

INFORMATION DISCLOSURE OF STATE-OWNED ENTERPRISES IN CHINA

Xu Xuelei and Xu Xin

TABLE OF CONTENTS

I. INTRODUCTION.....	3
II. REFORMS OF SOES AND ITS INFORMATION DISCLOSURE	
REGIME: EX ANTE AND EX POSTE.....	5
A. Setting Objectives: Ex Ante.....	5
B. Legalizing the State-planning Economic Activities: From SOUs to SOEs	6
C. Corporatization in Economic Sectors: From SOEs to Incorporation.....	8
D. Ongoing Corporate Governance Reform	9
III. GROUNDS OF INFORMATION DISCLOSURE	9
A. The Traditional Approach: Shareholder Ownership Theory and Inspection Right.....	10
1. Shareholder's ownership	10
2. Quasi-ownership	11
3. The Right to Inspection Reduces Costs Caused by the Conflict of Interests	12
B. Political Ownership Approach: The Ultimate Shareholders of SOE.....	13
1. Basis of Assets in Government.....	13
2. Basic Regulation Regime of State-Owned Corporation	15
3. Inspection Right.....	16
C. Public Function Theory.....	17
D. Other Foundations.....	18
1. Information Accessibility as a Basic Human Right.....	18
2. Transparency reduces Social Cost.....	19
3. Information Flow Prevents Corruption and Bribery.....	19
IV. CURRENT INFORMATION DISCLOSURE REGIME	20
A. Current Information Flow of State-Owned Companies.....	20
1. Listed SOEs	20

2. Non-listed SOE.....	21
B. Studies of Australia, Sweden and Austria's Practices	23
V. INFORMATION DISCLOSURE REFORM PROPOSAL: A	
MULTILEVEL SYSTEM.....	24
A. Adjusting the Goals.....	24
1. Goals of the Government.....	26
2. Goals of the SOE	27
B. Approaches: Listed and Non-listed.....	28
1. Listed SOEs	28
2. Non-listed SOEs	30
C. Re-Taxonomy of Information	30
1. Corporation Information.....	31
2. Selected Information.....	33
C. Information Flow Between SOEs and Shareholders:	
Internal Information Flow and External Audit	37
D. Information Flow Between SOEs and the Public:	
External Information Flow Control	38
VI. MECHANISM OF INFORMATION FLOW.....	38
A. Information Flow and Competitive Market	39
B. Information Flow and Society Supervision	40
1. Employees	40
2. Local Community	41
3. Dividends to the Chinese Citizens.....	41
4. Information Disclosure and the "Shareholders' Vote"	42

INFORMATION DISCLOSURE OF STATE-OWNED ENTERPRISES IN CHINA

Xu Xuelei and Xu Xin***

Abstract

State-owned enterprises (SOEs) of the People's Republic of China are criticized for their inefficiency. This article is dedicated to finding the appropriate solution to the conflict of interests caused by state representation of SOEs. The article suggests that the SOEs should build up a multi-level system of information disclosure to their ultimate owners, the Chinese people. In this article, the author spends substantial effort in examining who owns the SOEs and thus whose interests may be infringed for their limited liability. Through evaluation of the past SOEs reforms, the article proposes new goals for the information disclosure system. It also discusses how ordinary people can make use of the information disclosure system to maximize their goals.

I. INTRODUCTION

The state is a long-lasting and essential equity holder in both socialist and capitalist economies in both the developing and developed worlds.¹ A *state-owned enterprise* (hereinafter referred to as “SOE”) refers to a limited liability company invested and formed solely or partially by a state organ, state-controlled institution, state-authorized investment company or a department authorized by the state.² The SOE not only operates as a main market player, but also undertakes the execution of fundamental social mandates in China. Previous experience and the success of the “China Model” demonstrate the importance of maintaining state-ownership. However, despite its success, criticisms of state ownership have not diminished. Side effects, including but not limited to inefficiency, corruption and unreasonable costs threaten the SOE system.

* SJD candidate, Tulane University Law School, USA.

** China law consultant, Weil, Gotshal & Manges LLP.

We want to take this opportunity to sincerely thank Professor Stavros Gadinis and Professor Richard M. Buxbaum for their generous advice and valuable comments. Without their encouragement and inputs, we could not reach this outcome. However, any defects or flaws are, of course, our own.

¹ Notes from Professor Stavros Gadinis's instructions.

² See GU MINKANG, UNDERSTANDING CHINESE COMPANY LAW 79 (2006) (pointing that from this definition, there are two major elements; firstly, a SOE is formed by special investors, i.e. the state-authorized investment institution or a department authorized by the state, secondly, SOE is a form of corporation, with the nature of a normal corporation).

One frequent criticism leveled against the SOE system is that people such as the ordinary private shareholder who bear the risk of business under the existing economic rules are not in an adequate position to anticipate government officials' behavior. State officials³ who are not the ultimate "owners" of the SOE represent and act on behalf of the SOE as its representative, and it is difficult to expect these state officials to work in the best interest of the SOE, regardless of its ownership. Therefore, the true owners in China are not capable of knowing the actions of the company's representatives. The only restriction is internal, as no external party is allowed to supervise the SOE, except for those listed in stock exchanges. In such a system, the interests of the SOE are compromised when the representatives do not share the same principles.

The natural question then is who owns the SOE and whose interests may be infringed. The short answer to this question is the Chinese people or Chinese citizens. The concept of a social regime of socialist and communist governors strongly affects some basic characteristics of SOEs in China.⁴ The traditional theory regards the people as the sovereign body, as all public assets belong to them according to the abstract concept of the "people" as per the Constitution of the People's Republic of China (hereinafter referred as "PRC"). As such, the SOE, as a public asset, belongs to the people. In this article, we refer to the people as the Chinese citizens.⁵

³ If not defined specifically, state officials refer to officials in all levels of governments.

⁴ Briefly, although in China, the problems derive from the similar agency conflict between "shareholders" and "directors", SOE in China dominate in the majority, or at least in the most fundamental industries in China, such as the gasoline, chemistry, food and military industries. The SOE should dominate and control following industries: state security related, monopoly industry formed because of the nature of the industry, industries providing significant public goods and services, as well as the fundamental industries and main companies in high technology industries, see *Zhonggong Zhongyang Guanyu Guoyouqiye Gaige He Fazhan Ruogan Zhongdawenti de Jueding* (中共中央关于国有企业改革和发展若干重大问题的决定) [*Several Decisions of the Central Committee of the Chinese Communist Party Regarding the Reform and Development of SOE*], GUANGMING RIBAO (光明日报) [GUANGMING DAILY], Sept. 27, 1999, at 1 (explaining that the SOE should dominate and control following industries: state security related, monopoly industry formed because of the nature of the industry, industries providing significant public goods and services, as well as the fundamental industries and main companies in high technology industries).

⁵ The population of China is highly involved in the activities related to these companies, from employment and education to consumption, social welfare and social insurance, all of which are highly reliant or related to the activities of the SOE, see Guoqi Lirun Fenpei you Lifa he Guanli Bumen Juece: Ying Rang Quanguo Renmin Gongxiang (国企利润分配由立法和管理部门决策: 应让全国人民共享) [Distribution of SOEs' profit to be determined by the Legislature and the Administration: It Shall be Shared Among the People], 2011 Quanguo Lianghui (2011全国两会) [Two National Conference of 2011] (Mar. 5, 2011, 20:32), <http://2011lianghui.people.com.cn/GB/214392/14069361.html> (explaining that the profit of SOE should be distributed between the government and the public, with a ration of 10%, 15%, or even 30%).

The final question is how to solve the conflict of interests caused by state representation. One solution would be privatization. Countries and governments in Europe have chosen to privatize state owned enterprises through a number of approaches.⁶ Nevertheless, empirical evidence has shown that these approaches, albeit well developed in Western countries, have been ineffective in a number of Eastern countries,⁷ whose reasons are extremely complicated. Most importantly, privatization is impracticable under the current Chinese regime and unlawful under its Constitution. Thus, here, we propose a more realistic solution: sufficient and adequate information disclosure by SOEs to their ultimate owners, the Chinese people.

II. REFORMS OF SOES AND ITS INFORMATION DISCLOSURE REGIME: EX ANTE AND EX POSTE

A. *Setting Objectives: Ex Ante*

During the preliminary stages of SOE corporate governance reform, objectives of such corporate governance should be clearly defined. A list of general objectives of corporate governance includes, but not limited to, maximization of profit, production or management efficiency (reduction of costs caused by a conflict of interests), and protection for investors' or shareholders' rights.⁸

However, these objectives have not always been consistently pursued by SOEs in the past reforms. First, a fundamental dilemma of these objectives stems from the fundamental state policy of maintaining control of various enterprises across several sectors, even at the cost of sacrificing other objectives. In addition, the state also wants these SOEs to operate efficiently, as per the list of objectives above, but not solely for the purpose of wealth or production maximization for the people. Thus, the basic objectives of the government are not aligned with those of the people, the true "shareholders" of the SOEs (will be discussed below).

The list of current objectives of the government can be traced back to a comprehensive concept of "development" (*fazhan*)

⁶ Examples are England, France and Soviet Union, see John C. Coffee, Jr., *The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control*, 111 YALE L.J. 1 (2001).

⁷ Dieter Bos, *Privatization in Europe: A Comparison Of Approaches*, 9 OXFORD REV. ECON. POL'Y 95 (1993).

⁸ See Jian Chen., *Ownership Structure as Corporate Governance Mechanism: Evidence from Chinese Listed Companies*, 34 ECON. OF PLANNING 53 (2004).

enshrined in the “governors group.”⁹ One illustration is the “harmonious society” (*hexie shehui*) theory, in which the GDP is assigned relatively little importance. Instead, comprehensive and harmonious development, including the welfare of citizens and the environment, is central to the new concept.¹⁰ We may conclude that “development” is not in conflict with the interest of the Chinese citizens. Further details of this concept were illustrated in the development of the SOE.

B. Legalizing the State-planning Economic Activities: From SOUs to SOEs

China originally introduced the concept of “state-owned units” (hereinafter referred as “SOU”) as a form of economic entity, adopted from the Russian model.¹¹ In 1949, when the PRC was established, the new government declared that it would inherit all the assets of the old government as well as the companies and assets of the “Four Big Families” (*sida jiazu*) from the Republic of China (hereinafter referred as “RC”).¹² Subsequently, reform was undertaken in the following five years with the purpose of establishing socialist political institutions, which included transforming the “Four Big Families” assets into state-owned assets.¹³ Politically, the government proclaimed itself to be the People’s Government, in which the people had the ultimate power of the government. These state-run organizations were subsequently named SOUs, although they were constructed without any formal legal basis.¹⁴ These SOUs played the significant role of “commanding heights” in the state-planned economy. In this stage, SOUs were simply organs or departments of the government, which serve for the sole purpose of controlling the national economy.¹⁵

⁹ The “governors’ group” hereby refers to the governors collectively in the P.R.C. history.

¹⁰ Fang Liufang, *China’s Corporatization Experiment*, 5 DUKE J. COMP. & INT’L L. 149, 170 (1995).

¹¹ Xinqiang Sun, *Reform of China’s State-Owned Enterprises: a Legal Perspective*, St. Mary’s L. Rev. 15 (1999).

¹² The “Big Four Families” referred to the traditional capitalists and governors of the Republic of China, namely, Chiang’s, Soong’s, Kung’s, and Chen’s. They were responsible for much of China’s management of finance, politics, economy and law.

