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Study on the Information Rights of Minority Shareholders

-- With Comments on Article 57 of the Revised Company Law

Liya Ma

Henan Polytechnic University, Jiaozuo 454003, China

Abstract

Strengthening the protection of minority shareholders' rights represents a key improvement in the recent amendments to the Company Law. These revisions demonstrate the legislature's attempt to strike a balance between safeguarding minority shareholders' right to information and protecting corporate interests. In particular, Article 57 of the revised Company Law provides a clear legislative response to long-standing judicial disputes regarding the scope of information accessible to minority shareholders. It grants minority shareholders the right to inspect and copy accounting books and accounting vouchers, thereby establishing a mechanism that, to some extent, constrains the influence of majority shareholders. This adjustment is expected to mitigate the prevailing situation of absolute control by majority shareholders and contribute positively to corporate development.

Keywords

Revised Company Law; Accounting Vouchers; The System of Piercing Exercise of Shareholders' Right to Know.

1. Raising of the Issue

With the advancement of optimizing the business environment, the protection of minority shareholders' rights and interests has attracted considerable attention. The decision-making of most limited liability companies in China generally follows the rule of majority voting by capital contribution. As a result, controlling shareholders or actual controllers with a high proportion of capital contributions tend to hold a dominant position in the exercise of corporate control. In contrast, minority shareholders, who hold a low proportion of capital contributions and have limited participation in corporate operation and management, face significant risks in the protection of their shareholder rights and interests when disputes arise in corporate operation and management, or when controlling shareholders and actual controllers intentionally infringe upon their rights and interests. In judicial practice, such risks are mainly manifested in three prominent predicaments: difficulty in obtaining information, difficulty in receiving dividends and difficulty in withdrawing capital.

The newly revised Company Law has made significant adjustments to the provisions governing shareholders' right to know. It expands the scope of documents accessible to shareholders to include the shareholder register and accounting vouchers, and extends the objects of inspection to the wholly-owned subsidiaries of the company. Article 57 of the newly revised Company Law further clarifies and expands the scope, objects and exercise methods for the implementation and enforcement of the right-to-know system. In essence, it increases the possibility for minority shareholders excluded from corporate management to substantially understand the company’s operational status, thereby safeguarding their substantive rights such as equity dividends. However, in practice, there remain considerable disputes over whether nominal shareholders and shareholders with defective capital contributions are entitled to the right to know. Regarding the constraint of improper purpose on the exercise of minority shareholders' right to know, the Judicial Interpretation (IV) of the Company Law adopts a legislative model of enumeration plus residual provisions, yet courts at different levels hold highly divergent opinions on the recognition of improper purpose.

2. The Necessity of Protecting Minority Shareholders' Right to Know

Minority shareholders play a crucial role in corporate governance. They provide essential capital support for companies and serve as an important guarantee for the sound development of companies. However, due to their relatively small shareholding ratio, minority shareholders are often confronted with such challenges as information asymmetry, low participation in decision-making and vulnerable rights and interests in corporate governance. These challenges may lead to the neglect or sacrifice of minority shareholders' interests, thereby undermining the long-term stability of companies and the overall fairness of the market.

(1)Inevitable Interest Conflicts between Minority and Controlling Shareholders

First, in terms of internal corporate governance, the separation of ownership and management rights means that most minority shareholders do not participate in corporate operation and management. They are unable to exert a decisive influence on the major business decisions of the company, nor can they gain a good understanding of the company's operating status. This results in severe information asymmetry between controlling shareholders and minority shareholders, which largely lays the groundwork for controlling shareholders to damage minority shareholders' interests alone or in collusion with the management. Without legal protection, this inherent information asymmetry between the two parties is difficult to resolve.[1]

Second, in the distribution of interests, the absolute shareholding advantage of controlling shareholders aligns their interests with those of the management. Besides dividend income, controlling shareholders can obtain more earnings in the form of salaries and bonuses, making them shareholders with diversified income sources who prioritize corporate operation. In contrast, minority shareholders focus more on dividend income rights as shareholders with a single source of earnings. The divergent focus of their interests directly leads to conflicts between the two parties.

(2)Difficulties in Judicial Remedies

In equity disputes, after dominant shareholders seize control, minority shareholders often lose channels for communication and deliberation directly, leaving litigation as their last resort to safeguard their rights and interests. In reality, however, the path of judicial remedy is fraught with obstacles. The current Company Law entitles shareholders to the following rights: shareholder identity right, share withdrawal right, right to know, right to propose, convene and preside over extraordinary meetings, preemptive right to transfer and subscribe for new shares, and the right to institute litigation in their own name against those who infringe upon the company's or shareholders' interests. Minority shareholders may file lawsuits with people's courts if their aforementioned rights are infringed upon. Despite the diverse judicial remedies provided by law, it remains difficult to realize such remedies in practice.

