

Enhancement and Protection of Shareholder Inspection Rights under the Revision of the Company Law

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Abstract: The shareholder inspection rights to be informed, as the preliminary basis for exercising shareholder rights, is the cornerstone of the entire shareholder rights system, playing both a remedial and auxiliary role. [1] In this paper, we delve into the critical enhancement and protection of shareholder inspection rights in the wake of amendments to the Company Law in China. It scrutinizes the evolution and pivotal role of these rights in modern corporate governance, enabling shareholders to effectively supervise management and participate in decision-making. The study identifies challenges in the practical implementation of inspection rights, especially for minority shareholders in small to large companies, where issues like equity concentration and management obfuscation hinder transparency. Through a thorough analysis and international comparison, the paper proposes reforms to strengthen the legal framework around these rights, including improved shareholder education, standardized processes, enhanced information disclosure, and optimized corporate governance structures. This balanced approach aims to protect company interests while ensuring shareholder rights are respected, fostering a culture of accountability and transparency. The paper concludes with the potential of the Company Law revision as an opportunity to solidify shareholder inspection rights, enhancing corporate governance and equity in the corporate ecosystem in China.

1. Introduction

The establishment of the modern corporate system has led to the mutual independence of shareholders and companies in terms of property, and their separation in personality, adopting a management model where ownership and management rights are separated. The right of shareholders to know is an inevitable outcome based on this management model. The so-called right of shareholders to know refers to the legal right of shareholders to understand the company's operational status and supervise the activities of senior management personnel. It is the foundational right for shareholders to exercise rights to profits, decision-making, and supervision, and it is a precondition for small and medium-sized shareholders to protect their rights and interests under the modern corporate system. The term "shareholder inspection rights" translates more directly to "shareholder rights to inquire" in English. However, in practice, the term "shareholder inspection rights" has been widely used, especially after the Supreme People's Court issued the "Decision on

Amending the <Civil Case Cause Regulations>", clearly defining the cause of action for shareholder inspection rights as "shareholder inspection rights disputes". Therefore, this paper also adopts the term "shareholder inspection rights". Shareholder inspection rights are basic rights of shareholders, and the rights to decision-making, supervision, and inquiry of shareholders must be based on being informed about the company's operational situation. However, in practice, there are significant problems with the implementation of shareholder inspection rights. On the one hand, for small and medium-sized companies, there often exists a high concentration of equity or even dominance by a single shareholder, where minority shareholders do not directly participate in company operations, and controlling shareholders or actual controllers for various reasons are not willing to share the company's operational status actively, even intentionally concealing or providing incorrect information; on the other hand, as the company grows, for large and listed companies, there exists a separation of ownership and management rights, where shareholders do not participate in the company's daily operations, thus enabling the management to conceal the company's operational status, infringing upon the legitimate rights and interests of the company and shareholders.

2. Subject of Rights

Shareholder inspection rights are rights legally granted to shareholders to understand company information, with shareholder identity being the subject element of parties exercising rights to know. In general cases, shareholder identity can be determined based on the enterprise credit information publicity system, shareholder register, share transfer agreement, shareholder meeting resolution, company charter, etc. [2] In practice, situations where disputes arise over the subject of rights mainly include the following:

(1) Can hidden shareholders exercise rights to know?