¹³ See Gongtong Gangling (共同纲领) [The Common Guidelines] (promulgated by the People’s Political Consultative Congress of China, Sept. 29, 1949, effective Sept. 29, 1949) art. 3 (Chinalawinfo). [hereinafter The Common Guidelines]; XiaoWeiyun (肖蔚云), Xianfa Gailun (宪法概论) [Introduction to the Constitutional Law] 80 (2002) (pointing that the abolishment of old regime and the set up of the new regime which includes public ownership of lands, public ownership of public goods, and protecting the workers, farmers, and middle classes’ rights and properties).

¹⁴ The first constitution of the P.R.C. had not been adopted until 1954.

¹⁵ Features of the socialism reform are three-folded. First, around 30% of the market shares were vested by the government until the socialism reform began, but the government-controlled shares

From the people's perspective, there was no concept of "personal property" in China, and the government unilaterally arranged their employment.¹⁶ No individual person was allowed to be a "shareholder" in these SOUs, and there were no legal grounds to protect individual property rights. One critical point to be emphasized here is that the SOUs were the core of the Chinese society at that time because of its "employment focused" nature. It appears that there was no conflict of interests between government-controlled SOU system and its "shareholders" since there were no officially recognized shareholders at all. However, during the establishment of the SOEs, conflict of interest issues were hidden by the unilateral strength of the government, which acted on behalf of its principals, who had no legal power over their assets. Thus, during that era, the agent and the principal were one and the same.

The reform of SOUs was part of the macroeconomic reform during China's Open Door policy,¹⁷ which was mainly driven by foreign investors.¹⁸ After the economic reforms of the late 1970s, many foreign investors came to China to make profits. One challenge they faced was the need to set up certain entities to manage their businesses, since no corporate law existed in China before they arrived. In response to this demand, the government enacted the first business organization law in the history of PRC, that of joint ventures. However, there was another challenge: who should be the Chinese counterpart... A government organ, such as the SOU... In order to limit the function of government and avoid potential sovereignty issues, the foreign investor came into contract with these "legal persons", state-owned enterprises established under the Sino and Foreign United Business Organization Law (*zhongwai heyingshuanli banfa*).

Despite the introduction of foreign investment, the concept of personal property was still not applicable to the common people. During this period, there was still no concept of shareholders, not even the concept of "property." The government controlled most of the social wealth, including houses and other

leaped to more than 95% henceforth. Second, there were no legal entities production during the 1950s-1970s; all economic activities were organized through administration in "production units". Third, there was no sound legal system for economic activities, but widespread of administrative regulations and plans. See Xiao (肖), *supra* note 14, at 2.

¹⁶ Interview with Professor Richard M. Buxbaum. As both law professor and witness, Professor Richard M. Buxbaum mentioned that in the early 1970s, people in China do not have personal property rights or any freedom of geography mobility, because all social benefits came from employment, including education, accommodation, medical care, food supplies and so on.

¹⁷ Sun, *supra* note 11, at 10.

¹⁸ *Id.*

property.¹⁹ As such, the lack of public awareness regarding “ownership” hindered the reality of conflicts of interests. However, progress was made via the promulgation of the PRC Civil Law Principles. Property right concepts appeared in law for the first time in history, although the people did not fully enjoy these rights.

During the economic revolution of the late 1970s, people gradually took over ownership of some properties,²⁰ which further promoted their demand for personal property rights. After thirty years of continuous reform in China, people obtained ownership of most properties, including real estate (excluding land), autos, and securities.²¹ Ultimately, the government initiated a nationwide SOE reform in the late 1990s: corporatization of SOE.

C. Corporatization in Economic Sectors: From SOEs to Incorporation

The state-owned business associations in China experienced a significant transformation from one of government orientation to a market-based orientation between 1984 and 1995, a process also known as “corporatization”. During the process, the concepts of shareholder and individual possession gradually came into common usage.²² The purpose of the government changed dramatically as well, from that of controlling the nation to increasing the wealth of the nation. The governors’ group began to realize the importance of wealthy people.

While corporatization had many purposes, one of the most important was the promotion of efficiency through better management.²³ Through structural reform, corporatization addressed various features of the traditional system of state ownership that were to blame for its inefficiency.²⁴ However, the reform of parties in the market was difficult, because the majority of

¹⁹ See Gan Chaoying (甘超英), *Xin Zhongguo Xianfa Caichan Zhidu de Lishi Huigu* (新中国宪法财产制度的历史回顾) [The History of Property Right in Constitution], *ZHONGGUO FAXUE* (中国法学) [CHINA LEGAL SCI.], Aug. 9, 2010, at 132, 140-41 (China).

²⁰ *Id.*

²¹ Interview with Richard M. Buxbaum, Professor, UC Berkeley School of Law (The notion of the People’s ownership over the nation’s assets, such as the state-owned companies, never existed before the transformation. The trend seems to have initiated the concept of property right China.).

²² See Sun, *supra* note 11, at 10.

²³ *Id.*

²⁴ First, commentators criticize the supposed unity of ownership and control in the hands of the state under the old system, with the resultant imposition of non-profit-maximizing objectives on enterprise managers through “bureaucratic interference.” Second, they point to the problem of conflicting objectives from multiple state agencies with authority over the enterprise. Third, they point to the absence of an effective ultimate principal with an interest in, and ability to, police managers and ensure efficient operations.

them between the outset of this economic reform and 1900s were state-owned enterprises and therefore self-motivated.

These reform efforts did not necessarily involve privatization — the state remained in control, while only partial ownership was permitted for some collective or private institutions.²⁵ However, the notion of ownership, together with the creation of the corporate structure, caused the inherent conflicts of interest to emerge: conflicts between managers and shareholders, between controlling and minority shareholders, and between shareholders as a class and non-shareholder constituencies of the company such as creditors and employees.

D. Ongoing Corporate Governance Reform

A recent proposal, initiated by the State-owned Assets Supervision and Administration Commission of the State Council of PRC (hereinafter referred as “SASAC”), was developed to tackle this problem: restructuring the corporate governance to reflect the true owner’s interest.²⁶

III. GROUNDS OF INFORMATION DISCLOSURE

Upon deciding the principles of the agency, the next question will be the foundation of information disclosure. In common law, shareholders have the right to inspect their corporation’s books and records. Though this right is not absolute, it is exercisable only for a “proper purpose.”²⁷ Can the traditional right to inspection be used in the context of information disclosure of SOEs in China. . .

²⁵ New legislations, including Company Law, Foreign Joint Venture Law and State-owned Assets Management Regulation, were promulgated and the role of law in structuring corporate affairs so as to achieve these goals: whether, and to what extent standard forms — as opposed, on the one hand, to private contract, and on the other, to mandatory rules — are needed, and the role of regulatory competition.

²⁶ This reform is more focusing on the board of directors of the state-owned corporate and engaging in making the state-owned corporate to be listed and to establish modern corporate governance structure. Actually, the reform is designed to increase the ratio of independent directors or non-management directors in the board of directors. This reform is still not completed yet, and with the resignation of the current Chairman of SASAC, the prospective of this reform is still not clear, see Shaoyong Liu, *supra* note 5.

²⁷ See Gan (甘), *supra* note 19, at 140-41.

A. *The Traditional Approach: Shareholder Ownership Theory and Inspection Right*

1. Shareholder's ownership

The right to inspection stems from the shareholder's ownership. Shareholder ownership issues did not arise until the successful transformation of employment-based society to ownership-based society was completed.²⁸ Previously, people viewed shareholding as a kind of property right, and shareholder ownership was exclusively the priority of "governors".

There are two key rights that accompany owning a firm: the right to control and the right to receive its net earnings.²⁹ The law of business corporations is principally designed to facilitate the organization of investor-owned firms – that is, firms in whose elements of ownership are tied to investment of capital in the firm. In an investor-owned firm, both the right to participate in control – which generally involves voting in the election of directors and voting to approve major transactions – and the right to receive the firm's residual earnings, or profits, are typically proportional to the amount of capital contributed to the firm. Business corporation statutes provide for this allocation of control and earnings as the default rule.³⁰ Once modernization of the concept of ownership was incorporated in China, shareholders' rights were strongly emphasized.³¹

In recent years, even among more economic-minded thinkers, the property account of the corporation has fallen into a state of considerable disrepair for a number of reasons. Most notably, it no longer seems accurate to depict shareholders as the sole residual claimants of a corporation.³² The formal lines separating the various

²⁸ Discussions with Professor Richard M. Buxbaum.

²⁹ Discussions with Professor Stavros Gadinis.

³⁰ *Id.* ("A more recent variant, known as the 'nexus of contracts' or 'contractarian' model, which is one of Coase's many progeny, denies that shareholders own the corporation. A lawyer would know that the shareholders do not, in fact, own the corporation. Rather, they own . . . 'stock'. As owners of stock, shareholders' rights are quite limited."); see also Lynn A. Stout, *Bad and Not-So-Bad Arguments for Shareholder Primacy*, 75 S. CAL. L. REV. 1189, 1195-97 (2002) ("options theory demonstrates that bondholders and equity holders each share contingent control and bear residual risk in firms. How, then, can one describe a publicly held corporation that has issued debt as being owned by its shareholders? The short answer is that one cannot. . . .").

³¹ It is worthy to note that within academia there exist noticeable differences in perspective, with not a few commentators asserting that shareholders cannot properly be characterized as owners of the corporation. Professors William A. Klein and John C. Coffee, Jr. have described the matter: "In the traditional analysis . . . , the shareholders are 'owners' of the corporation. This depends on a strained use of the word 'owner'; shareholders can only vote for directors or on major issues, cannot withdraw their share of the firm's assets, cannot tell employees what to do, are limited in their ability to gain access to books and records, etc."

³² Discussion with Professor Stavros Gadinis.

constituents of a corporation have become progressively blurred in recent years, especially for creditors,³³ in contrast to the older theories at the shareholder primacy end.³⁴

As a matter of law, shareholders are the owners of the corporation; director fealty to owners is similarly immutable³⁵ where the corporate governance system believes shareholders have full ownership rights in the corporation.³⁶ The claim that shareholders own only *shares* of stock in corporations and not the corporations themselves is inaccurate under the law, which provides that the shareholders do indeed own the corporation, which many common law jurisdictions have enshrined in their statutory provisions.³⁷

No academics dispute the shareholders' right to corporate information, including the records of the corporation, the list of shareholder names (stock books),³⁸ and details on the business operation.³⁹ However, several sources have also established restraints on the information disclosure mechanism,⁴⁰ including Article 34 of the PRC Company law.⁴¹

2. Quasi-ownership

Corporate law sometimes deviates itself from the assumption of investor ownership to permit other investors, such as creditors or employees, either to participate in control or to share net

³³ See Stephen M. Bainbridge, *Director Primacy: The Means and Ends of Corporate Governance*, 97 NW. U. L. REV. 547, 547 (2003).

³⁴ Stout, *supra* note 30, at 1190-92.

³⁵ Henry T. C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty to Creditors*, COLUM. L. REV. 1321, 1355 (2007)

³⁶ Julian Velasco, *Shareholder Ownership and Primacy*, 2010 U. ILL. L. REV. 897, 934 (2010)

³⁷ *Id.* at 937.

³⁸ See JESSE H. CHOPER ET AL., CASES AND MATERIALS ON CORPORATIONS 632 (Aspen Publishers 2008) (1966); see also Delaware General Corporation Law (2007) § 220 (shareholders' right to inspection of books and records).

³⁹ *Id.*

⁴⁰ See *Seinfeld v. Verizon Commc'n*, 909 A.2d 117 (Del. 2006).