First, the resolution of disputes through judicial remedies always relies on shareholders' understanding of the company. Yet minority shareholders have been marginalized in the actual operation of the company, and the evidence necessary for litigation is often controlled by controlling shareholders, making evidence collection far from easy. Such difficulties may directly deter minority shareholders from safeguarding their rights. Second, if monetary claims are involved, shareholders must quantify the specific losses of rights to obtain court support, which is inherently difficult in practice. For example, in lawsuits claiming the right to obtain the company's residual assets, minority shareholders who do not participate in the company's direct operation have no access to the company's financial information and lack evidence to support their specific claims. They have to file a prior lawsuit for the right to know, which involves complex procedures and high time and economic costs, further increasing the difficulty for minority shareholders to protect their rights.

3. Innovative Provisions of the Revised Company Law on Protecting Minority Shareholders' Right to Know

The Revised Company Law has achieved remarkable progress in protecting minority shareholders' rights. Through a series of innovative provisions-such as strengthening shareholders' right to know and improving the appraisal right of dissentient shareholders-it has comprehensively elevated the status and rights of minority shareholders in corporate governance. These provisions not only balance internal corporate interests, but also advance the modernization of corporate governance, laying a solid foundation for establishing a fairer, more transparent and efficient corporate governance environment.

(1) Newly Added Right to Inspect and Copy the Shareholder Register and Accounting Vouchers

The exercise of shareholders' rights is premised on the confirmation of shareholder qualification. In practice, inconsistencies between the shareholder register and industrial and commercial registration are common. The Company Law explicitly stipulates that shareholders recorded in the shareholder register may claim and exercise their shareholder rights in accordance with the register. Therefore, the revision entitles shareholders of limited liability companies to inspect and copy the shareholder register, which helps them confirm their shareholder qualification and safeguards the important prerequisite for the subsequent exercise of shareholder rights.

For the purpose of exercising the right to know, accounting vouchers, as the basis for keeping accounting books, are core documents that best reflect the true financial status of a company. The authenticity and completeness of accounting books can only be judged by reference to accounting vouchers. Hence, an overwhelming majority of shareholders claim the right to inspect accounting vouchers in lawsuits over the shareholder right to know, yet courts at all levels across the country hold widely divergent opinions due to the lack of clear legal provisions. After this revision, shareholders of both limited liability companies and joint stock limited companies are entitled to inspect the company's accounting vouchers. This enables shareholders to gain an in-depth understanding of the company's financial activities and operating status, so as to exercise their supervision rights and participation rights in corporate decision-making more effectively, and unifies the judicial adjudication standards at the same time.[2]

(2)Expansion of the Subject of Exercise to Shareholders of Joint Stock Limited Companies

In terms of the subject entitled to exercise the right to know, the major change is the explicit confirmation of the qualification of shareholders of joint stock limited companies to exercise such rights. Prior to the revision, the original Company Law only granted shareholders of limited liability companies the right to inspect accounting books, but did not entitle shareholders of joint stock limited companies to the same right. The main reason is that most joint stock limited companies are listed companies with a large and highly mobile shareholder base. In addition, listed companies are subject to information disclosure obligations, and shareholders can obtain the company's accounting information through public channels. If the right to know is fully open to all shareholders who do not substantially participate in the company's daily operation and management, it may easily lead to the abuse of rights and thus damage the company's interests.[3] However, this original intention has neglected, to a certain extent, the demand of shareholders of unlisted joint stock limited companies to exercise their rights, leaving them with neither public channels to access the company's financial information

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nor legal basis for exercising their rights. The difficulty in inspecting accounting books has become an intractable practical problem for this group of shareholders.

The revision has addressed this problem effectively. Article 110 of the Revised Company Law explicitly confirms the status of shareholders who hold, individually or jointly, 3 percent or more of the company's shares for a consecutive period of 180 days or more as the subject entitled to inspect the company's accounting books and accounting vouchers. Meanwhile, it allows the company's articles of association to set a lower shareholding ratio, endowing the company with the autonomy to reduce the threshold for inspection. This has effectively balanced the protection of shareholders' rights and the restriction of rights abuse.