The equity holding relationship between hidden shareholders (actual contributors) and nominal shareholders belongs to an entrustment-agency relationship, with hidden shareholders being the principals and nominal shareholders being the agents. The Supreme People's Court has issued a judicial interpretation recognizing the legality of the mechanism. [3] The agency is divided into the hidden and explicit agency, corresponding to hidden and explicit equity holding, respectively. Hidden equity holding refers to other shareholders of the company being unaware of the equity holding relationship between the actual contributor and the nominal shareholder. Explicit equity holding refers to the company and other shareholders being aware of the hidden contribution relationship, agreeing to allow the hidden contributor to participate in company management, or allowing the hidden contributor to attend shareholder meetings and exercise voting rights corresponding to the hidden investment or distribute dividends to the hidden investor, and so on. The agreement on "equity holding" between hidden shareholders and nominal shareholders only takes effect between the contracting parties and cannot be opposed by the company and other shareholders. Therefore, unless the shareholder status of the hidden shareholder has been confirmed, they do not have the right to directly exercise shareholder inspection rights against the company. However, hidden shareholders recognized by the company can directly claim rights to know against the company. In the appeal case of the shareholder inspection rights dispute between Gan Commercial United Co., Ltd. and Shanghai Lifeng Logistics Co., Ltd., the court held that Gan Commercial Company confirmed Lifeng Company's fulfillment of contribution obligations and issued a "Shareholding Certificate" clearly stating that "the shareholder's obligations and shareholder rights are still the responsibility and enjoyment of Lifeng Company", hence Gan Commercial Company should be aware of and confirm Lifeng Company's shareholder status. Therefore, shareholder inspection rights are basic rights of shareholder interests, and the company,

being aware of the hidden shareholder's identity, should protect the hidden shareholder's rights to know.[4]

(2)Can shareholders who have not completed change registration exercise rights to know?

Regarding the issue of whether new shareholders who have not completed change registration have shareholder status. If investors have paid the equity transfer payment according to the contract and have participated in the target company's operations, although the equity change registration procedures have not been completed between the two parties to this day, this does not affect the investors becoming shareholders of the target company. Hence, new shareholders are shareholders of the target company and legally enjoy shareholder status rights.[5]

3. Scope of Rights

The scope of rights refers to which materials shareholders have the right to inquire into, which can be divided into the scope of materials and the scope of time. Correctly determining the scope of rights is key to the successful exercise of shareholder inspection rights. According to an empirical study conducted by the Shanghai No.1 Intermediate People's Court in 2007, from 2002 to 2006, the Shanghai No.1 Intermediate People's Court and two other basic courts accepted a total of 46 right-to-know cases. One of the main disputes was over the scope of accessible material, in particular, whether the term "financial reports" included the books of accounts [6]. The new company law has clarified this issue.

According to the provisions of the "Company Law", the scope of materials for shareholders to exercise shareholder inspection rights can be divided into the following two categories: One category is documented without purpose restrictions, including the company charter, shareholder register, shareholder meeting records, board of directors resolutions, supervisory board resolutions, and financial accounting reports. For joint-stock limited companies, they even need to be disclosed to an unspecified majority of entities, hence these documents are relatively public materials in nature. Therefore, shareholders' inquiries into these materials are not subject to purpose restrictions. The other category is documents for which shareholders must explain the purpose of inquiry, including accounting books and accounting vouchers. Company accounting books, as well as the original vouchers necessary for forming accounting books, such as bank transaction records, relate to the specific situation of the company's operations, including core information such as company transaction amounts, transaction objects, transaction prices, etc., belonging to the company's commercial secrets. If improperly disclosed, it may have a significant impact on the company's business opportunities, profitability, etc. Hence, the company is given the opportunity to review the purpose of shareholders exercising rights, preventing shareholders from improperly exercising rights and damaging company interests. In this case, shareholders requesting to inquire into company accounting books should follow the content stipulated by the aforementioned laws and regulations, submit a written application to the company, and clearly state the content and purpose of the inquiry. In practice, disputes over the scope of rights also include the following aspects:

(1)Can shareholders request excerpts from accounting books and accounting vouchers?