⁴¹ See Gongsi Fa (公司法) [Company Law] (promulgated by the Standing Comm., Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) art. 34 (Chinalawinfo) [hereinafter Company Law]

"A shareholder shall have the right to view the articles of association, the minutes of shareholders meetings, resolutions of board of directors and board of supervisors and the financial and accounting reports of the company. Shareholders may view the accounting books and reports of the company. For this purpose, they shall submit a written request and state reasons. Where the company reasonably believes that shareholders have unjust purposes in viewing the accounting books and reports which may harm the legal rights and interests of the company, the company may refuse such request and shall, within fifteen (15) days of such request, reply in written form and state reasons. As such, shareholders may apply to the people's court for an order under which the company shall provide the shareholders with such references."

earnings.⁴² Worker codetermination is an obvious example. The reasoning under which non-investor participation is allowed remains one of the basic controversies in corporate law, which can be solved, or at least relieved, through an adequate information disclosure system.⁴³ Though the creditor and debtor relationship is well structured, the creditor is more likely to benefit from this regime.⁴⁴ Nevertheless, we can see the importance of information disclosure in the construction of this relationship.

3. The Right to Inspection Reduces Costs Caused by the Conflict of Interests

Oversight costs is a fundamental concern within the corporate form, which consists of monitoring costs, bonding costs and other residual losses.⁴⁵ The shareholders' inspection right addresses certain agency problems that may arise between corporate managers and shareholders, minority shareholders and majority shareholders (the government). Among others, it provides an effective tool for the shareholders to monitor the management of the company. Traditionally, the shareholders need to pay the agency cost to the management to run the company. Because the agency cost is not sensible when outweighed by the benefit of the agency relationship, shareholders have pondered over possible ways to reduce this cost. Information disclosure can assist in reducing the cost of monitoring and supervising the controlling shareholders and managers' use of corporate assets for their own interests,⁴⁶ though the inspection right is not the main tool for saving agency costs.

Research shows that the information flow can effectively affect the action of managers and controlling shareholders.⁴⁷ This is also evident from the economic analysis of the effect of information disclosure on reducing agency costs.⁴⁸ In particular, there are some approaches for the evaluation of the performance of the SOEs. There should be no burden of proof placed on the shareholders for access to the information, as this right is obtained when they become shareholders.

⁴² Notes from Professor Stavros Gadinis's instructions; *see also* ALLEN, WILLIAM T. ET AL., COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION 131-32, 137-38 (3d ed. 2007).

⁴³ Notes from Professor Stavros Gadinis's instructions.

⁴⁴ *Id.*

⁴⁵ *See* Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 307 (1976).

⁴⁶ A few states, such as Michigan, require all corporations to prepare financial statements annually for distribution to shareholders, but these disclosures are not intended to benefit corporate creditors, *see* MICH. COMP. LAWS ANN., § 450.1901 (West 2006); ALLEN ET AL., *supra* note 42, at 132.

⁴⁷ *See* Jensen & Meckling, *supra* note 45, at 330.

⁴⁸ *Id.* at 320-35.

As a result, outside supervisions allow for an improvement in efficiency and reduction in agency costs, while at the same time allowing for constant evaluation for those who receive the information.

B. Political Ownership Approach: The Ultimate Shareholders of SOE

The first step is to establish the foundations of ownership of SOEs.⁴⁹ Political ownership theory is based on the PRC Constitution, the PRC Communist Party Policies and the basic political regime declared by Chinese leaders. First, that SOEs are national assets is one of the fundamental principles of the establishment of the PRC Communist Party. Secondly, on the grounds of the basic political structure, the SOE is the property of all of the Chinese citizens. Finally, the ultimate shareholders of the SOEs belongs are the Chinese citizens, a point which has been verified by several top political leaders, including the Chairman of SASAC.

1. Basis of Assets in Government

According to the PRC Constitution, state-owned assets belong to the whole nation. In other words, the entire people of China are the owners of all of the state-owned assets. Actually, there are four stages in the development of ownership in modern Chinese history.⁵⁰

In 1949, the PRC implemented a new declaration,⁵¹ in which private ownership was recognized and protected by the country; however, capitalist property and foreign capital were forfeited by the government.

In 1954, the PRC implemented a formal written constitution, in which private ownership, like personal belongings, was recognized and protected by the government; however, all means of production, like the land, industrial plants, or machines, remained as public property.⁵² There was a separation between property used for living and property used for production.

In 1975 and 1978, during the Cultural Revolution, the PRC changed its constitution and gradually abolished all kinds of private ownership, promulgating that all personal belongings were publicly

⁴⁹ SOE refers to all kinds of state-owned entities, no matter it is formed as joint venture, equity joint venture, limited liability company or joint stock company in custom.

⁵⁰ See Gan (甘), *supra* note 19, at 138-145.

⁵¹ The Common Guidelines, *supra* note 13.

⁵² See XIANFA art. 12 (1954) (China).

or collectively owned, and that the state would control the distribution of these properties.⁵³

In 1982, the new Constitution reverted to the old regime, recognizing personal property rights again. The concept of private ownership developed rapidly after that.

The following articles in PRC Constitution summarize the basis of state ownership:

“Article 6. The basis of the socialist economic system of the People’s Republic of China is socialist public ownership of [the means of production],⁵⁴ namely, ownership by *the whole people* and collective ownership by the working people. The system of socialist public ownership supersedes the system of exploitation of man by man; it applies the principle of “from each according to his ability, to each according to his work.”⁵⁵ (emphasis added)

“Article 7. The state economy is the sector of socialist economy under ownership by *the whole people*; it is the leading force in the national economy. The state ensures the consolidation and growth of the state economy.”⁵⁶ (emphasis added)

From the constitution, it is evident that state-owned assets belong to the whole nation. Now, the subsequent question is the meaning of “the whole people,” and how they execute their property rights.

The “whole people” is a concept, which can be traced back to the sovereignty of the people.⁵⁷ In China, the organs exercising such sovereign power are the National People’s Congress (hereinafter referred as “NPC”) and its local people’s congresses.⁵⁸ That is why

⁵³ See XIANFA pmbl. (1975) (China); see also XIANFA pmbl. (1978) (China).

⁵⁴ Means of Production (*Shenchan Ziliao*), refers to physical, non-human inputs used in production—the factories, machines, and tools used to produce wealth -- along with both infrastructural capital and natural capital, see JAMES M. HENSLIN, ESSENTIALS OF SOCIOLOGY 159 (2002), (including the classical factors of production minus financial capital and minus human capital, which include two broad categories of objects: instruments of labor (tools, factories, infrastructure, etc.) and subjects of labor (natural resources and raw materials), and people operate on the subjects of labor, using the instruments of labor, to create a product; or, stated another way, labor acting on the means of production creates a product, and when used in the broad sense, the “means of production” includes the “means of distribution” which includes stores, banks, and railroads); see MICHAEL EVANS, KARL MARX, 63 (1975); Frank Parson, *The Truth at the Heart of Capitalism and of Socialism*, THE ARENA, Jan.-June 1907, at 7, 9.

⁵⁵ XIANFA art. 6 (2004) (China).

⁵⁶ *Id.*

⁵⁷ See LIN FENG, CONSTITUTIONAL LAW IN CHINA 35 (2000).

⁵⁸ See XIANGFA art. 2 (2004) (China).

one prominent Chinese constitutional scholar has raised the difference between the concept of state power and people's sovereignty. His argument is that state power can be divided into different levels, central and local, whereas the people's sovereignty is a unitary concept. The connection between the two concepts is "the people." The concept that all powers belong to the people includes the concept of sovereignty of the people.⁵⁹ Nevertheless, the Communist Party consistently proclaims that the profit of SOE is the wealth of the whole people, an example of which is the NPC's press release claiming that the distribution of the SOE profit will be distributed through the social pension fund, infrastructure construction and reinvestment.⁶⁰ In addition, it should also be clear that the whole citizenry should be referred to as the PRC citizens, which include all those who bear a Chinese passport.⁶¹ To determine nationality, the PRC Nationality Law shall apply.

2. Basic Regulation Regime of State-Owned Corporation

For publicly owned firms, the task of monitoring managerial performance is entrusted to the government.⁶² According to PRC State-owned Assets Act of 2008 (*guoyou zichan fa*) (hereinafter referred to as "State-owned Assets law"), the internal division of power between the SASAC and the Ministry of Finance (hereinafter referred to as "MOF") is as following: the SASAC is in charge of monitoring industrial SOE while the MOF is in charge of the financial SOE (in practice, investment company Zhongjin represents MOF in owning financial institutions).

The State Council shall, on behalf of the state, exercise the ownership of the state-owned assets. Specifically, the SASAC at

⁵⁹ *Id.* art. 36; see also *Qiyue Guoyou Zichan Fa* (企业国有资产法) [Law on State-owned Assets in Enterprises] (promulgated by the Standing Comm., Nat'l People's Cong., Oct. 28, 2008, effective May 1, 2009) art. 16 (Chinalawinfo) [hereinafter Law on State-owned Assets in Enterprises].

⁶⁰ When asked the distribution of the benefit or dividend of the SOE, the vice president of SASAC answered, "The state-owned enterprises are fortune belonging to the state, and the people. Once the state needs this deposit, we will immediately make use of it", *Guoyou Qiye Shangjiao Hongli Bili Jiang Jinyibu Tisheng* (国有企业上交红利比例将进一步提升) [Fatter Dividends will be paid by the SOEs], Xinhua Wang (新华网) [www.news.cn] (Feb. 22, 2011, 15:26:53), http://news.xinhuanet.com/fortune/2011-02/22/c_121109841.htm.

⁶¹ See XIANFA art. 33; *Wuquan Fa* (物权法) [Law on Property], (promulgated by the Standing Comm. Nat'l Cong. Mar. 16, 2007, effective Oct. 1, 2007), 2007 STANDING COMM., NAT'L PEOPLE'S CONG. GAZ. 31, art. 45 (China).

⁶² Compared with private ownership, the most obvious differences in the relationships between managers and their immediate principals arise from the facts that (a) the principals do not typically seek to maximize profits, (b) there are not marketable ordinary shares in the firm, and hence no market for corporate control, and (c) there is no direct equivalent to the bankruptcy constraint on financial performance, see JOHN VICKERS & GEORGE YARROW, *PRIVATIZATION: AN ECONOMIC ANALYSIS* 1 (1991).

various levels that perform the investors' (*Chuziren*) functions for state-invested enterprises on behalf of the local people's government as authorized by the State Council and the relevant local people's government shall be entitled to the rights of the contributors. The rights of the SASAC mainly consist of receiving returns on assets, participating in major decision-making and selection of managerial staff for the SOE.⁶³

According to PRC Property Law of 2007 (*Zhonghua renmin gongheguo wuquanfa*) (hereinafter referred as "Property Law"), property owners have the right to dispose of their property.⁶⁴ Although this property right is restricted with respect to the assets of SOE, the owners should at least have the right to access basic information in connection with their property.⁶⁵

Interpreting the Constitution, State-owned Assets law, and Property law as a whole, the conclusion is that the people should be the owner of the SOE collectively, and that the people should at least know how their assets are being used, either as a whole or individually.

3. Inspection Right

The ability to inspect the corporation's records is often a useful tool for the shareholder who wishes to exercise the right to vote or maintain a lawsuit.⁶⁶ As we discussed, the shareholder's right to the corporation information has been confined to a reasonable purpose, which has been strictly enforced by the courts in the United States. As the shareholder, there was normally no good reason for them to get access to financial information, or in practice, this right was constricted by the charters or by-laws. In this regard, the shareholder theory is not enough to construe the argument to secure adequate information disclosure, no matter how sound this theory is in explaining disclosure of stock books and other stock records to the shareholders.⁶⁷ On the other hand, shareholder theory is not persuasive in the point that based on shareholder theory, the information is disclosed only to the company's shareholders, meaning the PRC government, rather than the public or the society as a whole. The question of how to connect the shareholder with the

⁶³ See Law on State-owned Assets in Enterprises, *supra* note 59, art. 4.