(3)Expansion of the Scope of the Subject of Actual Exercise of Rights and Codification of Judicial Interpretations into Statute

Article 10 of the Judicial Interpretation (IV) of the Supreme People's Court on the Application of the Company Law of the People's Republic of China (2020 Amendment) stipulates that where a people's court upholds a shareholder's claim to inspect or copy specific documents and materials of the company, it shall specify in the judgment the time, place and list of such documents and materials. Where a shareholder inspects the company's documents and materials in accordance with an effective judgment of the people's court, professional personnel of intermediary institutions who are legally or professionally bound to keep confidentiality, such as accountants and lawyers, may provide assistance in the presence of the shareholder.

The provisions governing professional assistants in Paragraph 2 of Article 57 of the Revised Company Law essentially codify the relevant judicial interpretation into statutory law, while expanding its scope of application. Pursuant to the Judicial Interpretation (IV) of the Company Law, a prerequisite applies to accountants or lawyers providing assistance in inspecting and duplicating relevant materials: the shareholder must be present in person at all times. Such professionals only render auxiliary services in the process, and their scope of inspection and authority cannot, in essence, be further extended to the company's wholly-owned subsidiaries.[4] They merely provide supportive inquiry services, rather than acting as entrusted agents. In contrast, the Revised Company Law further clarifies shareholders'right to entrust intermediary institutions with conducting accounting inspections. In the course of inspection and duplication, accountants, lawyers and other professionals become the primary participants, who conduct the inspection by virtue of the shareholders' direct authorization. This arrangement has significantly enhanced the operability of shareholders'right to know.

There have long been divergent views on whether a company's shareholders are entitled to the right to know in respect of the subsidiaries established by the company. In accordance with traditional corporate law theory, only a person with the status of a shareholder is entitled to the right to know against the company in which they hold shares. Both the parent company and its subsidiaries are independent legal persons, and shareholders of the parent company only enjoy shareholder rights in respect of the parent company, with no direct shareholder relationship with the subsidiaries. Therefore, shareholders of the parent company shall not break through the independent legal person status of the subsidiaries to directly inspect the relevant financial materials of the latter.

In practice, however, group companies are a common organizational form, where the parent company serves merely as a shareholding platform and subsidiaries engage in the main business operations. In such cases, the financial status of subsidiaries exerts a significant impact on the interests of the parent company and its shareholders, yet shareholders of the parent company lack legal basis and channels to obtain the financial information of subsidiaries, making it hard for them to truly understand the company's operating status. Furthermore, to evade minority shareholders' right to know, some controlling shareholders often transfer company assets to subsidiaries, resulting in the transfer or withdrawal of assets between parent and subsidiary companies and the long-term deprivation of profit distribution for minority shareholders.

This revision explicitly entitles shareholders of both limited liability companies and joint stock limited companies to exercise the piercing right to know against the company’s wholly-owned subsidiaries. It further safeguards the rights and interests of minority shareholders under multi-tier shareholding structures, prevents the management or controlling shareholders from conducting interest transfer or infringing upon the company’s rights improperly through multi-tier shareholding structures, and balances the protection of the rights of other shareholders of non-wholly-owned subsidiaries. In this way, the value and legislative purpose of the shareholder right to know have been further expanded and protected.

4. Judicial Remedies for Disputes over Minority Shareholders' Right to Know under the Revised Company Law

(1)Issues Concerning Subject Qualification

Article 7 of the Judicial Interpretation (IV) of the Company Law stipulates: "Where a shareholder initiates a lawsuit to request inspection or copying of specific documents and materials of the company in accordance with Articles 33 and 97 of the Company Law or the provisions of the company's articles of association, the people's court shall accept the case in accordance with the law." Therefore, the plaintiff initiating a lawsuit for the shareholder right to know must possess the qualification of a company shareholder. Generally, the burden of proving shareholder identity can be fulfilled by submitting the shareholder register or the registration with the company registration authority. However, with the increasing prevalence of equity holding on behalf of others, there are numerous disputes regarding whether nominal shareholders of limited liability companies can claim and exercise the right to know, as well as the methods of exercising such right.

