2023 art.189.

⁴⁰ See, e.g. Zhu and Shen, "Classified Shares and the Evolution of Chinese Corporate Law" (2013) 9 *Social Science in China* 144, 153.

as we can find in the listing rules, such as mechanisms that limit controller's disproportional voting rights on matters involving fundamental corporate changes,⁴¹ additional disclosure requirements regarding the corporate governance risks associated with weighted voting rights,⁴² limitations on the maximal voting differentials between weighted voting shares and ordinary voting shares.⁴³ Moreover, the sunset provisions, in particular those event-based sunsets—namely superior voting shares can be converted into single voting shares at a particular future date when a pre-specified event is triggered,⁴⁴ cannot be found in the new Company Law, which suggests the possibility of perpetual retention of superior voting rights.⁴⁵ All these indicate potential risks to minority shareholder protection are not adequately controlled as they are in the capital markets.

Apart from the lack of corresponding safeguarding measures that are available under the listing rules, another important limitation is the lack of market discipline. Companies that adopt different classes of shares according to the new Company Law may not necessarily have a ready market for their shares. It can then be very difficult for inferior voting shareholders and investors alike to sell their shares and leave the company when they are dissatisfied.⁴⁶ By the same token, an underperforming company with such share structures would not necessarily be disciplined by the market, such as through a decreasing share price. The entrenchment issue of the existing management would, therefore, be more severe. In short, the disciplinary measures available for publicly traded companies with weighted voting rights under the capital markets will not be effective either.

Not only are the *ex ante* safeguards absent, but the *ex post* remedies such as representative civil litigation under the Securities Law⁴⁷ and the China Securities Investor Services Centre⁴⁸ which provide support for public interest litigation would also be practically infeasible to the non-listed firms.⁴⁹

Looking forward

As already discussed at length elsewhere, restrictions on the superior voting rights on certain matters, limitations on the maximal voting differentials, enhanced disclosure obligations, and mandatory sunset clauses among other safeguarding measures can effectively help to mitigate the governance risks and agency costs

⁴¹ Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange art.4.5.10. Also see fn.30.

⁴² Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange, art.4.5.1.

⁴³ It is capped at 10:1, namely the high/low vote ratio should not exceed 10 to one. Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange, art.4.5.4.

⁴⁴ Rules Governing the Listing of Stocks on the Science and Technology Innovation Board of Shanghai Stock Exchange, art.4.5.9.

⁴⁵ For more discussion on perpetual retention of superior voting rights, see e.g. Yan, "The Myth of Dual Class Shares: Lessons from Asian Financial Centres" (2021) 21(2) *Journal of Corporate Law Studies* 397, 422–423.

⁴⁶ Not only would the so-called "vote by feet" become ineffective, but the ability for prospective shareholders to discount on shares with inferior voting rights would also be constrained.

⁴⁷ Chinese Securities Law 2019 art.95.

⁴⁸ The China Securities Regulatory Commission established the China Securities Investor Services Centre in December 2014 to hold 100 shares in each listed company in China for the sole purpose of exercising shareholder rights on behalf of minority investors and to represent them in court. See International Monetary Fund, *People's Republic of China: Financial Sector Assessment Program*, IMF Country Report No.17/404 (December 2017).

⁴⁹ Min Yan, "The Current Debate and Future Development of Dual-Class Share Structures in China" (2024) 54(1) *Hong Kong Law Journal* 135, 154.

arising from the separation between control rights and ownership rights.⁵⁰ However, those safeguarding measures that are designed to address corporate governance risks for listed companies with weighted voting rights are not applicable to those companies adopting different classes of shares under the new Company Law. Admittedly, there is a significant difference in scale between listed companies and most non-listed ones, particularly in terms of investor protection,⁵¹ however this does not diminish the necessity of protecting minority shareholders.

The extension of the duty of loyalty to controlling shareholders when dealing with corporate affairs,⁵² together with the derivative action, which was introduced in 2005,⁵³ appear to offer some protection for minority shareholders, including in the context of weighted voting rights.

The prior-2023 regime also has a similar implicit requirement for those taking part in the decision making to act in the interests of their company and not put self-interests before the interests of the company. Although the derivative action regime in China mainly targets wrongdoing directors and officers, shareholders can also be sued under the catch-all phrase that “other people” harmed the interest of the company.⁵⁴ And empirical studies do find shareholders are the largest group being sued under derivative action in China.⁵⁵

Apart from the ability to initiate derivative actions on behalf of the company, Chinese Company Law also provides that “a shareholder of the company shall be liable for any loss caused to the interests of the company or other shareholders by abusing shareholder’s rights”.⁵⁶ Such statutory remedies, like oppression claims for minority shareholders at common law, can also potentially play a vital role in protecting minority shareholders in terms of weighted voting shares among other matters. In other words, the Chinese derivative action can be used by minority shareholders in situations when their interests are oppressed by holders of weighted voting shares.⁵⁷ It should also be noted that companies involved in these cases are so far mainly limited liability company, while joint stock limited companies—which are generally larger and able to raise capital from the public—are extremely rare in these cases.⁵⁸

The dilemma arises when no law or fiduciary duty is breached. It is not uncommon that actions leading to minority shareholder oppression can appear to be in conformity with the company law legislation, administrative regulations and the articles of association, which means standards set in arts 21, 180 or 189 of the new Company Law are not met. Limiting the standard to the breach of

⁵⁰ See e.g. Min Yan, “A Control-Accountability Analysis of Dual-Class Share (DCS) Structures” (2020) 45(1) *Delaware Journal of Corporate Law* 1–48; Yan, “The Current Debate and Future Development of Dual-Class Share Structures in China” (2024) 54(1) *Hong Kong Law Journal* 135.

