Shareholder Inspection Rights in China: An Empirical Inquiry

Robin Hui Huang
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ROBIN HUI HUANG*

Abstract

Drawing upon overseas experiences, notably the U.S., China introduced the legal regime for shareholder inspection rights in its first national company law and over the years, has gradually developed more detailed rules and made amendments intended to better suit the local conditions. Apart from written law, this paper also conducts an empirical study of how the law has been applied in practice, by examining relevant cases adjudicated from 2012 to 2017. The empirical findings show that China’s shareholder inspection rights have some distinctive features, and there are similarities and differences between China and the U.S. (as represented by Delaware). Despite the different types of agency problems in corporate governance between China and the U.S., shareholder inspection rights are similarly useful in mitigating informational asymmetry and facilitating shareholder engagement. Some of the differences, such as those on the number and types of subsequent litigation, can be explained by the different patterns of corporate governance strategies as well as different corporate litigation regimes between the two jurisdictions. This paper also reveals that there are some significant differences in the key elements of the legal framework for shareholder inspection rights between the two jurisdictions and based on this, sets out improvement suggestions for China.

Keywords: shareholder inspection rights, access to corporate documents, informational asymmetry, corporate governance, China

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1. Introduction

The term “shareholder inspection rights” refers to an important type of shareholder right, which gives the shareholders access to relevant documents in their company. As a result of the separation of ownership and management, the shareholders, particularly those in large or public companies, are not involved in the daily operation of their company and thus the management (and actual controllers of the company) may have incentives to behave opportunistically to the harm of the shareholders. Hence, it is important to empower the shareholders to inspect corporate documents, so they can obtain relevant information to monitor the company’s performance, engage in corporate governance matters, and determine whether and how to take proper action such as a proxy fight to replace the incumbent...
management team or a derivative suit against directors and others who cause harm to the company.

Drawing upon overseas experiences, notably U.S. law, China introduced the concept of shareholder inspection rights in broad terms when its first national company law was enacted in 1993 and has since continued to improve the regime, particularly in the 2005 company law revision.1 Across the U.S., shareholder inspection rights are in the statutes, albeit with some significant differences amongst them. This paper will undertake a comprehensive examination of shareholder inspection rights in China and evaluate the effectiveness of the Chinese regime by comparing it with the law in Delaware, the preeminent corporate law jurisdiction in the U.S.2 It will examine not only written law, but also the law in action, namely how the law is applied in practice, by way of an empirical analysis of the relevant cases.

The remainder of the paper proceeds as follows: Part II will trace the historical development of the shareholder inspection rights in China and discuss the key features of the current law. Part III will present an empirical study of relevant cases on inspection rights in China. Part IV will compare the Chinese law for shareholder inspection rights with that of Delaware and offer explanations for the similarities and differences between them.

II. The Legal Framework

A. A Brief History

The Chinese regime for shareholder inspection rights can be traced back to the first national company law of the PRC, namely the 1993 PRC Company Law.3 The relevant provisions therein, however, were very brief and general, simply stating that the shareholders have the right to inspect certain materials such as the minutes of the shareholders’ meetings and the


financial reports. According to an empirical study conducted by a research team of the First Intermediate Court of Shanghai Municipality in 2007 (2007 Shanghai Study), there were a total of 46 inspection rights cases heard and two other local district courts in Shanghai during the period of 2002 to 2006. One main dispute related to the scope of materials that can be inspected, in particular, whether the term ‘financial reports’ covers accounting books. Further, in some cases, the company rejected the shareholder inspection request on the grounds that the request was not for a proper purpose, even though the 1993 PRC Company Law does not mention the ‘proper purpose’ requirement at all.

The 1993 Company Law underwent several minor amendments before it was overhauled in 2005 and was thus called the 2005 PRC Company Law, which is still in force today despite some minor revisions thereafter. The 2005 PRC Company Law represents a significant improvement on its 1993 predecessor, providing more details on the regime of shareholder inspection rights. However, over the years, the provisions concerning shareholder inspection rights under the 2005 PRC Company Law proved to be inadequate. On 25 August 2017, the Supreme People’s Court (SPC) promulgated the long-awaited fourth judicial interpretation on the 2005 Company Law (2017 Judicial Interpretation), which came into effect on 1 September 2017. It is focused on various types of company litigation concerning shareholder rights, including inspection rights litigation. A total of six provisions are devoted to inspection rights litigation, providing more guidance on how the cases should be brought and heard.


B. Key Features of the Law

The key features of the shareholder inspection rights under Chinese law can be summarized below. First, shareholder inspection rights are regulated differently according to the type of company. There are two main types of companies allowed under the Chinese company law, namely the limited liability companies (LLC) and the joint-stock limited companies (JSC). From a comparative law perspective, the Chinese LLC is broadly similar to the close corporation in the U.S. or the private company in British Commonwealth jurisdictions, while the JSC corresponds to the publicly held corporation or the public company in the Anglo-American world.6

Under §33 of the 2005 PRC Company Law, shareholder inspection rights are stipulated in the context of LLCs as follows:

Every shareholder shall be entitled to review and duplicate the company’s bylaws, the minutes of the shareholders’ meetings, the resolutions of the board of directors’ meetings, the resolutions of the board of supervisors’ meetings, as well as the financial reports.

Every shareholder may request to review the accounting books of the company. Where a shareholder requests to review the accounting books of the company, it shall submit a written request, which shall state his motives. If the company, has the legitimate reason to believe that the shareholder’s requests to review the accounting books has an improper motive and may impair the legitimate interests of the company, it may reject the request of the shareholder to review the books and shall, within in 15 days after the shareholder submits a written request, give the shareholder a written reply, which shall include an explanation. If the company reject the request of any shareholder to review the accounting books, the shareholder may plead a people’s court to demand the company to open the books for his review.

Further, §97 of the 2005 PRC Company Law provides for inspections rights for shareholders of JSCs, stating that:

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6. In the US, there is also a business form called ‘limited liability companies’, which is a hybrid of the US-style corporation and the partnership, and thus is different from the type of limited liability companies in China. In the US, the terms ‘corporation’ and ‘company’ have different meanings. Internationally, the term ‘corporation’ in the US is the counterpart of the term ‘company’ commonly used in many British Commonwealth jurisdictions as well as in China. For convenience, the two terms are used interchangeably in this paper, unless specifically indicated.
The shareholders shall be entitled to review the bylaws, the register of the shareholders, the stubs of corporate bonds, the minutes of the shareholders’ assembly meetings, the minutes of the meetings of the board of directors, the minutes of the meetings of the board of supervisors, and the financial reports, and may put forward proposals or raise questions about the business operations of the company.

Second, there are no statutory restrictions on the eligibility of the shareholder to exercise inspection rights, such as the requirements of shareholding level and period. According to the 2017 Judicial Interpretation, if a shareholder of a company files for inspection rights under §33 or §97 of the 2005 PRC Company Law, the court should accept the case. But if the company produces evidence that the plaintiff does not have the status of shareholder at the time of pleading, the court should dismiss the case. There is an exception, however, under which if a former shareholder can produce prima facie evidence that their interests were harmed at the time when they held shares, they also have the right to inspect relevant materials falling within their shareholding period.7

Third, the materials subject to inspection rights are divided into different categories. The first category consists of the company’s bylaws, the minutes of the shareholders’ meetings, the resolutions of the board of directors’ meetings, the resolutions of the board of supervisors’ meetings, as well as the financial reports. The second category is the accounting books of the company. In the context of LLCs, the shareholder can request for both categories of materials. By contrast, only the first category of materials is explicitly provided for the shareholders of JSCs. Presumably, as many JSCs are listed companies and are required to publicly disclose accounting information, there is usually little need to resort to inspection rights litigation to get them. Further, compared to the first category of materials available to LLC shareholders, there are two additional items listed for JSC shareholders, namely stock ledger and the stubs of corporate bonds. It is generally unnecessary to include them in the context of LLCs where the number of shareholders is normally small, and shareholders tend to know each other well. In any event, the shareholder register of LLCs can be readily available from the company registrar, and there is little need for inspection rights litigation. Ambiguity may arise here as to whether the term ‘accounting books’ include original accounting vouchers and whether the inspection right can extend to other materials not listed in the law such as contracts. For the

purpose of this paper, original accounting vouchers and other materials are treated as the third and fourth categories of materials respectively.