⁶⁴ See *Wuquan Fa* (物权法) [Law on Property] (promulgated by the Standing Comm. Nat'l People's Cong., Mar. 16, 2007, effective Oct. 1, 2007), 2007 STANDING COMM., NAT'L PEOPLE'S CONG. GAZ. 31, art. 39 (China).

⁶⁵ *Id.*

⁶⁶ See CHOPER ET AL., *supra* note 38.

⁶⁷ See DEL. CODE ANN. tit. 8, §§ 101-398 (West 2012).

whole public should be further discussed in the public function theory.

C. Public Function Theory

The traditional approach of inspection rights is not sufficient to provide an adequate information disclosure mechanism. Thus, why should shareholders of SOEs know more than the basic information conveyed to shareholders. . .

Public function theory is based on the assumption that their dealings with industry, SOEs should have the government oversight officials maximize on economic know-how so as to better serve the public interest.⁶⁸ The public function theory is mainly based on PRC Open Government Information Regulation (2007) (*zhonghua renmin gongheguo zhengfu xinxi gongkai tiaoli*) (hereinafter referred to as “OGI”) and provides that some SOEs may engage in some public function and therefore should at least disclose the operation process, which is material to the public interest, such as how the price is fixed.⁶⁹ Although there are some other regulations at play in this field, this theory provides a good method of analysis regarding the disclosure of SOE information to the public.

The SOEs dominate a number of significant industries, such as petrol production, electricity supply and public transportation, undertaking an important public function in Chinese society, for instance, the responsibility of “stabilizing the society as the government does”. In China, the SOEs function as more than just normal business corporations. Several core industries in China, such as the energy, financial and military industries are under the control of SOEs. The SOEs are more influential than their competitors because the government is their direct or indirect shareholder, and as such, SOEs are not only corporations but also an arm of the government.

The public function theory is mainly based on the fair competition principle and the OGI, and provides that because some SOEs engage in certain public functions, they should at least disclose their operation processes. In this regard, the theory helps illustrate why some SOEs undertaking public functions ought to pursue the transparency principle under the OGI. Based on this theory, the

⁶⁸ See VICKERS & YARROW, *supra* note 64, at 27.

⁶⁹ It function likes a government-sponsored enterprise, with public purposes created by the U.S. Congress to reduce the cost of capital for certain borrowing sectors of the economy, see Government-Sponsored-Enterprise-GSE, Investopedia, <http://www.investopedia.com/terms/g/gse.asp> (last visited Feb. 5, 2012).

SOEs are obligated to serve and provide basic living facilities and cannot make over the statutorily mandated profit rates. Also, the SOEs cannot make use of their monopolistic positions to gain excessive profits and are obliged by certain administration laws to provide sufficient public goods,⁷⁰ to disclose the cost of the service or product to the public and make reasonable and plain explanations of certain vital information.

It may be added here, frankly, the criteria and exact line of which information should be disclosed under public function is murky. The general objective to maximize the public's interest is not going to set a particular piece of information into the public domain. However, the public function theory opens the door for more substantial information to flow externally.

D. Other Foundations

1. Information Accessibility as a Basic Human Right

The right to freedom and availability of information, especially those held by public authorities, is one of the basic human rights. The importance of freedom of information as a fundamental right is embedded in various international conventions. In 1946, the UN General Assembly adopted Resolution 59(I), which stated that "freedom of information is a fundamental human right and the touchstone of all the freedoms to which the United Nations is consecrated," and that "freedom will be bereft of all effectiveness if the people have no access to information. Access to information is basic to the democratic way of life. The tendency to withhold information from the people at large is therefore to be strongly checked."

Some information concerning SOEs, including annual profits and their distribution, significant corporate transactions that take place due to the SOEs' stature as a state-owned enterprise, should be regarded as government, and thus public information. Information held by SOEs is not acquired for the benefit of corporate officials or politicians but for the public as a whole. Unless there are good reasons for withholding such information, every citizen should be able to access it, ultimately so as to enjoy their right to information. More importantly, freedom of information is a key component of the transparent and accountable operation of SOEs, as it plays a key role in enabling citizen oversight.

⁷⁰ For example, though not explicitly provided in laws, public transportation is obliged to take all reasonable passenger.

2. Transparency reduces Social Cost

“Social cost” refers to the cost that may be avoided if the information is adequately disclosed to the public. Take administrative costs as an example. Disclosing information to the public will be a costly process considering the process of collecting, submitting, auditing and publishing the information to the general public. However, compared to the alternative of each individual constituent conducting such tasks to garner government information, such a collective mechanism is much more efficient. Thus, increased transparency will reduce unnecessary costs resulting from individual behavior and substantially improve social efficiency.

3. Information Flow Prevents Corruption and Bribery

Some officials, if not all, working in SOEs are also civil servants whose positions can be traced back to the government within the Communist Party’s regime.⁷¹ In this regard, individuals managing the SOEs serve not only as private businessmen, but also civil servant (*gongwuyuan*).⁷² As a result, there has been ample room for corruption and bribery scandals in these management organizations.

Commercial bribery and corruption are two of the most detrimental issues facing Chinese SOEs, which has resulted in gross inefficiency and loss of capital. A greater flow of transparent information is one of the most important mechanisms to effectively prevent corporate bribery and corruption. Greater transparency, mandatory information disclosure of relevant transactions and detailed financial reports will greatly intensify outside surveillance on these officials.⁷³

⁷¹ See Zhongshihua Dongshizhang Su Shulin Churen Fujian Shengwei Fushuji (中石化董事长苏树林出任福建省委副书记) [Su Shulin, Chairman of Sinopec, Appointed as Vice Secretary of the Communist Party of the Fujian Province], Xinlang (新浪) [Sina] (Apr. 3, 2011, 10:13), <http://news.sina.com.cn/c/2011-04-03/101322232694.shtml> (explaining that Chairman of the Sinopec Group, Su Shulin, was appointed to be the Vice Secretary of the Communist Party of Fujian province).

⁷² This phenomena is reflected by the personnel flow between senior management of SOEs and government of various level.

⁷³ Improving transparency and accountability is a key priority to improve the corporate governance of SOE. First of all, it gives substance to shareholders’ rights by providing the information essential to their exercise. The state as a shareholder needs to collect enough, reliable and timely information on SOE’ performance to exercise its rights. Second, it is also a choice remedy for fraud and market manipulation. As the oft-quoted proverb goes, “sunlight is said to be the best of disinfectants; electric light the most efficient policeman”. Third, it is a prerequisite to and underpins public trust. The state as a shareholder needs to justify its ownership by clearly defining and disclosing its objectives in holding SOE. It is also important to show that political control is being exercised at arm’s length. Finally, as an agent to the general public, the state has also to report on its own performance as an owner, often via the Parliament.

Prior practice of mandatory information disclosure such as that of the Sarbanes Oxley Act illustrates that disclosure can achieve the desired result of greater accountability.⁷⁴ As a result of this aforementioned act, the mandatory information disclosure burdens became much heavier than before, and ultimately, transparency in the corporate governance field became much improved. Similarly, recent security regulations enforced in China for listed companies have also established a meritorious practice, and as a result, the corruption and bribery within such listed companies have decreased substantially.⁷⁵

IV. CURRENT INFORMATION DISCLOSURE REGIME

A. *Current Information Flow of State-Owned Companies*

Most of the relevant regulations of information disclosure of SOEs are limited for internal use and thus, not available to the public. The following analysis is based on academic research and information from the SASAC's website. An examination of the current information disclosure regime of publicly listed SOEs and non-listed SOEs will follow.

1. Listed SOEs

SOEs may be listed in one of China's two stock exchanges in Shanghai and Shenzhen. They may also be listed on overseas exchanges, typically on the Hong Kong or New York Stock Exchange (via ADRs). Among 1088 listed companies on Shanghai and Shenzhen Exchanges at the end of 2000, over 900 were originally SOEs, and of 1160 listed companies at the end of 2001, approximately 1103 were originally SOEs. A recent study

Moreover, improving transparency and accountability is not only a central element of governance reforms. It is also a good entry point for reform as it is doable and effective in mobilizing support for further reform: putting in evidence SOE' performance and the performance of the state as an owner will not only create incentives to better perform for all SOE officials and civil servants involved, but it will also strengthen public demand for further reforms. In addition, improving transparency is usually considered as politically more feasible and less costly than drafting new regulation. While requiring some political leadership, it is not too costly in terms of resources or capacity. It is thus a good substitute to regulation and the creation of additional institutions, even though increasing transparency might require in itself some degree of regulation. Transparency reforms are also suitable for gradual implementation. They might even be made sustainable and somehow irreversible if crafted in a way to ensure that economic and political dynamics lead some disclosers to promote improved transparency. Improving transparency and accountability will thus not only lead to improved performance but it will create trust in state ownership and has the potential to trigger further reforms down the road.

⁷⁴ Guanghua Yu, *Using Western Law to Improve China's State-Owned Enterprises: of Takeovers and Securities Fraud*, 39 VAL. U. L. REV. 339, (2004-2005).

⁷⁵ See Daniel M. Anderson, *Taking Stock in China: Company Disclosure and Information in China's Stock Markets*, 88 GEO. L.J. 1919, 1936 (2000).

concluded that approximately 84% of listed companies were viewed solely from the standpoint of equity ownership and did not take into account the informal mechanisms of influence that are directly or indirectly under state control.⁷⁶ Listed SOEs shall disclose information according to the securities regulations and Shanghai or Shenzhen Exchanges' rules.⁷⁷

2. Non-listed SOE

Generally, information is collected through the "SOE Annual Performance Reports"⁷⁸ issued by the SASAC. Like in other countries, the basic information of incorporation is always available in the Commerce and Industrial Bureau.⁷⁹ Methods for public disclosure are as follows:

(a) Information sheets and financial statements submitted to the State-owned Assets Supervision and Administration Commission within proper level of the position in the hierarchy (hereinafter "SASAC") and financial department within the same level of government.⁸⁰

(b) Information sheet evaluations by the responsible SASAC and financial department. According to the new rules (internal

⁷⁶ See Qiye Niandu Baogao Tianbao Gongzuo Zhinan (《企业年度报告》填报工作指南) [Guidelines on Filing of the *SOE Annual Performance Report*], Guoziwei (国资委) [SASAC], <http://www.sasac.gov.cn/n1180/n1241/n2830/n13931/11948062.html> (last visited Mar. 20, 2011) [hereinafter *SOE Annual Performance Report*].

⁷⁷ See, e.g., Xinxi Pilu Weifa Xingwei Xingzheng Zeren Rending Guize (信息披露违法行为行政责任认定规则) [Regulation on Indemnity of Offences Against Information Disclosure] (promulgated by the Securities Regulatory Commission, Apr. 19, 2011, effective Apr. 19, 2011) (Chinalawinfo); Gongkai Faxing Zhengquan de Gonsi Xinxi Pilu Bianbao Guize Di 15 Hao: Caiwu Baogao de Yiban Guiding (公开发行证券的公司信息披露编报规则第15号 — 财务报告的一般规定) [Regulation No. 15 of Contents and Formats of Public-offering Companies' Information Disclosure: General Provisions on Financial Report] (promulgated by the Securities Regulatory Commission, Jan. 11, 2010, effective Jan. 11, 2011) (Chinalawinfo). In this article, the capital market information disclosure rule is regarded as an efficient information disclosure approach.

⁷⁸ See *SOE Annual Performance Report*, *supra* note 77.