One view holds that nominal shareholders are entitled to the shareholder right to know. For example, in the dispute over the right to know with case number (2019) Chuan 01 Min Zhong No. 5465, the court held that in disputes over the shareholder right to know, the general standard for courts to examine a party’s shareholder qualification is formal examination. Disputes over the confirmation of shareholder qualification and disputes over the shareholder right to know are not the same legal relationship. If a party disputes the shareholder qualification, it may seek remedies through other litigation or dispute resolution methods, but this does not affect the court’s trial of the dispute over the shareholder right to know based on existing evidence. In the dispute over the right to know with case number (2020) Hu 02 Min Zhong No. 8776, the Shanghai No. 2 Intermediate People’s Court held that the shareholder right to know is a fundamental right of shareholder interests, and if the company is aware of the identity of the nominal shareholder, it shall protect such shareholder’s right to know.[5]

The other view argues that nominal shareholders are not entitled to the shareholder right to know. Most of the current judicial adjudication rules hold that nominal shareholders have no right to exercise the shareholder right to know before being recognized as registered shareholders. For instance, in the dispute over the right to know with case number (2015) Min Shen Zi No. 2709, the Supreme People’s Court held that since Wu Zengfu was a nominal shareholder of Fajina Company, the shareholder rights he enjoyed against Fajina Company should be claimed through the registered shareholder. Wu Zengfu’s personal claim to exercise the shareholder right to know against Fajina Company and request the company to provide relevant accounting materials lacked legal basis. In the dispute over the right to know with case number (2018) Su 04 Min Zhong No. 1853, the court held that even if it is verified that the identity of the nominal shareholder is recognized by other shareholders of the company and

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the nominal shareholder enjoys certain rights within the company, such shareholder cannot independently exercise shareholder rights externally in their own name before being registered; instead, their shareholder rights should be exercised through the registered shareholder.

Article 57 of the Revised Company Law regulates the right to know of shareholders of limited liability companies, but it does not directly exclude nominal shareholders from the scope of subjects entitled to the right to know. The establishment of the nominal shareholder system reflects the freedom of contract and autonomy of will, which is fully in line with the purposes of contractual freedom and private law autonomy. Such a special contract is not essentially different from ordinary contracts. As long as both parties reach a consensus and there is no malicious intent, the legal effect of such a contract should not be denied. In addition, public power should not excessively interfere with private rights. Commercial law is inherently private law, while company registration is an administrative legal act that reflects state will, featuring obvious mandatory state provisions and belonging to the scope of public law. Public law is based on private law, and the structure between public law and private law should be dominated by private law. The rights that nominal shareholders are entitled to should not be easily denied merely due to the irregularity of their formal characteristics. [6]Therefore, when a nominal shareholder meets the standard of "substantive registration," their right to know should be affirmed in legislation.

(2)Selection of Litigation Defendant

The Revised Company Law stipulates: "Where a shareholder requests to inspect or copy relevant materials of the company’s wholly-owned subsidiary, the provisions of the preceding four paragraphs shall apply." However, it does not clearly specify whether a shareholder of the parent company should submit the request to the parent company or the wholly-owned subsidiary when seeking to inspect relevant materials of the latter. Prior to the entry into force of the Revised Company Law, judicial practice generally required such requests to be submitted to the parent company, which would then provide the relevant materials of the subsidiary. From the perspective of the provisions of the Revised Company Law, neither approach conflicts with the law, but the two interpretations correspond to different methods of right remedy and litigation. If the exercise of the right pierces through to the subsidiary (i.e., piercing subject), the wholly-owned subsidiary shall be listed as the defendant in the lawsuit, and the parent company may be listed as a third party. If the effect of the exercise pierces through to the subsidiary (i.e., piercing effect), the parent company shall be listed as the defendant, but the litigation claim must specify a request for the parent company to provide relevant materials of the wholly-owned subsidiary for inspection or copying, and the wholly-owned subsidiary may be listed as a third party. Therefore, the specific implementation method needs to be further clarified through judicial interpretations. Given that the Revised Company Law has already made clear provisions, it is inappropriate to continue requiring shareholders to submit requests to the parent company, as this would undermine efficiency.

There are also numerous disputes over whether the "piercing" of the shareholder right to know can be extended to non-wholly-owned subsidiaries. Before the Revised Company Law improved the system of piercing exercise of the shareholder right to know, most courts denied requests by parent company shareholders to exercise the right to know against subsidiaries, citing three main reasons: first, allowing parent company shareholders to inspect subsidiary information would undermine the independent legal personality of the subsidiary; second, there is no legal relationship between parent company shareholders and the subsidiary; third, the parent company has no legal basis to exercise the right to know against the subsidiary. The Revised Company Law expands the objects of the shareholder right to know to include subsidiaries, but only wholly-owned ones. Why not further expand it to controlled subsidiaries? Some scholars have pointed out that under the current situation of multi-tier shareholding,

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parties can still evade the application of the piercing rule by establishing a subsidiary with 99% shareholding.

However, it would be inefficient to include controlled subsidiaries in the regulation to avoid such drawbacks. Besides the controlling shareholder, a controlled subsidiary must have at least one minority shareholder, who can exercise the shareholder right to know and initiate a simple shareholder derivative lawsuit on their own, without the need for a dual shareholder derivative lawsuit as a supporting measure.