Fourth, a bifurcated approach sets out the prerequisites for exercising inspections rights, depending on what category of materials the shareholder is trying to access. Basically, for the first category of materials, access is more liberal without any explicit prerequisites laid down in the law. In contrast, as the second category of materials is more sensitive, there are both procedural and substantive restrictions. To start with, the shareholder needs to submit a written request for this type of information, which shall state his purpose. Then, if the company has legitimate reasons to believe that the shareholder’s request for inspecting the accounting books is for improper purposes and may impair the legitimate interests of the company, it may reject the request of the shareholder to inspect the books and shall, within 15 days after the shareholder submits a written request, give the shareholder a written reply to explain the rejection. Finally, after the company refuses the shareholder’s request, the shareholder may apply to the appropriate court for an order compelling production. If the court supports the shareholder’s request, the judgment should clearly specify what materials the shareholder can inspect as well as when and where to inspect those materials.8

The difficult and perennial question here is what constitutes “improper purpose” on the part of the requisitioned shareholder. The 2017 Judicial Interpretation sheds some light on this issue, enumerating four circumstances where improper purpose may be found:

1) The shareholder is engaged in any business in substantial competition with the main business of the company for the shareholder’s own account or on behalf of any other person, except as otherwise specified by the company’s bylaws or agreed upon by all shareholders.

2) The shareholder’s consultation of the company’s accounting books for the information of any other person may damage the company’s lawful interests.

3) During the three years before the day when the shareholder files a request with the company for consultation of accounting books, the shareholder once consulted the company’s accounting books for the information of any other person, causing damage to the company’s lawful interests.

8. 2017 Judicial Interpretation, §10.
Any other circumstances showing that the shareholder has an illicit purpose.

As can be seen above, the first three circumstances are specific, but the fourth limb is a catch-all provision.

Finally, there are other rules designed to strike a balance between protecting legitimate use of and preventing abuse of shareholder inspection rights. On the one hand, a shareholder of a company cannot be substantially deprived of their inspection rights by the company’s bylaws or any agreement between shareholders.9 Further, if a director or a senior executive of a company fails to perform duties in making or preserving the company’s documents and materials covered within the shareholder inspection rights, and causes harm to a shareholder, they can be held personally liable to compensate the shareholder.10 On the other hand, if a shareholder of a company divulges any trade secret of the company after exercising his or her inspection right, causing damage to the company’s lawful interests, then the shareholder can be held liable to compensate for the relevant losses suffered by the company.11

As shown above, China has gradually set up a relatively complete legal framework for shareholder inspection rights. However, there are still many unanswered questions. For instance, can the inspection rights be exercised by the beneficial owner whose shares are held in a voting trust or by a nominee on their behalf? What materials can be inspected? What is the content of the “improper purpose” restriction? What is meant by substantial deprivation of the inspection right? Hence, it is interesting to examine how the shareholder inspection right has been exercised in China. To this end, an empirical study will be undertaken by looking at relevant cases, and the above questions will be answered in light of the empirical findings.

III. Empirical Inquiry

A. Research Design and Methodology

This empirical study endeavors to provide insights into the way in which China’s inspection rights regime has been applied in practice. To this end, we try to collect relevant cases across the country from 1 January 2012 to 31 August 2017. There are two main reasons for the selection of this research period. On the one hand, as noted earlier, a research team of the

10. 2017 Judicial Interpretation, §12.
11. 2017 Judicial Interpretation, §11.
First Intermediate Court of Shanghai Municipality empirically examined the inspection rights cases adjudicated by three Shanghai courts between 2002 and 2006 under the 1993 Company Law. In addition, there is another important empirical study published in 2013, examining a sample of inspection rights cases adjudicated under the 2005 Company Law across China from 2006 to 2011 (the 2013 Study). On the other hand, the 2017 Judicial Interpretation became effective on 1 September 2017, hence it would be appropriate to treat cases before and after this point of time separately. As the 2017 Judicial Interpretation has been in effect for a little over one year, more time is needed to generate sufficient data necessary for a proper empirical examination of its effect.

Research was conducted using an authoritative and widely used electronic database of Chinese law, with search terms based on the relevant legislative provisions. To avoid the problem that may be caused by different search methods, we searched for all inspection right cases during the entire 12-year period of 2006 through 2017 (full year), rather than relying on the case numbers from 2006 to 2011 as produced by the 2013 Study.

It should be acknowledged, that as with any empirical study of court cases, my dataset is inevitably subject to the issue of selection bias. In other words, the cases in my dataset may not be a representative sample for some reasons. First, many disputes may have been resolved without litigation. This is particularly so in China due to its general litigation-averse culture. Second, some cases may have been simply rejected by the court and thus did not proceed to trial. Third, some court cases may never be publicly reported. Finally, although the electronic database used for this research is the best available one, it is both incomplete (the updating of the database is quite slow) and inaccurate (as noted above, there are issues of duplication and misplacement of cases). In response to the above issues, interviews have also been conducted, whenever possible, to provide further information on the subject matter under study.

B. General Statistics

1. Number and Distribution of Cases

As illustrated in Table 1, the number of cases has increased steadily and significantly over the years. A total of 7545 cases were located from the six-
year period of 2012 to 2017 (full year), which is nearly ten times that during the six-year period of 2006 to 2011 (781 cases). Geographically, Jiangsu Province had the most cases (1048), followed by Shanghai (895), Guangdong province (634), Zhejiang province (548) and Beijing (518), all of which are economically more developed regions in China.

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of cases</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>2440</td>
<td>29.31%</td>
</tr>
<tr>
<td>2016</td>
<td>2109</td>
<td>25.33%</td>
</tr>
<tr>
<td>2015</td>
<td>1347</td>
<td>16.18%</td>
</tr>
<tr>
<td>2014</td>
<td>990</td>
<td>11.89%</td>
</tr>
<tr>
<td>2013</td>
<td>395</td>
<td>4.74%</td>
</tr>
<tr>
<td>2012</td>
<td>264</td>
<td>3.17%</td>
</tr>
<tr>
<td>2011</td>
<td>225</td>
<td>2.70%</td>
</tr>
<tr>
<td>2010</td>
<td>206</td>
<td>2.47%</td>
</tr>
<tr>
<td>2009</td>
<td>194</td>
<td>2.33%</td>
</tr>
<tr>
<td>2008</td>
<td>107</td>
<td>1.29%</td>
</tr>
<tr>
<td>2007</td>
<td>25</td>
<td>0.30%</td>
</tr>
<tr>
<td>2006</td>
<td>24</td>
<td>0.29%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>8326</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

It should be noted that in Table 1, the number of cases in 2017 means the cases in the whole year of 2017, because the purpose of Table 1 is to compare the number of cases yearly. As noted earlier, however, the study period of our research ends on 31 August 2017, so the year of 2017 mentioned in the empirical data below means the period from January 2017 to August 2017, unless otherwise indicated. The 2013 Study randomly selected a sample of 192 cases for actual analysis due to ‘the large number of cases’ from 2006 to 2011. Clearly, the total number of cases from 2012 to 2017 is much larger. Hence, as shown in Table 2, we also conducted a random sampling exercise to get a similar-sized sample of 193 cases. This would facilitate comparing our findings with those of the 2013 Study.