⁷⁹ For example, Beijing Commerce and Industrial Bureau, from the search system, basic corporation information, such as the name of the corporation, the registered capital, the legal representative, and domicile are available to the public, Beijing Shi Qiye Xinyong Wang (北京市企业信用网) [Beijing Enterprise Credit Network], <http://qyxy.baic.gov.cn/zhcx/zhcxACTION!query.dhtml> (last visited Mar. 25, 2011).

⁸⁰ See Guowuyuan Guoyouzichan Jianduguanli Weiyuanhui Guoyouzichan Jianduguanli Xinxigongkai Shishibanfa (国务院国有资产监督管理委员会国有资产监督管理信息公开实施办法) [SASAC Regulation on Implementation of Information Disclosure] (promulgated by the SASAC, Feb. 5, 2009, effective Feb. 5, 2009) art. 10 (Chinalawinfo) [hereinafter *SASAC Regulation on Implementation of Information Disclosure*].

government regulations that are not publicly available),⁸¹ the SASAC will grade the main leader of the SOE and will determine their compensation based on their performance. The new rules also stipulate the situations in which the management team must be dismissed.⁸²

(c) Some information will be disclosed to the public through the website of these companies or the SASAC. However, press releases will disclose some additional information through their own publications, either through their website or commercial brochures.

(d) There is no regulation on the types of information that are required to be disclosed, and no regulation regarding which SOEs are obliged to disclose. The draft of the Open SOE Information Act has been proposed, but has not been able to move further in the process of SOE information disclosure. The SASAC promulgated new instruction recommendations on the transparency of the SOE and specified some leading companies as “pilot units” (shidian danwei). However, these recommendations are not mandatory.⁸³

(e) Some People’s Representatives have submitted a bill to establish the state-owned company information disclosure rules in the 15th NPC. However, no further discussion of the bill has been made and this bill is not on the schedule for legislative consideration.

The following table illustrates specific information disclosure regime by individual industries.

State-council managed SOE information disclosure status

(Information resource: SASAC website, updated in 2008)⁸⁴

Information category SOE by Industries	No. of SOE	Introduction of SOE	Operation Scope	Organization structure	Capital investment	Human resource	Financial report	Group annual report ⁸⁵	Social responsibility	Profit or revenue
Heavy	27	27	27	20	14	5	2	2	2	5

⁸¹ Zhongyang Qiye Fuzeren Xingchouguanli Zanxing Banfa (中央企业负责人薪酬管理暂行办法) [Tentative Regulation on Emolument of the Central SOEs’ Executives] (promulgated by the SASAC, June 2, 2004, effective June 2, 2004) (Chinalawinfo).

⁸² See SASAC Regulation on Implementation of Information Disclosure, *supra* note 83, art. 7.

⁸³ *Id.*

⁸⁴ In 2007, there were 150 central SOEs; of which 132 have their own websites including 18 which can be linked from the other SOEs’ website.

⁸⁵ Group annual report refers to those SOEs who are shareholder of SOEs, and are in the control of SASAC.

2012

INFORMATION DISCLOSURE

23

industry										
Light industry	16	16	16	10	6	1	1	1	2	3
Energy industry ⁸⁶	16	16	16	13	14	4	5	4	5	5
Science and Technology service	17	17	17	9	5	1	2	1	2	4
Construction industry	5	5	5	4	2	0	0	0	0	3
Agriculture industry	8	8	8	3	1	0	0	0	1	0
Information industry	9	9	9	5	5	0	0	0	0	1
Foreign trade	11	11	11	8	4	1	1	1	1	3
Transportation industry	9	9	9	5	3	0	1	0	0	2
Investment industry	7	7	7	4	2	0	0	0	0	1
Service	7	7	7	2	2	0	0	0	0	0
Total	132	132	132	83	58	12	12	9	13	27

B. Studies of Australia, Sweden and Austria's Practices

In this section, in order to discover useful precedents for Chinese SOE information disclosure practices, I provide a comparative analysis of SOE information disclosure systems for Australia, Austria and Sweden. The body disclosing the information can be divided into two types: the company per se and the owners of enterprises. In the first instance, the enterprise itself is responsible

⁸⁶“Energy industries” refer to the combination of oil industry, electric industry, and mining industry.

for preparing a report and disclosing collective information to the public; in the second instance, the owner of the SOE, such as the government, investment management departments or stated-owned holding institutions, will be responsible to issue a summary of the state-owned enterprises it controls and to disclose collected information to the public.

The summary report makes the overall operation results of the state-owned enterprise public knowledge. This kind of information is particularly intended for individual investors and for their analyses. We can see from the table that Australia, Austria, and Sweden adopted different reporting systems mostly due to the different bodies of information disclosure.

China should adopt the Swedish model, requiring both state council and individual SOEs to file a report to the public. The combined model is particularly important in China because of the large number of SOEs and the strong reliance on governance of the public. At the same time, this combined report serves as a good mechanism for the state authority to supervise the SOE. As we may see, the current reform of the Chinese SOE system has taken some steps for some SOEs to implement this mechanism.

V. INFORMATION DISCLOSURE REFORM PROPOSAL: A MULTILEVEL SYSTEM

A. *Adjusting the Goals*

Since state ownership is often characterized by vague, complex or contradictory objectives, improvement in this area is logically the very first step towards a better information disclosure regime. This chapter provides guidance on how to adjust, formulate and communicate clear objectives at all relevant levels of information disclosure.

In particular, a policy of wealth maximization requires simply that the state acquire, maintain, or relinquish control according to whatever will realize the most wealth for the state. Since the Chinese government does not have such a policy, it follows that a necessary element of state control of an enterprise must be for purposes other than the maximization of its wealth as a shareholder – purposes such as the maintenance of urban employment levels, environment protection, direct control over sensitive industries and the maintenance of international relations.⁸⁷

⁸⁷ Donald C. Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 495 (2003); see Chen, *supra* note 8, at 34, 53–71.

This in turn creates several problems. First, many of these goals are not easily measured and there is no obvious way of balancing them, which leads to monitoring obstacles. As the shareholder of the SOE, the government cannot simply insist on the most favorable dividend rates, but has to support a reasonable welfare regime and maintain social stability. For example, the inflating price index forced the government to pressure the SOEs into taking the responsibility for curbing market prices.⁸⁸ In the infrastructure field, the government artificially lowered the price, although the government is the shareholder of these SOEs and beneficiary of the rising price. Second, the policy of continued state involvement sets up a conflict of interest between the state as controlling shareholder and other shareholders or creditors (which we will see in the next section). By using its control for purposes other than value maximization, the state exploits minority shareholders who have no other way to benefit from their investment. This conflict is particularly obvious in the privatization process as well, where much of the shareholders' interests may be infringed by the controlling shareholder's self-interest.

Nevertheless, in this article, while various objective issues will be considered, the lynchpin of the objectives remains the maximization of social wealth. The difference is that we should recognize the shareholders' rights more comprehensively than before. We also assume that in most circumstances there is no fundamental conflict of interest. Therefore, the corporate governance reform of the SOE is still focused on the agency problem and market efficiency. With this purpose in mind, SOE reform has progressed through history from 'units' to 'legal person' and finally to that of a 'corporation'.

Before setting up an overall information objective for Chinese SOEs, we examine those of other countries. In Sweden, "[t]he Government's overall objective is creating value for the owners" (State Ownership Policy, 2006).⁸⁹ In France, the overall objective is "to contribute to a better valorization of state shares in SOE".⁹⁰ In the UK, the overall objective of the shareholder executive is "to ensure that Government's shareholdings deliver sustained, positive returns and return their cost of capital over time within the policy, regulatory and customer parameters set by Government, by acting as

⁸⁸For example, recently the salt are bought in huge volume because of the concerns on nuclear radiation resulted from the Japan tsunami. The SOE, China Salt Corporation took an effective measure to assure the salt supply and took the responsibility to stabilize the salt price.

⁸⁹ MINISTRY OF INDUSTRY, EMPLOYMENT AND COMMUNICATIONS, STATE OWNERSHIP POLICY 2006 at 3 (2006) (Swed.), available at <http://www.sweden.gov.se/content/1/c6/06/61/87/8ad7f9df.pdf>.

⁹⁰ OECD, ACCOUNTABILITY AND TRANSPARENCY: A GUIDE FOR STATE OWNERSHIP 14 (2010).

an effective and intelligent shareholder.” In Finland, the core purpose of state ownership is defined as follows: “The State seeks to achieve an economic and societal overall result that is as good as possible”.⁹¹ What this means in practice is further clarified: “The overall economic result is the sum of the development in value of the shares owned and their annual dividend yield.”⁹² In Norway, “[t]he purpose of state ownership is to attend to the common good. As owner, the State also expects these companies to take corporate responsibility and to uphold our basic values in an exemplary manner,”⁹³ just like that of New Zealand.⁹⁴

In aligning the goals of other jurisdictions to the Chinese SOE socialist context I suggest the following changes:

1. Goals of the Government

The objective of information disclosure is to provide a comprehensive capacity to supervise companies and industries. This includes the general capacity for supervising the socio-economic status of the SOE, together with the other objectives as shareholders, or at least on behalf of its shareholders. In this light, information disclosure should be more positive and over-inclusive, which means that information disclosure should be maximized with only a few exceptions.

The state with due authority has rights and duties to manage the society. Functioning like a managerial figure or any organization, the state itself needs a comprehensive set of information to regulate and execute its responsibilities.

Furthermore, the state acting as the direct shareholder of the SOE has basic rights against the companies. The management of the SOE directly owes a fiduciary duty to the state. In other words, company law requires the SOE to disclose information to the state in order to fulfill its fiduciary duty. On the other hand, due to the state ownership (shareholders) of all the SOEs, particularly the wholly state-owned companies,⁹⁵ the state is prohibited to make use of this information for its own benefit and will encounter criminal penalties

⁹¹ *Id.*

⁹² MINISTRY OF TRADE AND INDUSTRY, STATE SHAREHOLDINGS IN FINLAND 2005 at 4 (2006) (Fin.), available at http://www.omistajaohjaus.fi/documents/Pdf-tiedostot/State_Shareholdings_in_Finland_05.pdf.

⁹³ Norwegian Ministry of Trade and Industry, The State's Ownership Report 2005 at 5 (2006), available at http://www.eierberetningen.no/2010/asset/ownership_report_2005.pdf.

⁹⁴ See CRWON COMPANY MONITORING ADVISORY UNIT, OWNER'S EXPECTATIONS MANUAL FOR STATE-OWNED ENTERPRISES 9 (2007).

⁹⁵ Company Law, *supra* note 41, art. 217 (“ . . . Unless otherwise specified, [C]ompanies with majority of shares controlled by the state are not deemed to be affiliated with one another on the ground that the composition the majority of their shares are controlled by the state.”).

for any abuse, violation or illegal behavior. That is, the state should make use of the information solely for the purpose of the shareholders, in this case, the whole population.

Finally, the executive branch, the State Council, should make any necessary measures to disclose SOE information in a separate chapter of their annual report to the NPC, and guarantee the information flow within the state authority for the purpose of protecting the ultimate owner.

2. Goals of the SOE

The goal of disclosing information to the public is intended to provide the public with a basic understanding of its assets and how they are operated by the management. As discussed above, although the people have delegated their rights to the government, the people are still the ultimate owners. Hence, the people are entitled to exercise their ownership rights over the SOE in regards to the certain basic information.⁹⁶ Besides, an effective information disclosure mechanism also helps the SOE to maintain rational financial targets, as following:⁹⁷

- (a) Secure the creation of goals by the board and executive management to work towards ambitious, long-term targets;
- (b) Achieve efficient use of capital by clarifying its cost;
- (c) Keep the company's risks at a reasonable level;
- (d) Assure the owner of sustainable and predictable dividends, taking into consideration the company's future capital requirements and financial position; and

⁹⁶ OECD, *supra* note 93, at 9.