For accounting books and accounting vouchers, the Company Law stipulates that shareholders can only inquire, not copy. On the one hand, company accounting books generally include a large amount of professional data information. In cases where shareholders cannot fully understand professional data information, it cannot be considered that merely shareholders themselves inquiring into accounting books realize the right to know.[7] From an objective common sense understanding, necessary excerpts are an implementation form of "inquiry" under this method of rights exercise, with its rationality. On the other hand, "excerpts" can easily become a form of "copying", becoming a means for parties to circumvent legal restrictions. Article 44 of the "Several

Provisions of the Supreme People's Court on Civil Litigation Evidence" stipulates: "Excerpts from files and materials related to case facts produced by relevant units should indicate the source and be sealed with the producing unit or custodian unit's seal." Referencing legal and judicial interpretation regulations on evidence, shareholders should specify the specific file range and source for excerpts and fully explain the reasons, otherwise, courts generally should not support it.

(2) Can shareholders request an audit of the company's financial situation

In practice, it is very common for companies to set up internal and external accounts and operate smuggled accounts. Merely relying on inquiring into financial reports or accounting books often cannot check the company's overall operational situation. Therefore, some shareholders request an audit of the company's financial situation. However, on the one hand, judicial audits are not within the statutory scope of shareholder inspection rights. Shareholder inspection rights are important rights legally granted to company shareholders to understand the company's operational situation, but the exercise of this right must comply with the provisions of China's "Company Law", "Accounting Law", and other laws, as well as the provisions of the company charter. Conducting an audit belongs to the company's autonomous area, and in general, the court should not directly intervene in a company's autonomous affairs through state coercive force. In the absence of clear stipulations in the company charter or investment agreement, shareholders have no right to request a judicial audit of company accounts.[8]

4. Practical Recommendations

4.1 Clarifying and Standardizing the Exercise Process

Companies should establish a clear process for exercising the right to know, including how requests are made, the review process, and response times, ensuring that the process is open, transparent, and efficient. Additionally, companies should actively respond and cooperate with shareholders' reasonable requests, which not only protects shareholders' legal rights but also aids in the efficient operation of the company management.

4.2 Establishing an Effective Information Disclosure Mechanism

Transparent information disclosure can reduce the need for shareholders to exercise their right to know and enhance the company's credibility. Companies should proactively and promptly disclose information about the company's operations through regular financial reports, shareholder meetings, and official websites, thus reducing unnecessary inquiries by shareholders and improving the transparency of company operations.

4.3 Optimizing Corporate Governance Structure

Companies should continuously improve the corporate governance structure and strengthen internal governance to ensure smooth information flow. Emphasizing the role of the board of directors and the supervisory board is crucial to ensuring clear responsibilities and rights among shareholders, the board, and management, thereby reducing potential friction and misunderstandings when shareholders exercise their right to know.

5. Conclusions

In conclusion, this paper comprehensively investigates the imperative of enhancing and protecting shareholder inspection rights within the context of the Company Law revisions. Our

analysis underscores the crucial role these rights play in bridging the inherent gap between ownership and management in modern corporations, thus empowering shareholders with the necessary tools to effectively oversee managerial conduct and partake in corporate governance. Through a meticulous examination of the evolution of shareholder inspection rights, legal disputes, and comparative international practices, we have identified several areas where the current legal framework could be further strengthened to better serve its intended purpose. Our recommendations for enhancing shareholder inspection rights include the need for greater shareholder education, standardization of processes, effective information disclosure, optimization of corporate governance structures, and careful consideration of cross-border legal variances. These measures are essential for ensuring that shareholders are well-equipped to exercise their rights effectively and contribute to the overall health and transparency of corporate governance systems. Moreover, our analysis of legal disputes and barring conditions has highlighted the need for a balanced approach that safeguards the company's interests while ensuring shareholders' rights are not unduly restricted. This balance is crucial for maintaining trust and promoting a culture of accountability and transparency within corporations. Ultimately, the ongoing revision of the Company Law presents a pivotal opportunity to fortify shareholder inspection rights, thereby enhancing corporate governance and contributing to a more robust, transparent, and equitable corporate ecosystem. As this paper has demonstrated, achieving this goal requires a concerted effort from lawmakers, corporations, and shareholders alike, guided by a commitment to continuous improvement and adaptation to the evolving demands of the modern corporate landscape.

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