14. See Li, Supra note 12, at 83, 84.
Table 2: Temporal Distribution of Sampled Cases and subsequent cases from 2012 to 2017 (as of end of August)

<table>
<thead>
<tr>
<th>Year</th>
<th>Sample cases</th>
<th>Subsequent suits</th>
<th>Class action</th>
<th>Derivative suits</th>
<th>Appraisal suits</th>
<th>Liquidation suits</th>
<th>Other suits</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>40</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>2016</td>
<td>52</td>
<td>8</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>2015</td>
<td>47</td>
<td>11</td>
<td>0</td>
<td>0</td>
<td>3</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>2014</td>
<td>37</td>
<td>3</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>2013</td>
<td>9</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>2012</td>
<td>8</td>
<td>1</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>193</td>
<td>24</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>10</td>
<td>8</td>
</tr>
</tbody>
</table>

Table 2 presents the information on ‘subsequent cases,’ namely the cases filed by the same plaintiffs against the same defendants after the inspection right cases. The purpose here is to find out whether the inspection right cases in China were filed by the plaintiffs as a tool to investigate the company and collect relevant evidence to bring subsequent cases.

As Table 2 shows, during the study period, the subsequent suit rate varied from year to year and overall, there were 24 subsequent suits concerning the 193 sampled cases, with the subsequent suit rate being 12.4%. This rate is lower than that found in the U.S. study where 97 subsequent suits arose from 542 inspection right cases, representing a subsequent suit rate of 17.9%.\(^\text{15}\)

Further, we group subsequent suits into four categories, namely derivative suits, appraisal suits, liquidation suits and other suits which are mainly related to disputes over validity of shareholders’ resolutions, distribution of dividend and capital contribution by shareholders. While derivative suits and class actions accounted for almost half and one-fifth of all subsequent suits respectively in the U.S.,\(^\text{16}\) they were not found in China. In China, there were up to 10 liquidation suits and 6 appraisal suits, representing 41.7% and 25% of all subsequent suits respectively.

2. The Hearing Court and Time-length

Table 3 shows the distribution of cases according to whether the case was finalized at first instance or on appeal. In China, two trials usually conclude a case with the second trial judgment being final, but a third trial

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16. See Id.
(zai shen) is possible in exceptional circumstances where there are errors in the finding of facts or the application of the law. If a case goes through more than one trial, it will be counted only once, because it is still the same dispute. From the table, it can be seen that 85 out of 193 cases appealed, including 5 cases undergoing the unusual third trial, which represents an appeal rate of 44.1%. According to research conducted by the Judgment Management Office of the Supreme People’s Court, the overall appeal rate for all cases in 2017 across China is only 10.59%, and the appeal rate for civil and commercial cases is lower than that for criminal cases. Clearly, the appeal rate for inspection right cases is very high, as compared to the overall appeal rate for corporate law cases.

According to Li’s study, the appeal rate for the period of 2006 to 2011 was 49.5%, which is even higher than that in the more recent years. This indicates that the shareholders’ inspection right case has long been a very complicated and controversial issue for the courts to handle.

<table>
<thead>
<tr>
<th>Table 3: Was the case concluded at first instance or on appeal?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Court</td>
</tr>
<tr>
<td>----------------</td>
</tr>
<tr>
<td>First trial</td>
</tr>
<tr>
<td>Second trial</td>
</tr>
<tr>
<td>Third trial</td>
</tr>
<tr>
<td>Total</td>
</tr>
</tbody>
</table>

Table 4 provides information on the number of days between the date of the initial court filing and the date of the final outcome in the case. We find that during the whole period of 2012 to 2017, the mean delay is around 101.46 days (around 3.38 months), while the median delay is roughly 81 days (2.7 months). In China, a civil case should normally be closed within six months of its filing date; a six-month extension is available in special circumstances, and upon the approval of the president of the court; further extension is possible with the approval of the next higher court. The mean

19. See Li, supra note 12, at 87.
and median of the number of days taken to close an inspection case in China are both 6 months, suggesting the Chinese court tended to adjudicate cases quite quickly. By contrast, the mean and median figures in the U.S. are 331.8 and 212 respectively, both significantly higher than those in China.

We also conducted a longitudinal study to determine whether there is any change in the time length of the case over the years. Excluding 2012 and 2017, the mean and median of the number of days taken to close an inspection case are quite stable.

Table 4: Number of days between court filing and final outcome

<table>
<thead>
<tr>
<th>Year</th>
<th>Mean</th>
<th>Standard Deviation</th>
<th>Minimum</th>
<th>Median</th>
<th>Maximum</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>135.708</td>
<td>106.41</td>
<td>14</td>
<td>111.5</td>
<td>408</td>
</tr>
<tr>
<td>2016</td>
<td>70.933</td>
<td>40.259</td>
<td>13</td>
<td>72</td>
<td>175</td>
</tr>
<tr>
<td>2015</td>
<td>103.04</td>
<td>70.639</td>
<td>18</td>
<td>82</td>
<td>248</td>
</tr>
<tr>
<td>2014</td>
<td>94.913</td>
<td>56.991</td>
<td>25</td>
<td>69</td>
<td>354</td>
</tr>
<tr>
<td>2013</td>
<td>112.833</td>
<td>71.899</td>
<td>25</td>
<td>114.5</td>
<td>195</td>
</tr>
<tr>
<td>2012</td>
<td>91.333</td>
<td>42.730</td>
<td>51</td>
<td>86</td>
<td>170</td>
</tr>
<tr>
<td>Total</td>
<td>101.46</td>
<td>77.091</td>
<td>13</td>
<td>81</td>
<td>408</td>
</tr>
</tbody>
</table>

C. Key Features of the Cases

1. The Features of the Plaintiff Shareholders

Table 5 looks at the identity of the plaintiff shareholder, that is, whether the case was brought by a natural or legal person. Compared to individual shareholders, corporate shareholders usually have more resources and leverage to obtain information from the company, and thus less need to bring suit to inspect corporate documents.21 This hypothesis seems to be borne out of our research finding that 85.5% of cases were brought by individuals and only 14.5% of cases were initiated by legal persons. Li’s study also supported this hypothesis by showing that only 18% of sampled cases were brought by legal person plaintiffs22

21. For cases that there were both natural person and legal person plaintiffs, the cases fall into the category of legal person plaintiffs.
22. See, Li, supra note 12, at 84.
Table 5: Was the plaintiff a natural or legal person?

<table>
<thead>
<tr>
<th>Identity</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Individual</td>
<td>165</td>
<td>85.5%</td>
</tr>
<tr>
<td>Legal Person</td>
<td>28</td>
<td>14.5%</td>
</tr>
<tr>
<td>Total</td>
<td>193</td>
<td>100%</td>
</tr>
</tbody>
</table>

Under the 2005 Company law, the shareholders have certain governance powers depending on their shareholding levels. To begin, the shareholders separately or aggregately holding 3% or more of the shares of the company have the power to put forward an interim proposal to the shareholders’ assembly for discussion.23 Second, the shareholders separately or aggregately holding 10% or more of the shares of the company can ask for an interim shareholders’ assembly session to be held.24 Further, the shareholders who hold 10% or more of the voting rights are empowered to plead the people’s court to dissolve the company, when the company meets serious difficulty in its operation so that the interests of the shareholders will face heavy loss if the company continues to exist and the difficulty cannot be solved by any other means.25 Third, under Chinese law, the shareholders separately or aggregately holding 30% or more of shares are considered to have actual control of the company.26

As shown in Table 6, for a total of 68.72% of plaintiffs, the shareholding level is less than 50%, and the plaintiffs with a shareholding level between 10% and 30% filed most of the inspection cases. This empirical finding is consistent with Li’s finding27 and supports the theory that the inspection right suits provide an important remedy mainly for minority shareholders. However, up to 10 cases, or 5.13% of all cases, were brought by shareholders who held more than 50% of shares in the company. This is surprising because those shareholders presumably had control over their companies and there should be no need for them to resort to inspection right suits to get relevant information.