Objective 1: Ensure the increase in State shares' value

Indicator 1: Operational profitability of capital (operational result / assets)

Indicator 2: Financial profitability (net result / equity)

Indicator 3: Operational margin (operational results / turnover)

Indicator 4: Indebtedness sustainability (EBITDA/net debt)

Objective 2: Ensure the success of selling transactions

Indicator 1: Difference between receipts from sales and intrinsic or stock values of sold shares (based on valuations made by the Commission on Participations and Transfers)

Indicator 2: Level of fees and commissions paid to advisers

Objective 3: Contribute to the decrease in state debt

Indicator 1: Decrease in debt and interest charges of entities in public administration except the state

Indicator 2: Decrease in debt and interest charges of the State

⁹⁷ MINISTRY OF INDUSTRY , EMPLOYMENT AND COMMUNICATIONS, ANNUAL REPORT STATE OWNED COMPANIES 2005 at 30 (2006).

- (e) Make possible and facilitate measurement, follow-up and assessment of the company's profitability, efficiency and risk level.⁹⁸

The goals of the Chinese citizens are not to be directly in charge of the businesses, but rather to receive adequate information in order to be cognizant of how the SOEs are operating (see discussion in the Grounds part). Equipped with such information, the citizens may adopt further actions through the NPC or the government. It should be emphasized that the information disclosure regime of SOEs is not aimed at promoting a capital market or at protecting the investors, but is solely designed for the shareholders.

B. Approaches: Listed and Non-listed

1. Listed SOEs

Listed SOEs are the more typical, widely dispersed SOEs that are not wholly SOEs. First, there are several types of shares known as "circulating shares" that may be traded freely and publicly on various stock markets.⁹⁹ A-shares may be listed on a domestic stock exchange and owned and traded by any domestic individual, entity or specially approved foreign institutional investor. B-shares are also listed on domestic stock exchanges and until recently, could be bought only by foreigners using foreign currency; now, they may be purchased by domestic investors as well with foreign currency.¹⁰⁰ Other letter-designated shares include H-shares (listed in Hong Kong), N-shares (represented by American Depositary Receipts listed in New York), L-shares (listed in London), and so on. Second, there are several types of shares known as non-circulating shares that are subject to more severe trading restrictions. These are state shares (国家股 *guojia gu*), which may be owned only by state organs; legal person shares (法人股 *faren gu*), which may be owned only by organizations with formal legal identities, such as companies; and employee shares (内部职工股 *neibu zhigong gu*), which generally represent accumulated profits in a state enterprise prior to its public share offering and are deemed to be formally owned by the collective body of the employees of the

⁹⁸ OECD, CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES, A SURVEY OF OECD COUNTRIES (2005); New Zealand Crown Company Monitoring Advisory Unit, OWNER'S EXPECTATION MANUAL 15-24 (reporting requirements for Crown companies).

⁹⁹ Jiong Deng, *Corporate Governance and State Owned Shares in China Listed Companies*, 14 J. ASIAN ECON., 771 (2003).

¹⁰⁰ Benjamin L. Liebman & Curtis J. Milhaupt, *Reputational Sanctions in China's Securities Market*, 108 COLUM. L. REV. 929 (2008).

enterprise.¹⁰¹ As we can conclude, only the A-share state shares and other shares indirectly owned by the state¹⁰² may fall within the current discussion for the purpose of information disclosure, as only the state share or its progeny are reported within the information disclosure system.¹⁰³

Despite all these issues, the bottom line is that concentrated ownership, and therefore control, by a single state shareholder is quite common in Chinese listed companies. A study of corporate governance conducted in 2002 by the CSRC and the State Economic and Trade Commission (SETC) found that, of 1015 controlling shareholders in the 1175 listed companies studied, 77% could be considered state organs (*guojia xingzhi*), while in 390 companies a single state shareholder held over half of the shares.¹⁰⁴ Using a different approach that traced the ultimate ownership of state shares and legal person shares, a recent study found that 84% of listed companies were ultimately under state control.¹⁰⁵

Information disclosure requirements for listed SOEs are further illustrated in the stock exchange requirements.¹⁰⁶

¹⁰¹ See Sean M. Dougherty & Robert H. McGuckin, *The Effects of Federalism on Productivity in Chinese Firms*, 4 MGMT. & ORG. REV. 39 (2008).

¹⁰² It should be noted that the state share/legal person share distinction is well established in law and statistics but is conceptually problematic. Legal persons that hold shares can be state-owned and state-controlled, so in some sense many legal person shares should be seen as state shares. That said, it must be added that the various government bodies holding state shares do not act with one mind and may pursue conflicting objectives. Some government bodies may well be purely profit seeking, while others seek to use their share ownership to influence the company to fulfill certain government objectives such as full employment, see *id.*

¹⁰³ By the same token, apparently some shares classified as state shares are in fact held not by government agencies but by companies (e.g., parent companies of corporate groups) that are controlled by the government agency in charge of that industry. These should technically be called legal person shares, but they are called state shares because their voting and use is in some sense directly controlled by government. The principles governing the classification of shares as legal person shares or state shares are neither clear nor uniform. The bottom line of the state share/legal person share distinction, therefore, is that it does not tell us much about the nature of the ultimate controlling shareholder, see Xufei Ma et al., *Business Group Affiliation and Firm Performance in a Transition Economy: A Focus on Ownership Voids*, 23 ASIA PACIFIC J. MGMT., 467, 469-70 (2006).

¹⁰⁴ See Guy S. Liu & Pei Sun, *Identifying Ultimate Controlling Shareholders in Chinese Public Corporations: An Empirical Survey* 2-3 (Royal Institute of International Affairs, Asia Programme Working Paper No. 2, 2003).

¹⁰⁵ *Id.*

¹⁰⁶ See Xinxin Pilu Xiangguan Guize (信息披露相关规则) [Rules on Information Disclosure], Shanghai Zhengquan Jiaoyisuo (上海证券交易所) [Shanghai Stock Exchange], http://www.sse.com.cn/ps/zhs/fwzc/flfgk_xxpl.shtml (last visited Mar. 21, 2011) [hereinafter Shanghai Stock Exchange] (stock exchange requirements). In addition, information disclosure obligation are enhanced by major capital market. For instance, beyond regular information disclosure required by the 1933 and 1934 US federal security regulations, SOEs listed in the US stock market now required to prepare annual reports on Form 10-K have the benefit of wide-ranging disclosure guidance issued in 2011 by the Securities and Exchange Commission. The overarching theme of this guidance is the

2. Non-listed SOEs

SOEs should be listed in the stock exchange markets, whether it is the Shanghai Stock Exchange, the Shenzhen Stock Exchange or even an overseas stock exchange, because the security regulations provide adequate information disclosure requirements.¹⁰⁷ However, due to some restraints – such as, amongst others, state security, public policy or foreign investment control¹⁰⁸ — it will not be possible in the near future for all SOEs to be listed in the stock exchange markets. As such, the approach discussed in the following sections is designed for those SOEs not listed. To begin, we are required to analyze which kind of information should be disclosed to the public or other parties. Additionally, the procedures on various levels of disclosure must be clarified and standardized.

C. *Re-Taxonomy of Information*

The chapter below defines the scope of information into internal and external, which is categorized for the purpose of public companies and closed companies.

The puzzling issue here is that SOEs have dual-characteristics. In the first place, the SOEs are commercial entities and thus need to maximize their profits in the market, which consists of Chinese citizens.¹⁰⁹ Yet, SOEs are assets of the whole nation, and the people as a whole are their shareholders. To be clear, the dilemma here is that the whole nation is both where the profit stems from and where the profit needs to be distributed. In light of this dilemma, defining the scope of information disclosure will not be as easy as the listed companies.

This information taxonomy is based on the United States 1934 Exchange Act.¹¹⁰

importance of providing “early-warning” disclosures — in the Management Discussion and Analysis, Risk Factor sections of periodic reports, as well as the financial statement footnotes -- of material risks and uncertainties that, if realized, could have a material adverse effect on a company’s liquidity, capital resources or operating results.

¹⁰⁷ Chen, *supra* note 8 (explaining the economics of planning).

¹⁰⁸ Guanyu Tuijin Guoyou Ziben Tiaozheng He Guoyou Qiye Chongzu de Zhidao Yijian (关于推进国有资本调整和国有企业重组的指导意见) [Guidelines on Promotion of State-owned Capital Restructure and State-owned Enterprises Reorganization] (promulgated by the SASAC, Dec. 5, 2006, effective Dec. 5, 2006) (Chinalawinfo) (This document has no longer been cited by the government since Li Rongrong, retired as the Chief Officer of the SASAC in 2010.).

¹⁰⁹ According to the statistics, more than 80% of the revenue of SOE is from the domestic market, see Xiaonian Xu & Yan Wang, *Ownership Structure, Corporate Governance, and Firms’ Performance: The Case of Publicly Listed Chinese Stock Companies* (World Bank Policy Research Working Paper No. 1794, 1997).

¹¹⁰ See 15 U.S.C. §§ 78L (b), 78L (c) (Registration requirements for securities).

“(b) Procedure for registration; information

1. Corporation Information

Information regarded as corporation information can be exempted from distribution to the shareholders. As discussed above, the

A security may be registered on a national securities exchange by the issuer filing an application with the exchange (and filing with the Commission such duplicate originals thereof as the Commission may require), which application shall contain—

(1) Such information, in such detail, as to the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer, and any guarantor of the security as to principal or interest or both, as the Commission may by rules and regulations require, as necessary or appropriate in the public interest or for the protection of investors, in respect of the following:

(A) the organization, financial structure, and nature of the business;

(B) the terms, position, rights, and privileges of the different classes of securities outstanding;

(C) the terms on which their securities are to be, and during the preceding three years have been, offered to the public or otherwise;

(D) the directors, officers, and underwriters, and each security holder of record holding more than 10 per centum of any class of any equity security of the issuer (other than an exempted security), their remuneration and their interests in the securities of, and their material contracts with, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer;

(E) remuneration to others than directors and officers exceeding \$20,000 per annum;

(F) bonus and profit-sharing arrangements;

(G) management and service contracts;

(H) options existing or to be created in respect of their securities;

(I) material contracts, not made in the ordinary course of business, which are to be executed in whole or in part at or after the filing of the application or which were made not more than two years before such filing, and every material patent or contract for a material patent right shall be deemed a material contract;

(J) balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by a registered public accounting firm;

(K) profit and loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by a registered public accounting firm; and

(L) any further financial statements which the Commission may deem necessary or appropriate for the protection of investors.

(2) Such copies of articles of incorporation, bylaws, trust indentures, or corresponding documents by whatever name known, underwriting arrangements, and other similar documents of, and voting trust agreements with respect to, the issuer and any person directly or indirectly controlling or controlled by, or under direct or indirect common control with, the issuer as the Commission may require as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.

(3) Such copies of material contracts, referred to in paragraph (1)(I) above, as the Commission may require as necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.

(c) Additional or alternative information

If in the judgment of the Commission any information required under subsection (b) of this section is inapplicable to any specified class or classes of issuers, the Commission shall require in lieu thereof the submission of such other information of comparable character as it may deem applicable to such class of issuers. . . . “

shareholder and the corporation hold different interests. The corporate form, per se, specifies that the corporation's ultimate goal of self-benefit is the first priority, also known as company opportunity.¹¹¹ In this sense, the principal should delegate their management power to the corporation and its management team.¹¹² As a corporation, the SOE should have its own interest to maximize the profit, which is also aligned with the shareholder's interest.