⁵¹ To this extent, it is understandable not having very strict regulatory measures as those under the listing rules to mitigate the additional corporate governance risks that weighted voting rights may pose.

⁵² Chinese Company Law 2023 art.180.

⁵³ Chinese Company Law 2005 art.152, and now art.189 of the Chinese Company Law 2023.

⁵⁴ Chinese Company Law 2005 art.152, and now art.189 of the Chinese Company Law 2023.

⁵⁵ See Jingchen Zhao and Chuyi Wei, “Shareholder Remedies in China—Developments towards a More Effective, Accessible and Fairer Derivative Action Mechanism” (2021) 16 *Capital Markets Law Journal* 445, 453.

⁵⁶ Chinese Company Law 2023 art.21. Further, art.190 allows shareholders to lodge a lawsuit in the people’s court when their legitimate interests are damaged by directors or senior managers’ violation of any law, administrative regulation, or the company constitution.

⁵⁷ For example, see Nicholas C. Howson, “Fiduciary Principles in Chinese Law” in Evan Criddle, Paul Miller and Robert Sitkoff (eds), *The Oxford Handbook of Fiduciary Law* (New York: Oxford University Press, 2018), pp.603–622.

⁵⁸ Howson, “Fiduciary Principles in Chinese Law” in Criddle, Miller and Sitkoff (eds), *The Oxford Handbook of Fiduciary Law* (2018), pp.603–622.

law/regulations or breach of fiduciary duties⁵⁹ may set the bar too high to trigger shareholder remedies.

A useful lesson can be drawn from the English company law regarding the good faith requirement. In the UK, different voting rights arrangements are not uncommon,⁶⁰ and the House of Lords also confirmed the effectiveness of clauses creating classes of shares with weighted voting rights.⁶¹ However, the majority is required to exercise their power bona fide for the benefit of the company as a whole and subject to those general principles of law and equity.⁶² For instance, any constitutional amendments can be set aside by courts if the powers are exercised by controlling shareholders not for the benefit of the company as a whole. If a company wishes to issue a new class of shares with weighted voting rights, the additional “good faith” requirement would help ensure the change is for the benefit of the whole company rather than just a small group of shareholders. As a result, to have a more overreaching requirement/obligation to act in good faith may provide better protection for minority shareholders.

In a nutshell, if those safeguarding measures contained in the listing rules cannot be easily replicated at the company law legislation level, the threshold for minority shareholders to seek remedies should be lowered. When controlling shareholders do not act in good faith but their oppressive action falls short of breach of law or breach of company’s constitution, the ability of minority shareholders to bring a complaint about the oppression would not only provide some more protection but also serve as a deterrent to the potential abuse of special voting power.⁶³

Conclusion

The statutory recognition and introduction of different classes of shares (i.e. classified shares), especially the inclusion of weighted voting shares, represent an important step forward. In addition to resolving the clash between the listing rules and company law legislation on the one share-one vote principle, it allows founders to retain control with a small percentage of share ownership in all types of companies and offers flexibility for investors both domestically and internationally.

The heightened corporate governance risks resulting from this statutory change is also not a novel issue. While the extension of the duty of loyalty to controlling shareholders who are de facto director or shadow director under the new Company Law certainly aligns the standard with other jurisdictions and has the potential to hold those with weighted voting rights accountable, the market disciplines and corporate governance checks available for listed companies are absent for those non-listed companies. The lack of common law good faith check would also mean shareholders with inferior voting rights in Chinese companies may not be protected

⁵⁹ In particular the duty to avoid conflicts of interests by seeking private benefits at the expense of corporate interests under art.180 of the new Company Law.

⁶⁰ When facing the emerging hostile takeover market and the threat of hostile takeovers in the mid-20th century, companies are used to issue different classes of ordinary shares, such as voting shares to insiders and non-voting or limited-voting shares to external investors. Yan, “Permitting Dual Class Shares in the UK Premium Listing Regime—A Path to Enhance rather than Compromise Investor Protection” (2022) 42(2) *Legal Studies* 335, 338.

⁶¹ *Bushell v Faith* [1970] A.C. 1099; [1970] 2 W.L.R. 272 HL.

⁶² For example, in the context of alteration of articles and variation of class rights, see *Allen v Gold Reefs of West Africa Ltd* [1900] 1 Ch. 656 CA at 671.

⁶³ The unfair prejudice petition under the English company law can be a good reference for the Chinese company law.

to the same extent as their counterparts in the UK for example. We should closely monitor the effectiveness of existing safeguards now that the newly revised Company Law has come into force and be prepared for further reforms to strengthen minority shareholder protection.