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23. Company Law art. 102, para. 2 (China).
24. Company Law art. 100, para. 3 (China).
25. Company Law art. 182 (China).
27. See, Li, supra note 12, at 85. (According to Li’s study, 41.67% of plaintiffs’ shareholding level was less than 10%, 22.22% of plaintiffs’ shareholding level was between 11% and 30%, and 31.94% of plaintiffs’ shareholding level was between 31% and 50%. A total of 95.83% of plaintiffs’ shareholding level was under 50%).
Upon closer examination, these cases share a common feature that ownership and management of the company are relatively separated. Namely, the minority shareholder is the legal representative and executive director of the company, while the majority shareholder acts as supervisor or even has no management position. When a majority-minority shareholder conflict arises, the majority may not easily solve the issue through the exercise of its voting power. For one thing, the position of legal representative has important power to represent the company to sign contracts and bring suits, and can only be removed by a special resolution of the shareholders’ meeting which requires approval by two-thirds or more of the voting rights. In most of the cases, the majority shareholder held more than half but less than two-thirds of voting powers. Further, directors usually serve a term of three years and cannot be removed without cause. Finally, in practice, even if the majority shareholder may succeed in exercising its voting power to change legal representative or executive director, the former legal representative or executive director (the minority shareholder) may refuse to hand over company seals and documents. Hence, the majority shareholder may have to bring inspection right suits to obtain relevant information.

28. See, e.g., Liu Ye Su Shanghai Xinxin Gongmiao Youxiangongsi Gudongzhiquingquanjunfuen An (刘晔诉上海信鑫工贸有限公司股东知情权纠纷案) [Liu Ye vs Shanghai Xinxin Gongmiao Co.], https://www.pkulaw.com/pfnl/a25051f3312b07f35b6e5434f630722e7b812ee18abb321bd6b.html?keyword=%EF%BC%882014%EF%BC%89 %E9%9D%92%E6%B0%91%E4%BA%8C%E9%9D%92%E6%B0%91%E5%85%86%EF%BC%89%E 5%88%9D%E5%AD%97%E7%AC%AC163%E5%8F%B7 (Shanghai Municipality Qingpu District Court Apr. 16, 2014) (China); Chen Fuquan Su Tianjin Minchuang Jiancai Shichangguanli Youxiangongsi Gudongzhiquingquanjunfuen An (陈伏谦诉天津闽创建材市场管理有限公司股东知情权纠纷案) [Chen Fuqian vs Tianjin Minchuang Jiancai Shichang Co.], https://www.pkulaw.com/pfnl/a25051f3312b07f331897ed3ca8cda753017ca5e50a4edcbdfb.html?keyword=%EF%BC%882014%EF%BC%89%E8%BE%B0%E6%B0 %91%E5%88%9D%E5%AD%97%E7%AC%AC3128%E5%8F%B7 (Tianjin Municipality Beicheng District Court Oct. 22, 2014) (China); Zhongshang Zichan Pinggu Youxianzeren Gongsi Jilin Fengongsi Yu Luo Donghao Gudongzhiquingquanjunfuen Shangsu An (中商资产评估有限责任公司吉林分公司与罗东皓股东知情权纠纷上诉案) [Zhongshang Zichan Pinggu Co vs Luo Donghao (Appeal)], https://www.pkulaw.com/pfnl/a25051f3312b07 f31897ed3ca8cda753017ca5e50a4edcbdfb.html?keyword=%EF%BC%882015%EF%BC %89%E9%95%BF%E6%B0%91%E5%9B%B7%E7%BB%88%E5%AD%97%E7%AC%A C175%E5%8F%B7, (Jilin Province Changchun City Intermediate Court May 20, 2015) (China).

29. Company Law art. 43 (China).

30. Company Law art. 45 (China).
Table 6: What was the plaintiff’s shareholding?

<table>
<thead>
<tr>
<th>Shareholding Level</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 3%</td>
<td>16</td>
<td>8.21%</td>
</tr>
<tr>
<td>More than 3% and Less than 10%</td>
<td>18</td>
<td>9.23%</td>
</tr>
<tr>
<td>More than 10% and less than 30%</td>
<td>58</td>
<td>29.74%</td>
</tr>
<tr>
<td>More than 30% and less than 50%</td>
<td>42</td>
<td>21.38%</td>
</tr>
<tr>
<td>More than 50%</td>
<td>10</td>
<td>5.13%</td>
</tr>
<tr>
<td>Not clear</td>
<td>51</td>
<td>26.15%</td>
</tr>
<tr>
<td>Total</td>
<td>193</td>
<td>100%</td>
</tr>
</tbody>
</table>

Table 7 further examines whether the plaintiff held any office in the company. There is a total of 199 plaintiffs, which is more than the number of cases because some cases have more than one plaintiff. Not surprisingly, the majority (84.92%) of shareholders hold no position in the company. For the plaintiff shareholders holding a position in the defendant company, most of them held the position of supervisor. This reflects the reality that due to the lack of real powers, particularly the power to appoint and remove directors as is the case in the German system, the supervisors in China can barely perform its statutory role in monitoring the management board.31

Table 7: Was the plaintiff in the management?

<table>
<thead>
<tr>
<th>Role in the Company</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director</td>
<td>9</td>
<td>4.52%</td>
</tr>
<tr>
<td>Non-director manager</td>
<td>1</td>
<td>0.50%</td>
</tr>
<tr>
<td>Supervisor</td>
<td>13</td>
<td>6.53%</td>
</tr>
<tr>
<td>Other officer</td>
<td>7</td>
<td>3.52%</td>
</tr>
<tr>
<td>No position</td>
<td>169</td>
<td>84.92%</td>
</tr>
<tr>
<td>Total</td>
<td>199</td>
<td>100%</td>
</tr>
</tbody>
</table>

2. The Features of the Defendant Company

Table 8 presents the information on the types of defendant companies involved in the sample cases. The vast majority of defendant companies are

31. Company Law art. 53 (China). See also Wang Shiquan (王世权), Jianshihui de Benyuan Xingzhi, Zuoyong Jili yu Zhongguo Shangshigongsizhi Hui Zhili Chuangxin (监事会的本质属性、作用机理与中国上市公司治理创新) [The Nature and Mechanism of the Supervisory Board and the Innovation of Corporate Governance of Listed Companies in China], Guanli Pinglun (管理评论) [Management Review], no. 4, 2011, at 51 (finding that “the supervisory board is not effective in practice”).
LLCs, while only 4 defendant companies are JSCs. In addition, there are a small number of other types of business entities such as joint ventures and even private schools. Several plausible reasons may be offered to explain the little use of inspection right suits in the context of JSCs. On the one hand, the JSCs, particularly listed companies, are subject to a heightened level of disclosure duties under securities law, and thus there is much less need for their shareholders to resort to inspection right suits. On the other hand, as discussed earlier, unlike the shareholders in LLCs, JSC shareholders are not empowered to inspect company accounting books according to the Chinese company law. Since the shareholders in JSCs cannot inspect company accounting books which usually contain very important information, there will be fewer incentives for them to take the trouble to file an inspection right suit. Further, the shareholders in JSCs can inspect, but are not allowed to copy, the relevant company documents. Plainly, this significantly reduces the usefulness of the inspection right suit.

Table 8: What was the type of the defendant company?

<table>
<thead>
<tr>
<th>Company Type</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>LLC</td>
<td>183</td>
<td>94.81%</td>
</tr>
<tr>
<td>JSC</td>
<td>4</td>
<td>2.07%</td>
</tr>
<tr>
<td>Others</td>
<td>6</td>
<td>3.12%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>193</td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

32. Most of the JSCs concerned here were not listed on the two national stock exchanges, namely the Shanghai Stock Exchange and the Shenzhen Stock Exchange, but rather on regional stock exchanges such as the Tianjing Equity Exchange. See e.g., Huang Tianyi Su Hubei Wudang Juye Gufenyouxiangongsi Deng Gudongzhiquengan Jufen An (黄田毅诉湖北武当酒业股份有限公司等股东知情权纠纷案) [Huang Tianyi vs Hubei Wudang Liquor Co.], https://www.pkulaw.com/pfnl/a25051f3312b07f3404f9de8c7172d740788ffe324449bdfb.html?keyword=%E5%8F%A5%E6%B0%91%E5%88%9D%E5%AD%97%E7%AC%AC01768%E5%8F%B7 (Hubei Province Danjiangkou City Court Mar. 24, 2015) (China).