The bottom line should be defined: once information is disclosed to the public, the corporation will suffer substantial losses. For example, the proprietary knowledge of a corporation should not be disclosed because leaks in proprietary knowledge will provide the corporation's competitors with an obvious advantage. As a result, the corporation will suffer substantial losses in the market without recovering the pre-investment on the know-how because of the information disclosure.¹¹³

Disputes may arise as to whether any financial information should be disclosed. This question shall depend on the type of industry the SOE operates in and the anticipated side effects to the public if such information is disclosed.¹¹⁴ In addition, financial information will be regarded as corporation information if the financial data contains substantial business secrets, for example, detailed financial information regarding its materials and costs of goods, which cannot be found in the open market. If exposed to competitors, this information will substantially reduce the corporation's competitive advantage, unlike in the listed company's information disclosure system. If this is the case, the information disclosure can be made with discretion.¹¹⁵

Additionally, the government shall reserve the power to request corporation reports in particular circumstances. In the case of such a request, the government should be strictly obliged to keep the information confidential. This taxonomy does not present clear guidelines regarding information that should not be disclosed to the public and this conclusion does not foreclose the corporation information disclosure to the SASAC.

¹¹¹ See Michael Begert, *Corporate Opportunity Doctrine and Outside Business Interests*, 56 U. CHI. L. REV. 828, 829 (1989).

¹¹² Chen, *supra* note 8, at 55.

¹¹³ See Begert, *supra* note 114, at 829.

¹¹⁴ See Marson, Charles C., *Disclosure to Third Parties of Information Filed with Government Agencies: Discussion*, 34 BUS. LAW. 1071, 1072-73 (1979).

¹¹⁵ See SASAC Regulation on Implementation of Information Disclosure, *supra* note 83, art. 7.

2. Selected Information

Selected information refers to information that cannot be withheld, such as organization information, profile of the management team, board resolutions and internal procedures. That is, all this information should be disclosed to the public as well as to the government. Disclosure regulations “can be seen as a means to break the managers’ monopoly over corporate information.”¹¹⁶ Disclosure regulations in China are found in various sources of law, such as the Chinese Securities Law, Chinese Company Law and other administrative regulations.¹¹⁷ A list of selected information required to be disclosed is stipulated under the Chinese Company Law¹¹⁸, Chinese State-owned Assets Law, United States Security Regulations¹¹⁹, and various other academic researches.

(a) *Earnings Release*¹²⁰

Earnings information is one of the fundamental standards of performance evaluation. The earnings release is particularly important since SOEs are not required to disclose detailed financial statements. Earnings releases should include secular financial data such as net revenue and cost, net income and information on profit distribution. All of the above information should be audited by external auditors and competent government agents.

(b) *Direct Financial Obligations and Off-Balance Sheet Arrangements*¹²¹

This piece of information is particularly important since the government audits these off-balance sheet arrangements. Subject to the government’s discretion, if the off-balance sheet information is

¹¹⁶ See Anderson, *supra* note 76.

¹¹⁷ See *id.*...

¹¹⁸ It should be noted that, powers of the shareholder’s meeting in the P.R.C. are more extensive and more detailed than those of western countries, see Company Law, *supra* note 41, arts. 38, 103 (providing that powers of the shareholder’s meeting include, *inter alia*, deciding on matters of merger, division, dissolution and liquidation, making amendment to articles of associations, appointing directors, and adopting operational policies, investment plans, annual reports and budgets, etc.); see also GU, *supra* note 2, at 79.

¹¹⁹ The SEC has developed the concept of “basic information package” which consist of certain essential financial information and a qualitative discussion of recent performance, known events and uncertainties likely to impact future performance, see CHOPPER ET AL., *supra* note 38, at 303.

¹²⁰ Profit should be the most important information to evaluate its performance, see Lin Yifu (林毅夫) et al., *Xiandai Qiye Zhidu de Neihan Yu Guoyou Qiye Gaige Fangxiang* (现代企业制度的内涵与国有企业改革方向) [*Modern Enterprise Regime and Direction of State-owned Enterprises*], JINGJI YANJIU (经济研究) [ECON. STUDIES], Mar. 5, 1997, at 3, 5.

¹²¹ *Id.* at 6.

essential to the people's interest, the information should be disclosed to the public either through a government information disclosure procedure or an internal control system, such as the SASAC's website.

*(c) Material Impairment Charges*¹²²

Material impairment charges will cause fundamental changes to SOEs. Scholars emphasize the disclosure of this kind of information because SOEs tend not to be aware of legal risks that accompany such charges. Furthermore, information on significant charges will not only alert the SOE but also the public as shareholders. The relevant material information to be disclosed should be based on the extent to which it would affect the total assets of the SOE, or the percentage of the revenues of SOE.¹²³

Disputes may rise what constitute a material or substantial change, US cases suggest more than three fourth changes of the total assets is material. However, in China, common practice will regard more than one half change of total assets will definitely be material.

*(d) Errors in Financial Statements*¹²⁴

This piece of information stems from United States security law practice. Material misleading information should be immediately disclosed to the public to ensure that the information available in the market reflects the most recent and accurate status of the company.¹²⁵

*(e) Resignation or Replacement of Accountants and Changes in Other Key Professionals*¹²⁶

Accountants act as independent supervisors of the SOEs, although in China, the Board of Supervision is also established for this purpose. The securities practice in the United States has demonstrated the significance of having independent external accountants.¹²⁷ As such, in case of their resignations or replacements, the shareholders ought to be informed of the reasons. Detailed information should be disclosed in a timely

¹²² See Company Law, *supra* note 41, art. 38 (5).

¹²³ See *Mills v. Electric Auto-life Co.*, 396 U.S. 375 (1970) ("Materiality Standard"); *Basic Inc. v. Levinson*, 485 U.S. 224 (1988).

¹²⁴ See Lin (林) et al., *supra* note 127, at 5.

¹²⁵ See 15 U.S.C. §§ 77k-77l, 78j, 78j-2 (2006).

¹²⁶ See generally Pan Hua (潘华) & Zhong Xianbing (钟献兵), *Guoyou Qiye: Xinxin, Daili, Jili Yu Jiandu* (国有企业: 信息、代理、激励与监督) [*State-owned Enterprises: Information, Agency, Incentive and Supervision*], *QIYE JINGJI* (企业经济) [ENTERPRISE ECON.] Aug. 21, 2003, 51.

¹²⁷ Chen, *supra* note 8, at 38.

manner, which serves as an essential guarantee for the quality of the financial reports.

*(f) Entry into, Amendment or Termination of Main Agreements*¹²⁸

Under the Chinese Company Law, material agreements are one of the fundamental matters that should be approved by the shareholders. Shareholders have the power to vote on fundamental changes within the corporation and without the relevant information, shareholders would not have sufficient capacity to make wise decisions.¹²⁹ Therefore, shareholders ought to have access to the necessary information.

*(g) Acquisition or Disposition of Main Assets*¹³⁰

Based on the Chinese Company Law, shareholders have the power to vote on fundamental changes within the corporation.¹³¹ Shareholders will not have the sufficient decision-making capacity without sufficient information. However, the information flow in merger transactions is quite subtle and the issue on disclosure in connection with such matters is highly debatable.¹³²

*(h) Unauthorized Sales of Shares*¹³³

For the unauthorized sales of shares, a similar analysis to that of item g can be applied. On the other hand, the State-owned Assets Act and Company Law also require the SOE to report and obtain governmental approval before the sale of SOE equities.¹³⁴ The government should therefore act in accordance with the OGI Act and publish or make known the relevant information to the public.

*(i) Modification of Rights of Shareholders*¹³⁵

As in item (g), modification of the rights of shares directly affects the shareholders' interest in the SOE.

¹²⁸ See Company Law, *supra* note 41, art. 38 § 9.

¹²⁹ See *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988); see also Ezra Ripley Thayer, *Public Wrong and Private Action*, HARV L.REV. 317 (1914).

¹³⁰ See *Basic, Inc. v. Levinson*, 485 U.S. 224 (1988); see also Ezra Ripley Thayer, *Public Wrong and Private Action*, HARV L.REV. 317 (1914).

¹³¹ See *Backham v. Polaroid Corp.*, 910 F.2d 10(1990).

¹³² See *In re Time Warner Securities Litigation*, 9 F.3d 259 (2nd Cir. 1993).

¹³³ Pan (潘) & Zhong (钟), *supra* note 130, at 52.

¹³⁴ See Law on State-owned Assets in Enterprises, *supra* note 59, art. 34; Company Law, *supra* note 41, art. 67.

¹³⁵ *Id.*

(j) *Nomination of Director and Compensation of Senior Officer*¹³⁶

See items (g) and (m). The shareholders should rely on the disclosure of information to make judgments when the state nominates directors or senior managers.¹³⁷ In China, the director and other senior officers also hold corresponding administrative titles in the government. All such information should be disclosed. Additionally, senior officers' compensation should be disclosed and director's compensation should be determined by the shareholders or charters.

(k) *Changes of Registered Capital*¹³⁸

Again, a similar analysis to that of item (g) can be applied here. Information on the change of registered capital is currently available to the public through the official government website. Citizens can obtain this information from the Commerce and Industrial Bureau's Enterprises Information Web.¹³⁹

(l) *Amendments of Charter or Bylaw*¹⁴⁰

Again, a similar analysis to that of item (g) can be applied. The charter or by-laws of an SOE are originally created by the state government and any changes or amendments thereof are first subject to the approval of the corresponding government authority.¹⁴¹ The SOE should disclose the amendments of the charter and by-laws to the public in a timely manner.

(m) *Interested Transactions*

Transactions between a corporation and a director or controlling shareholder, or "interested transactions," should be disclosed. Also, transactions between SOEs should also be disclosed because of their nature of being state-owned.¹⁴²

The taxonomy of information was established in order to identify which kind of information should be disclosed, while the final step shall be what the disclosure procedure should be. In the following

¹³⁶ See Company Law, *supra* note 41, art. 38 § 1.

¹³⁷ Anderson, *supra* note 76, at 1919.

¹³⁸ See Company Law, *supra* note 41, art. 38 § 7.

¹³⁹ For example, in Beijing, all companies registered in Beijing Commerce and Industrial Bureau can be found through the search engine, Beijing Enterprise Credit. Beijing Shi Qiye Xinyong Wang (北京市企业信用网) [Beijing Enterprise Credit] <http://qyxy.baic.gov.cn/zhcx/zhcxACTION!query.dhtml> (last visited Jan. 10, 2011) (China).

¹⁴⁰ See Company Law, *supra* note 41, art. 38 § 10.

¹⁴¹ Anderson, *supra* note 76.

¹⁴² This information disclosure requirement is questionable under current PRC Company Law. According to the Company Law, the transaction is not automatically be regarded as interested transaction solely because of the state-ownership.

sections, the author illustrates two situations: Information flow between SOEs and shareholders, and information flow between SOEs and the public.¹⁴³

C. Information Flow Between SOEs and Shareholders: Internal Information Flow and External Audit

An SOE should individually disclose select information through its website, and before such disclosure to the public, should retain an external firm to audit the information. It should then file this audited information to the relevant government authority in order to ensure its quality. After the execution of the external audit, the corporation should distribute to the public all of the qualified information electronically. Due to the large number of Chinese citizens, the information does not need to be confidential. Also, only a Chinese language version is required.

The SOE should also implement effective internal controls in order to verify the accuracy of such information.¹⁴⁴ A department in charge of the information management should be set up as well, whose senior officers should then approve any information disclosure related decisions.