(3)Issues Concerning the Legitimate Purpose of Lawsuits for the Right to Know

The determination of "improper purpose" is an important means to restrict shareholders' exercise of the right to inspect, essentially representing a balance struck by law between protecting the shareholder right to know and maintaining the normal order of corporate operation and management. The purpose of a shareholder initiating a lawsuit for the right to inspect may not only be to obtain information itself, but also to use the information to take further legal actions, such as claiming profit distribution, applying for company liquidation, or initiating a derivative lawsuit against the management.[7]

Pursuant to Article 57 of the Revised Company Law and Article 8 of the Judicial Interpretation (IV) of the Company Law, when a shareholder requests to inspect accounting books, a limited liability company has the right to refuse the exercise of the right to know if it can provide evidence proving that the shareholder has an improper purpose. Through research on cases involving the "improper purpose" of the right to inspect, the main reason for determining such a purpose is the existence of a substantive competitive relationship between the shareholder and the company. [8]A major dispute in judicial practice lies in how to determine a "substantive competitive relationship," which is also the most commonly used defense by defendant companies. Some courts hold that a substantive competitive relationship refers to a conflict of interest between the shareholder and the company, and such a situation needs to be comprehensively determined based on the facts of the case, generally including factors such as the content of services and products produced, service objects and product audiences, the industry and geographical location of the corresponding market, and the intensity of competition in that market. For example, in case number (2020) Su Min Shen No. 1341, the court held that the plaintiff held shares in two companies, and the main business scope of the defendant company included that of the other company. The medical devices produced by the defendant company had the same or highly similar names and functions as those of the other company, which was sufficient to prove that the plaintiff had formed horizontal competition with the defendant company by establishing an affiliated company, indicating an improper purpose. Therefore, the court rejected the plaintiff's claim to exercise the right to know. Other courts hold that a "substantive competitive relationship" may exist as long as there is a high degree of overlap in business scopes, adopting a relatively direct standard of determination.

In practice, it is common for shareholders to engage in businesses that compete with the company. It is consistent with shareholders' pursuit of economic interests to invest by leveraging their familiarity with relevant businesses. If shareholders engaging in businesses with certain competitive relations with the company are subject to strict requirements or their right to know is excessively restricted, it will damage their rights and hinder the sound development of market competition. Shareholders can prove the legitimacy of their purpose from the perspective of not operating on their own behalf or on behalf of others. "Operating on their own behalf" emphasizes that the shareholder participates in the actual operation and management of the competing company, i.e., the shareholder actually holds the company's operational decision-making power and can determine the company's operation and development direction. Therefore, the shareholder generally needs to hold positions such as director or senior manager in the competing company. If the shareholder only invests in the competing company and receives returns from the investment without participating in the specific operation and management of the company, it cannot be concluded that the shareholder exercises the right to know with an improper purpose. Second, shareholders can demonstrate the absence of a substantive competitive relationship from a market perspective by comprehensively considering factors such as the region of business operation, business hours, product types, and customer scope between the company they operate and the target company. In addition, if a shareholder's main business was similar to that of the company before becoming a shareholder, it should be deemed that the company, by accepting them as a shareholder, had full knowledge and recognition of this fact, and cannot subsequently refuse to allow the shareholder to exercise the right to know on this ground.

Furthermore, shareholders can prove the legitimacy of their purpose through the following aspects: first, to understand the company's financial and operational status; second, to prepare for relevant equity evaluation or commercial transactions; third, to collect evidence for investigating potential improper conduct.[9]

5. Conclusion

There exists information asymmetry between shareholders, especially minority shareholders, and the company, controlling shareholders, and management. The right to know is the foundation for shareholders to resolve such information asymmetry and exercise other shareholder rights. The Revised Company Law has strengthened the protection of minority shareholders' rights and interests, but such protection cannot be absolutely achieved solely through legal norms. What truly safeguards minority shareholders' rights and interests is their own prudence and active attitude towards participating in corporate management. Due to the nature of commercial activities being dominated by autonomy, many matters are still governed by the company's articles of association as autonomous norms. This requires minority shareholders to fully consider risks, pay close attention to and make good use of the company's articles of association, and fully understand matters such as the company's meeting agenda and profit distribution before becoming shareholders. After becoming shareholders, they should recognize their identity, actively participate in the actual operation and management of the company, and actively promote the implementation of various provisions in the articles of association regarding shareholder rights and corporate governance to safeguard their own interests.

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