33. See, e.g., Shanghai Jiahua Qiye Fazhan Youxiangongsi Su Shanghai Jiahua Jiaoyu Jinxiu Xueyuan Gudongzhiquengan Jufen An (上海佳华企业发展有限公司诉上海佳华教育进修学院股东知情权纠纷案) [Shanghai Jiahua Enterprise Ltd vs Shanghai Jiahua Continuing Education School], http://gongbao.court.gov.cn/Details/b55ce4524093e9dbcb3949a1a5d4ea.html, 2019 Sup. People’s Ct. Gaz. 2 (Shanghai Municipality 1st Intermediate Court 2016) (China) (holding that although private schools do not take the company form in China, their organizers can bring inspection right suits in a way by analogy with the company law).

34. See discussion supra Part II.B.
Table 9 conducts an investigation into whether the defendant was a state-owned enterprise (SOE).\textsuperscript{35} It is shown that SOEs were found to be the defendant in inspection right suits, but the number is quite low. One possible reason is that it can be harder to file the case in the court, because the purpose of the case is to gain access to non-public information of SOEs which can be too politically sensitive.

**Table 9: Was the defendant company a state-owned enterprise (SOE)?**

<table>
<thead>
<tr>
<th>SOE</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
<td>9</td>
<td>4.66%</td>
</tr>
<tr>
<td>No</td>
<td>183</td>
<td>94.82%</td>
</tr>
<tr>
<td>Unclear</td>
<td>1</td>
<td>0.52%</td>
</tr>
<tr>
<td>Total</td>
<td>193</td>
<td>100%</td>
</tr>
</tbody>
</table>

As Table 10 illustrates, up to 123 defendant companies, or about two-thirds of all defendant companies, had less than RMB 10 million in registered capital. According to the tax law in China, this group of companies is generally considered to be the so-called Micro and Small-sized enterprises (Xiao Wei Qi Ye).\textsuperscript{36} There were even 42 defendant companies with registered capital which is less than RMB 1 million. Hence, inspection right suits are mostly used in the context of small companies which generally have weaker corporate governance.

**Table 10: What was the size of defendant company?**

<table>
<thead>
<tr>
<th>Registered capital</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Below 1 m</td>
<td>42</td>
<td>21.76%</td>
</tr>
<tr>
<td>1m to 10 (含10m)</td>
<td>81</td>
<td>41.97%</td>
</tr>
<tr>
<td>10m-100m(含100m)</td>
<td>60</td>
<td>31.09%</td>
</tr>
<tr>
<td>Above 100m</td>
<td>7</td>
<td>3.63%</td>
</tr>
<tr>
<td>Not clear</td>
<td>3</td>
<td>1.55%</td>
</tr>
</tbody>
</table>

\textsuperscript{35} As many judgments do not contain complete information on the ownership of the defendant company, we used an authoritative database called Tian Yan Cha to check the shareholding structure of the defendant company. Tian Yan Cha (天眼查), www.tianyancha.com (last visited Oct. 13, 2020).

3. *The Types of Materials Requested for Inspection*

Table 11 examines what information the plaintiffs asked for in the suits and whether their requests were supported by the court. As discussed earlier, the information requested can be broadly divided into four categories. In practice, the plaintiffs usually request more than one category of information in a case, which explains why the total number of entries in Table 11 is significantly higher than the number of inspection right suits. In adjudicating the case, the court will look at the multiple requests separately and make decisions accordingly. Hence, we calculate the rate of support on the basis of the category of information requested.

<table>
<thead>
<tr>
<th>Types of Materials requested for inspection</th>
<th>Number</th>
<th>Percentage</th>
<th>Support</th>
<th>Not support</th>
<th>Support rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1st category (stockholder list etc)</td>
<td>164</td>
<td>34.10%</td>
<td>141</td>
<td>23</td>
<td>85.98%</td>
</tr>
<tr>
<td>2nd category (accounting books)</td>
<td>172</td>
<td>35.76%</td>
<td>132</td>
<td>40</td>
<td>76.74%</td>
</tr>
<tr>
<td>3rd category (original accounting vouchers)</td>
<td>109</td>
<td>22.66%</td>
<td>68</td>
<td>41</td>
<td>62.39%</td>
</tr>
<tr>
<td>4th category (contracts, client list etc)</td>
<td>36</td>
<td>7.48%</td>
<td>5</td>
<td>31</td>
<td>13.89%</td>
</tr>
<tr>
<td>Total</td>
<td>481</td>
<td>100%</td>
<td>346</td>
<td>135</td>
<td>71.93%</td>
</tr>
</tbody>
</table>

As Table 11 shows, for the 193 sample cases, there is a total of 481 information requests. Within the four categories of information requested, the second category (accounting books) was most frequently requested (35.76%), closely followed by the first category (34.10%). The fourth category was requested the least (7.48%). This contrasts with the finding of Li’s study that the largest portion of requests (48.34%) was made for the first category of information. Further, the percentage of requests for the third category materials (original accounting vouchers) under our study (22.66%) is significantly higher than the figure in Li’s study a few years ago (9.27%). The difference shows that there has been a clear trend towards the request for accounting materials, including accounting books and original accounting vouchers.
Out of the total 481 requests, 346 requests are supported by the court, making the average support rate 71.93%. However, the support rate varies greatly amongst the different categories of information. Not surprisingly, the first category has the highest support rate (85.98%), since it is clearly allowed under Article 33 for LLCs and Article 97 for JSCs. The major reason for rejecting a request for the first category of information is that the plaintiffs were found not to be the shareholders of the defendants. The second category of information gets the second-highest support rate (76.74%). Again, Article 33 clearly allows access to the second category of information, but there is a procedural prerequisite, that is, the plaintiff should send a prior written request to the company. In some cases, the plaintiff shareholder lost simply by failing to satisfy this procedural requirement.

The support rate of the third category of information is also quite high (62.39%), even though it is below the average support rate. In general, the courts consider original accounting vouchers to be covered under inspection right provisions. The failure of the plaintiff shareholders in those unsupported suits is usually either due to their lack of shareholder status or because they did not fulfill the procedural prerequisite as noted above. In contrast, the request for the fourth category of information was seldom supported (13.89%), as the court generally considers it to fall outside the scope of the inspection right provisions.

4. The “Improper Purpose” Defense

Table 12 presents how the defense of improper purpose has been used by the defendant company in inspection right suits. Overall, the improper purpose defense was raised in 59 cases, representing 30.57% of all cases. As discussed earlier, the 2017 Judicial Interpretation provides guidance on the meaning of improper purpose by listing four types of improper purposes. Amongst the first three specific types of improper purposes enumerated therein, the first type was most frequently raised (32.76%), while there is no case using the second type and only one case using the third type. As the fourth type is a catch-all category of “other circumstances,” we further divide this type into four sub-categories which are found to be used by the defendant company in the sample cases. The first sub-category was very general and raised in 29 cases, accounting for almost half of all cases.