A more complicated topic is the liability of misstatement, which is also a hot topic in the United States security law field. In China, the civil liability system is still in the process of development.¹⁴⁵ In this paper, we assume the existence of an effective liability system under the Chinese Security Law.¹⁴⁶

¹⁴³ Anderson, *supra* note 76.

¹⁴⁴ See Shanghai Stock Exchange, *supra* note 111 (information disclosure rules and internal control requirement).

¹⁴⁵ Deng, *supra* note 102.

¹⁴⁶ The PRC Tort law and PRC Criminal Law also stipulates several kinds of securities fraud, including insider trading, and misuse of corporation information when this act severely affected the society, see Xing Fa (刑法) [Criminal Law] (promulgated by the Standing Comm., Nat'l People's Cong., Mar. 14, 1997, effective, Oct. 1, 1997) 1997 STANDING COMM., NAT'L PEOPLE'S CONG. GAZ. 138, art. 180 (Chinalawinfo).

"A person knowing inside information of securities transaction or a person obtaining illegally inside information of securities transaction who, prior to the information concerning issue of securities, transaction of securities or other information of great impact on the price of other securities is made public, buys or sells the said securities or reveals the information, shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention and concurrently or independently, to a fine of not less than one time and not more than five times of the illegal gains therefrom if the circumstance is serious and; if the circumstance is especially serious, to fixed-term imprisonment of not less than five years and not more than ten years and concurrently to a fine of not less than one time and not more than five times of the illegal gains.

If a unit commits a crime under the preceding paragraph, the unit shall be sentenced to a fine and concurrently, the person-in-charge directly responsible and other persons directly responsible of the unit shall be sentenced to fixed-term imprisonment of not more than five years or criminal detention.

D. Information Flow Between SOEs and the Public: External Information Flow Control

Due to the huge population of PRC, it is not possible or economical to send proxies or other materials to each individual citizen. Therefore, information disclosure to the public using public media, such as websites or newspapers would be more feasible. However, such disclosure should be limited to Chinese citizens.¹⁴⁷ As we have discussed above, the party obligated to disclose certain information should be the wholly state-owned enterprise or the holding company. That is, partially state-owned companies are not required to report the entire corporation information to the public – rather, only the profits belonging to the state should be reported through the aforementioned government information disclosure approach.

SOEs are encouraged to develop an online information distribution network for the purpose of gathering, analyzing and distributing the select information.¹⁴⁸ Whether information flows between SOEs and the public are effective partially depends on the people's demand for information, but generally, the SOEs should make the information clear, easy to understand and simple to follow. SOEs should also present explanations to the disclosed information and evaluations so that the public may truly understand its significance.

VI. MECHANISM OF INFORMATION FLOW

This part will focus on how ordinary people can make use of the information disclosure system to maximize their goals. Currently in China, there is not an efficient share-exchange market for state-owned shares, which is quite different from the Western regime. It should be clear that the information disclosure regime provides two mechanisms for the shareholders' goals. The first mechanism is that adequate information provides a competitive and equal market for other companies, and external market conditions are paramount to the success of efficient societies. The second information disclosure mechanism provides an insider supervision regime between the SOE and its shareholders, the community as a whole and the society. The

The range of inside information shall be delimited in accordance with the provisions of laws and administrative regulations.

The range of persons knowing inside information shall be delimited in accordance with the provisions of laws and administrative regulations.

¹⁴⁷ See generally Guoji Fa (国籍法) [Nationality Law] (promulgated by the Standing Comm., Nat'l People's Cong., Sept. 10, 1980, effective Sept. 10, 1980) (Chinalawinfo).

¹⁴⁸ See CHOPER, *supra* note 38, at 305.

latter is essential for social benefits such as a reasonable distribution of profit, a salary package and reasonable pricing when the SOE is a monopoly.

A. Information Flow and Competitive Market

As discussed above, information obstacles have been one of the systematical restraints for SOEs.¹⁴⁹ Building a competitive market is one of the goals for an efficient SOE, and a selective information disclosure regime will further this goal in the following ways:

First of all, the selective information disclosure provides other competitors, especially private competitors, with an equal position to understand the business operations of the SOE. The competitor is able to make use of information in connection with any advantages of the SOE, which they would not have easy access to without a reasonable information disclosure regime. Although the regime itself is unable to alter the competitive capacity of the SOE competitors, it will potentially bring these competitors to an equitable position in deciphering how more effectively to operate its business.

Secondly, selective information disclosure will also provide a reasonable pre-market price formation mechanism. The consumer will better understand the products and be more responsive to price increases. Considering how most of these SOEs are monopolies, information disclosure will substantially increase the transparency of the monopoly market and improve the consumers' capacity to choose reasonable products. Hence, the market will become more competitive and the bargaining power of consumers will increase accordingly.

Thirdly, selective information will promote the competitiveness of the suppliers' market. With an adequate information disclosure regime, competitors will be able to share information equally, and the bargaining power of these vendors will naturally increase, a positive outcome for the efficiency of the society as a whole.

As aforementioned, the information disclosure is selective. The SOE should not be required to disclose information of the so-called "corporate information."

¹⁴⁹ Lin (林), *supra* note 119, at 7.

B. Information Flow and Society Supervision

To build a disciplined information disclosure regime, it is paramount to have the SOE run responsibly. This part will be analyzed through a case analysis.

1. Employees

Information flow between workers is an important factor for SOEs. As I mentioned in the previous chapters, Chinese society is highly employment-oriented, and most employment is related to SOEs to some extent. The SOEs hired more than 60 million people by the end of 2009,¹⁵⁰ although this number has decreased rapidly over the past ten years.

Take Sinopec Group as an example; it had 678,000 employees in total at the end of 2010, including 6,120 fresh graduates joining in 2010. Sinopec has a considerable number of employees who have worked for Sinopec for decades.¹⁵¹ There is no accurate number as to how many people are employed by informal contracts with the SOE or its joint-venture subsidiary; however, the employees constitute a high proportion of the total labor force in China.¹⁵² The employment related information is high in demand among the employees. The employees are able to make use of this information, especially when trade unions are established and employees are able to bargain with their employer about, for example, its legal obligations to maintain endowment insurance, health insurance, occupational injury insurance, unemployment insurance, maternity insurance and housing provident funds for all employees in addition to their salaries.¹⁵³ The potential use by the employees will increase when adding the employees' relatives.

¹⁵⁰ According to the Human Resource Report, the number of working staff in all SOE in China is 60,960,700 in March 2009.

¹⁵¹ Care for Employees, Sinopec, http://english.sinopec.com/environment_society/careforemployees/ (last visited Mar. 31, 2011).

¹⁵² See 2007 Nian Di Si Jidu Bufen Chengshi Laodongli Shichang Gongqiu Zhuangkaung Fenxi (2007年第四季度部分城市劳动力市场供求状况分析) [Analysis on the Supply and Demand of the Employment Market of the Fourth Quarter of 2007], Renli Ziyuan He Shehui Baozhang Bu (人力资源和社会保障部) [Ministry of Human Resource and Social Security], http://wl.mohrss.gov.cn/gb/zwxx/2008-01/22/content_222087.htm (last visited Apr. 3, 2011) (foreseeing the Chinese labour force to be 807,700,000 in 2008) (China).

¹⁵³ In 2010, the Company launched corporate annuity plan, a valuable addition to the mandatory pension scheme.

2. Local Community

The local community consists of, *inter alia*, consumers, suppliers, employees, science research groups, and local authority.¹⁵⁴ Positive supervision and social pressure on the SOE could be formed via mass media and information disclosure. Local communities are more concerned with the economic status, social stability, education and training in their district. SOEs are commonly obligated with social responsibilities. With adequate information made available, the local community would have a better understanding for the operation of the SOE. They may also determine whether certain SOE strategy is sound because the local community usually holds a direct influence in the operation of SOEs through political demonstration. Information disclosure will also build a trustful relationship between the SOE and the local community.

Information disclosure promotes collective action among local community, in which case ordinary people would benefit from the selected information and act together for their interest.¹⁵⁵

3. Dividends to the Chinese Citizens

Based on the shareholder ownership theory, Chinese citizens are the ultimate shareholders, while the government remains the shareholder in law. As one of the direct benefits of ownership of the SOEs, the Chinese citizens are eligible to any dividends distributed by the SOEs, via the government, or by indirect benefit in terms of social environment development as well as local community prosperity. However, the reality is that there are several obstacles for direct dividends distribution.¹⁵⁶ Recently, Mongolia distributed dividends to its citizens for the first time in its history.¹⁵⁷ The Mongolian government decided to disburse two years of cash and non-cash payments of 1.5 million [currency] to each citizen Tugrik (MNT 1 yuan or about 180) of the benefits.¹⁵⁸

In a recent news release by several high-level officials of SASAC, a possible solution to distribute the profit of SOE to Chinese citizens would be indirectly via a money transfer to the

¹⁵⁴ "Constituencies" should include shareholders, creditors, customers, employees, and perhaps even community general, see *Unocal Co. v. Mesa Petroleum Co.*, 493 A.2d 946. .

¹⁵⁵ Professor Gadinis's class instruction notes.

¹⁵⁶ See *infra* ch. IV.

¹⁵⁷ Menggu Guo Zhengfu Shouci Yi Gufen Xingshi Xiang Quanti Gongmin Fenhong (蒙古国政府首次以股份形式向全体公民分红) [Mongolian Government for the First Time Pay Dividends to Its Citizens in Form of Equity], *Remin Wang* (人民网) [People] (Mar. 31, 2011, 22:01), <http://world.people.com.cn/GB/14290732.html>.

¹⁵⁸ *Id.*

social welfare fund.¹⁵⁹ Information disclosure will help people to understand whether the distribution is reasonable.

4. Information Disclosure and the “Shareholders’ Vote”

Although there is no efficient share exchange market for state-owned shares, people may vote in terms of the “People’s Representative Election”. The election is political, but the process will indirectly affect the executive branch because the People’s Representative Congress is in charge of the recognition of senior local authority officials.¹⁶⁰ In China, the local People’s Reprehensive Committee is elected directly by the community.¹⁶¹ The local community, directly affected by the activities of SOEs located nearby, is able to express their ideas through the local election process. Selected information disclosure, in this regard, will be essential for the local community.

It should be clear that the local authority, which is nominated by the PRC Communist Party and approved by the NPC, is in charge of the appointment of senior officers of the SOE.¹⁶² CEO and Chairman of Sinopec Group, for example, was announced by the PRC Communist Party Central Committee and the SASAC, but the nomination process involved discussions between the Chinese executive branch, (which is selected by the NPC) and the PRC Communist Party.¹⁶³

Nevertheless, the exercise of SOE shareholders rights is highly connected with the political development and reform in China. More importantly, the shareholders’ vote is essential for supervision of the CCP as well as the relationship between the CCP and SOE.

¹⁵⁹ *Id.*

¹⁶⁰ See XIANFA art. 55 (2004).

¹⁶¹ See Quanguo Renmin Daibiao Dahui he Difang Geji Renmin Daibiao Dahui Xuanju Fa (全国人民代表大会和地方各级人民代表大会选举法) [Law China on Election of the National People’s Congress and Local People’s Congress] (promulgated by the Nat’l People’s Cong., Mar. 14, 2010, effective Mar. 14, 2010) art. 2 (Chinalawinfo).

¹⁶² China Moves Top Bosses in Oil Sector, Wall Street Journal (Apr. 9, 2011), http://online.wsj.com/article/SB10001424052748704503104576250243224429846.html?mod=WSJ_hp_p_sections_management (last visited Apr. 10, 2011).

¹⁶³ It should be noted that the public is not involved in the election process. Notwithstanding the PRC Communist Party is claimed to be the representative of all Chinese people, Chinese people are not entitled to vote on the appointment of senior management of the SOEs.