37. See discussion supra Part II.B.
Table 12: What were the types of improper purposes for requesting accounting books?

<table>
<thead>
<tr>
<th>Types of claimed improper purposes</th>
<th>Number</th>
<th>Percentage</th>
<th>Support</th>
<th>Not support</th>
<th>Support rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>The shareholder is engaged in any business in substantial competition with the main business of the company</td>
<td>19</td>
<td>32.2%</td>
<td>1</td>
<td>18</td>
<td>5.26%</td>
</tr>
<tr>
<td>The shareholder is seeking inspect rights to provide information to others</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>The shareholder did seek inspect rights to provide information to others within the past three years</td>
<td>1</td>
<td>1.69%</td>
<td>0</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Other circumstances</td>
<td>39</td>
<td>66.1%</td>
<td>0</td>
<td>39</td>
<td>0</td>
</tr>
<tr>
<td>The shareholder may damage the interest of the company</td>
<td>29</td>
<td>49.15%</td>
<td>0</td>
<td>29</td>
<td>0</td>
</tr>
<tr>
<td>The shareholder may affect the normal operation of the company</td>
<td>4</td>
<td>6.78%</td>
<td>0</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>There is improper purpose</td>
<td>4</td>
<td>6.78%</td>
<td>0</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>The shareholder seeks to get information as evidence in another case</td>
<td>2</td>
<td>3.39%</td>
<td>0</td>
<td>2</td>
<td>0</td>
</tr>
<tr>
<td>Total</td>
<td>59</td>
<td>100%</td>
<td>1</td>
<td>58</td>
<td>1.69%</td>
</tr>
</tbody>
</table>

However, the defendant company was successful in only one case, and there are several possible reasons behind this. First, it is very difficult for the defendant company to establish improper purposes on the part of the plaintiff shareholder. The only successful case is *Jianghan vs Qichang Xingli Haimen Railway Materials Ltd.*, where the defendant company proved that the plaintiff shareholder was involved in another company which had the same business and the same target clients as the defendant company so that the first specific type of improper purposes applied.38 However, if the

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38. See Jiangmou Qichang Xingli Haimen Tielu Cailiao Youxiangongsi Gudongzhiqiangquan Jiufen An (姜某戚厂兴力海门铁路材料有限公司股东知情权纠纷案) [Jianghan vs Qichang Xingli Haimen Railway Materials Ltd.], https://www.pkulaw.com/pnfl/a25051f3312b07f342102f5d266ec5a216f4f76f524d8d2456.html?keyword=%EF%BC
plaintiff shareholder engages in a business which is not the same as the
defendant company, it can be difficult to convince the court that the first
specific type of improper purposes should apply. For instance, in the case of
Zhang Zhenping vs. Beijing Heshi Lianchuang Culture Promotion Ltd, the
defendant claimed that the shareholder was engaged in a business in
substantial competition with the main business of the company, but the court
rejected it because evidence showed that the plaintiff shareholder’s spouse
ran a company whose business scope only overlapped partly with the
defendant company.39

Further, a common feature of the four sub-categories of the defenses
under the catch-all provision is that the defendant company just makes a
general claim without giving concrete evidence. This helps explain why all
of them were not supported by the court. Finally, before the promulgation
of the 2017 Judicial Interpretation, it was less clear what might constitute
improper purposes, and sometimes, the court did not even find improper
purposes when the requesting shareholder is engaged in a business in
substantial competition with the main business of the company. For
instance, in the case of Yang Jianbing and Ma Haoran at al vs Jiangsu
Province HuaiAn City Guoyuan Taxation Firm,40 the plaintiff shareholders
left the company and joined another company in the same business. The
court held that the non-competition rule applied to directors and not
shareholders under Chinese law and that there was no evidence to suggest
improper purposes on the part of the plaintiff shareholders. Had the case
occurred after the 2017 Judicial Interpretation, the mere fact of the plaintiff
shareholders engaging in business competition could suffice to find improper
purposes.

39. See Zhang Zhenping Su Beijing Heishi Lianchuang Wenhua Chuanbo
Youxiangongsi Gudongzhixianduan Jiujuan An  
张振平诉北京黑石联创文化传播有限公司 股东知情权纠纷案
[Zhang Zhenping vs Beijing Heishi Lianchuang Culture Promotion
Ltd.],  
https://www.pkulaw.com/pfnl/a25051f3312b07f38f00ec1ad54a4ca0ed9e756ee6b6
60dbfh.html?keyword=%E9%BC%882017%E7%AC%AC0114%E6%B0%91%E5%88%9D12911%E5%8F%B7
(Jiangsu Province Haimen City Court June 24, 2016) (China).

40. See Yang Jianbing, Ma Haoran deng yu Jiangsusheng Huaiianshi Guoyuan Shuiwu
Lushi Shiwusuo Youxiangongsi Guodongzhixianduan Jiujuan An  
杨建兵、马浩然等与江苏省淮安市国源税务事务所有限公司 股东知情权纠纷案
[Yang Jianbing and Ma Haoran at al vs Jiangsu Province HuaiAn City Guoyuan Taxation Firm],
https://www.pkulaw.com/pfnl/a25051f3312b07f34f28c823d76d37b85625c3c2f8d4742dbfh.html?keyword=%E9%BC%882015%E7%AC%AC00513%E5%8F%B7
(Jiangsu Province HuaiAn City Qingpu District Court Aug. 13, 2015) (China).
5. Substantial Deprivation of the Inspection Rights

As discussed earlier, it is stipulated in China that a shareholder of a company cannot be substantially deprived of their inspection rights by the company’s bylaws or any agreement between shareholders, and thus Table 13 is intended to provide information on whether and how the ‘substantial deprivation’ rule has been applied. Out of the total 193 sample cases, the substantial deprivation issue was raised in only 3 cases, showing that it is not common to restrict the shareholders’ inspection right through the bylaws or the shareholders’ agreement in China. Further, out of the three cases, only one case was found to constitute substantial deprivation. Finally, the restrictions in dispute are mainly based on the confidentiality issue, and thus are functionally similar to the defense of improper purposes which also includes leaking information to others.

### Table 13: Frequency distribution of circumstances of substantial deprivation

<table>
<thead>
<tr>
<th>Forms of disputed substantial deprivation</th>
<th>Number of cases</th>
<th>Percentage</th>
<th>Not substantial deprivation</th>
<th>Substantial deprivation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Company constitution</td>
<td>1</td>
<td>33.33%</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Shareholder resolution</td>
<td>2</td>
<td>66.67%</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Total</td>
<td>3</td>
<td>100%</td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

In the first case of *Wujing vs Nanjing Xnliansheng Ltd.*, the company’s bylaws required that the shareholder should make a written request and a confidentiality commitment before exercising the inspection right. Under the bylaws, the company could also refuse the inspection request of the shareholder who has leaked the company’s secrets before. The court held that the restrictions in the bylaws were reasonable and did not constitute substantive deprivation. Similarly, in the second case of *Yang Jianbing and Ma Haoran at al vs Jiangsu Province HuaiAn City Guoyuan Taxation Firm*, the company’s bylaws stipulated that the company can disallow a

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41. See *Wujing Su Nanjing Xnliansheng Shiye Youxiangongsi Gudongzhqingsuan Jiufen An* (吴静诉南京新联盛实业有限公司股东知情权纠纷案) [Wujing vs Nanjing Xnliansheng Ltd.]. https://www.pkulaw.com/ptml/a25051f312b07f3e47f8a42e4a937a4co830226eb825fbdflb.html?keyword=%E4%BC%88%E5%82%89%E5%8F%91%E6%A0%96%E5%9B%86%E5%AD%97%E7%AC%AC286%E5%8F%B7 (Jiangsu Province Nanjing City Qixia District Court Dec. 5, 2013) (China).

42. See *Yang Jianbing, Ma Haoran deng yu Jiangsusheng Huaianshi Guoyuan Shuiwu Lushi Shiwusuo Youxiangongsi Gudongzhqingsuan Jiufen An* (杨建兵、马浩然等与江苏省淮安市国源税务师事务所有限公司股东知情权纠纷案) [Yang Jianbing and Ma Haoran
shareholder to exercise the inspection rights for the purpose of protecting its business secrets. The court did not hold this to be invalid but nevertheless ordered the defendant company to provide the documents requested because it failed to prove that the plaintiffs’ request for information was for improper purposes.

However, in the third case of Jiang Xuyang vs Sichuan Rongyi Holding Ltd., the defendant company passed a shareholder resolution because the requesting shareholder was involved in another case against the company, he would lose his inspection rights. The court found this shareholder resolution to constitute ‘substantial deprivation’, holding that ‘the shareholders’ inspection rights are the inherent rights of the shareholders, and should not be restricted through shareholder agreements or other means.’

IV. Analysis and Suggestions

A. Overview

As shown in the empirical study above, shareholder inspection rights have been used with increasing frequency in China over the years, exhibiting many interesting features. Compared to the relevant empirical findings in the U.S. (as represented by Delaware), there are similarities and differences.

On the one hand, shareholder inspection rights are introduced and applied in both jurisdictions as an important corporate governance measure. This similarity may warrant a further explanation, given that the two jurisdictions actually face quite different corporate governance issues. Indeed, as is well-recognized in comparative corporate law scholarship,
agency problems and thus the strategies used to deal with them differ systematically across jurisdictions. There are three main agency problems in the company, namely the conflict between the shareholders and the managers, the conflict between the majority shareholders and the minority shareholders, and the conflict between the shareholders and the non-shareholder stakeholders such as creditors, employees, and customers. In the U.S. where the publicly traded company is characterized by dispersed ownership, the shareholder-manager conflict is the main type of agency problem, while in China where the ownership of shares is more concentrated in the hands of majority shareholders, whether the state or families, the second agency problem is more severe. In both contexts, however, shareholder inspection rights can play an important role in generating relevant information needed for controlling their respective agency problems. Hence, despite the different types of agency problems in corporate governance between China and the U.S., shareholder inspection rights are similarly useful in mitigating informational asymmetry and facilitating shareholder engagement.

On the other hand, there are noteworthy differences in the use of shareholder inspection rights between the two jurisdictions. For instance, while inspection rights in both countries are frequently used as a pre-suit discovery device, significant differences can be seen in relation to the number and the types of subsequent litigation filed in each country. As already explained elsewhere, this can be explained by the differences in the pattern of corporate strategies for reducing agency costs as well as in the corporate litigation regime between the two jurisdictions. To be sure, there can be other factors contributing to the differences in the practice of shareholder inspection rights, including the differences in the law itself. Indeed, although China introduced its legal framework for shareholder inspection rights by borrowing overseas experiences, notably the U.S., China has tried to make relevant adaptations to suit its local conditions.

As such, it is useful to conduct a detailed comparison of the key elements of the shareholder inspection rights law in the two jurisdictions, and based on it, make improvement suggestions for China. In some sense, shareholder inspection rights seem to be a double-edged sword, because, while it can usefully empower the shareholders by giving them access to relevant information to engage in corporate governance, there is a danger that it may be misused by some shareholders to the detriment of the company. Hence, in evaluating the law on shareholder inspection rights, it

47. See Huang & Thomas, supra note 2 at 907.
is important to strike a proper balance between facilitating the right of the shareholder to inspect and preventing misuse of the right to harm the corporation and other shareholders.

B. Facilitating Exercise of the Rights

1. What Kinds of Shareholder can Inspect?

In China, inspections rights are available to any current shareholder of the company as well as former shareholders who can establish their interests were harmed during the shareholding period. It is unclear however whether inspection rights can be exercised by the beneficial owner whose shares are held in a voting trust or by a nominee on their behalf.

Similarly, Delaware’s statute grants inspection rights to any shareholder which is defined as a shareholder of record. Although other evidence may be considered, the corporation’s stock ledger is prima facie evidence of stock ownership. The Delaware courts have traditionally refused to give beneficial owners access to corporate documents under the statute, but a beneficial owner may sue for inspection rights under the common law.

In recent years, China has seen a rise in the popularity of the so-called “nominal shareholding” mechanism (mingyi chigu), under which an actual shareholder asks another person to act as a nominal shareholder to hold shares for him as a beneficial owner of the shares. The Supreme People’s Court has issued a judicial interpretation to formally recognize the validity of such a mechanism. It should be noted that this rule applies only in the context of a limited liability company, and there is a debate on

49. See, e.g., State ex rel. Crowder v. Sperry Corp., 15 A.2d 661 (Del. Super. 1940) (holding that a stockholder who had placed his stock into a voting trust was a beneficial owner and that the beneficial owner was not entitled to inspection rights); Lenahan v. Natl. Computer Analysts Corp., 310 A.2d 661 (Del. Ch. 1973) (holding that a beneficial owner was not entitled to inspection rights under s220 of Delaware General Corporation Law).
50. Zuigao Renmin Fayuan Guanyu Shiyong <Zhonghua Renmin Gongheguo Gongsi Fa> Ruogan Wenti de Guiding (San), Fashi [2014] Er Hao (最高人民法院关于适用《中华人民共和国公司法》的解释 (三), 法释【2014】2号)[The Third Judicial Interpretation on Various Issues Concerning the Application of <Company Law of the People’s Republic of China>, Judicial Interpretation No. 2 [2014]] (promulgated by the Judicial Comm. Sup. People’s Ct., Dec. 6, 2010, effective Feb. 16, 2011, amended in 2014), sec. 24, Sup. People’s Ct. Gaz., Apr. 10, 2011, http://gongbao.court.gov.cn/Details/2e87b414e9d3b1f7099 d2d19551.html?sw=%e6%9c%80%e9%ab%98%e4%ba%ba%e6%b0%91%e6%b3%95%e9%99%a2%e5%85%b3%e4%ba%8c%e9%80%82%e7%94%a8%e3%80%8a%e4%b8%ad %e5%8d%8e%4e%ba%ba%e6%b0%91%e5%85%b1%e5%92%8c%e5%9b%bd%e5%85% ac%e5%8f%8b%e6%b3%95%e3%80%8b%e8%8b%a5%e5%b9%b2%e9%97%ae%e9%a2 %98%e7%9a%84%e8%8a%7%84%e5%ae%9a%ef%bc%88 (China). It should be noted that this rule applies only in the context of a limited liability company, and there is a debate on
owners of the stock, they should be entitled to inspect corporate documents in order to protect their interests. In practice, however, it can be difficult or costly to allow beneficial owners to exercise inspection rights, as it entails the task of analyzing various forms of beneficial ownership in order to determine who actually and ultimately receives the benefit from stock ownership. In China, share ownership is usually determined by reference to the company’s list of shareholders. Article 32 of the Company Law states that “the shareholders recorded in the registry of shareholders may, pursuant to the registry of shareholders, claim to and exercise the shareholder’s rights.”

Hence, at least for now, it might be advisable to confine inspection rights to the legal owner of shares as recorded in the shareholder registry. Another issue here is whether the shareholder of a parent company has the right to inspect the relevant materials of the subsidiary company. This question may be answered in the negative under a literal reading of Chinese law. In contrast, Delaware law allows it, to the extent that:

a. The corporation has actual possession and control of such records of such subsidiary; or
b. The corporation could obtain such records through the exercise of control over such subsidiary, provided that as of the date of the making of the demand:
   1. The stockholder inspection of such books and records of the subsidiary would not constitute a breach of an agreement between the corporation or the subsidiary and a person or persons not affiliated with the corporation; and
   2. The subsidiary would not have the right under the law applicable to it to deny the corporation access to such books and records upon demand by the corporation.

This paper suggests China should consider adopting the Delaware experience to allow the shareholder of a parent company to inspect the relevant materials of the subsidiary company. In practice, given the close relationship between a parent company and its subsidiary company, it is often important to check not only the documents of the parent company but also those of the subsidiary company. Without access to relevant documents whether the “nominal shareholding” mechanism is allowed in a joint stock company. In practice, the China Securities Regulatory Commission, the watchdog of the Chinese securities markets, has often asked listing applicants to dismantle such mechanisms before they get listed.

51. Company Law art. 32, para. 2 (China).
of the subsidiary company, the shareholder may not be able to see the complete picture, particularly when the parent company’s control over the subsidiary company is high enough to manipulate relevant transactions.

2. Can the Shareholder Inspect via Agents?

In exercising inspection rights, the shareholders may need to seek expert assistance, due to the complexity and sheer volume of financial data contained in corporate documents. Under Chinese law, an inspecting stockholder may conduct their inspection of the company’s documents with the assistance of an accountant, a lawyer, or any other practitioner of an intermediary. There are two conditions for the use of agents here. First, the shareholder needs to be present. Second, the agent has an obligation of confidentiality in accordance with the law or the code of practice.

In comparison, Delaware law appears to be more flexible, allowing a stockholder to conduct his inspection of corporate records in person or through an attorney or other agent. At the same time, the Delaware court also has more freedom to restrict the stockholder’s choice of agents. Apart from confidentiality reasons, there can be other restrictions on the choice of agents, as long as it is necessary to protect the interests of the company. For instance, the court may bar the inspecting stockholder from selecting as his agents’ persons involved in pending litigation against the company.

This paper submits that Delaware law is worthy of serious consideration for China. On the one hand, there does not seem to be any strong reason why the shareholder needs to be present when their agent actually does the inspection work. As long as the agent can show proper authorization from the shareholder, the presence of the shareholder does not serve any useful purpose. By allowing the agent to work on its own, the shareholder does not have to waste time, money, and energy to come to the inspection site. On the other hand, it would be desirable to let the court to have more flexibility in imposing relevant restrictions on the choice of agents. Confidentiality is certainly one of the key conditions for the choice of the agent but may not be the only one. For instance, conflicts of interest should also be a key factor in considering whether a particular person would be appropriate to act as an agent. Due to the complex and varied circumstances of each case, a one-size-fits-all approach should be avoided as much as possible.

53. 2017 Judicial Interpretation, sec. 10, para. 2.
3. What Types of Documents can be Inspected?

Chinese law is very detailed on the documents that can be inspected, dividing them into four different categories, including the first category such as stockholder list, the second category such as accounting books, the third category such as original accounting vouchers, and the fourth category such as contracts.56 A shareholder has almost absolute right to inspect the first category of documents, such as the company’s bylaws, the minutes of the shareholders’ meetings, the resolutions of the board of directors’ meetings, the resolutions of the board of supervisors’ meetings, as well as the financial reports. In contrast, the second category of documents means accounting books, which is more sensitive than the first category. Hence, the shareholder needs to follow certain procedural rules to make a request, and the company may reject the request on the grounds of “improper purpose.”

It is not entirely clear whether inspection rights can cover other documents, such as original accounting vouchers, contracts and client lists. As the empirical inquiry finds out, most of the requests for the third category of information were actually supported by the courts, while the fourth category of information was generally considered by the court to fall outside the scope of the inspection right provisions.57

In contrast, Delaware’s statute is silent on the scope of corporate documents that a shareholder can inspect, let alone divide them into different categories with different treatments. Unlike China, there is no list specifying the documents subject to inspection in Delaware’s statute. Rather, a stockholder can examine any documents, as long as they are essential to his purpose. It is a question of fact as to what documents are essential to a stockholder’s purpose, and the courts may limit the scope of the examination as they see fit.58

From a practical perspective, Chinese law is clearer and more detailed, providing more guidance on what documents can be inspected and what requirements to follow in doing so. This can facilitate shareholders exercising the right to obtain relevant documents, particularly the first category of information. However, by enumerating specific items of information that can be inspected, Chinese law invites the problem of rigidity. As noted above, the Chinese courts are found to generally refuse to extend the inspection rights to the documents not listed in the statute. Indeed, looking into the wording of the relevant provisions of the Company Law, the list of documents that can be inspected does seem to be exhaustive rather

56. See discussion supra Part II.B.
57. See discussion supra Part III.C.3.
than indicative. Hence, this paper suggests that China should allow some flexibility in relation to the scope of documents to be inspected, by introducing a general provision to the relevant provisions of the Company Law. Drawing on the Delaware experience, the general provision can stipulate that the document must be essential to the relevant purpose and the court has the discretion to attach certain conditions.

C. Preventing Abuse of the Rights

1. The “Proper Purpose” Rule

As the main tool to prevent abuse of shareholder inspection rights, there is a ‘proper purpose’ rule, under which a stockholder must have a proper purpose for making his inspection. Conceptually, this requirement sounds straightforward but can be very difficult to apply in practice.

As discussed earlier, Chinese law explicitly lists two categories of corporate documents that can be inspected, and based on this categorization, provides for a bifurcated approach to the requirement of proper purpose. The requirement of proper purpose is not attached to the first category of documents and only applies to the second category of corporate documents, namely accounting books.

Furthermore, when a shareholder requests to inspect the second category of information such as accounting books, the company can reject the request on the grounds that the inspection is for improper purposes. Through the empirical study noted earlier, we found that when requesting relevant information, the plaintiff shareholders just need to state that they make the request for the general purposes of knowing the operational and financial situation of the company, and then it is the defendants’ burden to prove that the plaintiffs seek information for improper purposes. This effectively shift the burden of proof to the defendant company to establish the existence of improper purpose. As revealed by our empirical study, it is very difficult for the defendant company to discharge this burden to the satisfaction of the court.59

By contrast, as a substantive rule, Delaware law requires proper purpose not only in relation to accounting books but also other types of corporate documents. Then, depending on the type of documents sought to be inspected, Delaware bifurcates the allocations of the burden of proof for the requirement of proper purpose. Unlike Chinese law, however, Delaware draws the line between the stock ledger and all other books and records. Specifically, when the requested document is a stock ledger, the requesting

59. See discussion supra Part IV.C.1.
shareholder only needs to allege a proper purpose in general terms, and then the company bears the burden of proving the purpose to be improper. Where the shareholder seeks to inspect other documents such as accounting books, such a shareholder has the burden of proving his purpose to be proper. The evidentiary standard is a “credible basis” one which is seen as an important safeguard against “fishing expeditions.” Plainly, due to this difference in the allocation of evidentiary burden, it is usually harder to gain access to other documents than the stock ledger.

Hence, it appears that compared with China, Delaware places a higher degree of restriction on inspection rights. First, for the least sensitive corporate documents such as the shareholder list, there is no explicit requirement of proper purpose under Chinese law, but the requirement still applies under Delaware law. The burden of proof is shifted to the company, so it needs to prove the purpose of the shareholder to be improper. Second, for more sensitive documents such as accounting books, Chinese law applies the requirement of proper purpose and shifts the burden of proof to the company, just like Delaware law regulates the request for the shareholder list. Under Delaware law, the requesting shareholder has the burden to prove that his purpose is proper. In sum, the shareholder faces a lower barrier to obtaining access to corporate documents in China than Delaware. As discussed elsewhere, this may be explained on the grounds that due to the special role of the state in the Chinese corporate landscape, Chinese corporate governance is pro-shareholder while the U.S. one is pro-management, in terms of the allocation of corporate power, including shareholder inspection rights.

2. The “Substantial Deprivation” Rule

Another way to restrict inspection rights takes the form of restrictive corporate constitutional provisions or shareholder agreements. It is very difficult to determine whether such restrictions can be allowed. On the one hand, corporate constitutional provisions or shareholder agreements may be seen as contractual arrangements amongst shareholders, embodying the spirit of corporate autonomy. On the other hand, the interests of shareholders, particularly minority shareholders, would be harmed if inspection rights were to be restricted by the shareholders at will. Indeed, from a policy perspective, there is a need to strike a balance between

60. Del. Code Ann. tit. 8, § 220(c) (West).
61. Seinfeld, 909 A.2d at 122.
62. See Huang & Thomas, supra note 2 at 943-944.
managerial accountability by way of inspection rights and managerial authority by insulating managers from too much shareholder interference.

As discussed earlier, Chinese law stipulates that a shareholder of a company cannot be substantially deprived of their inspection rights by the company’s bylaws or any agreement between shareholders. In the U.S., the issue is framed in terms of the reasonableness of a restriction that can be imposed on the inspection right. Despite the difference in their expressions, they are functionally equivalent in that an instance of substantial deprivation in China would well be considered to be unreasonable in the U.S., and vice versa.

An often-discussed restriction in the U.S. is the requirement that the requesting shareholder must own at least 5% of the outstanding shares of the corporation and/or hold the stock for at least six months immediately preceding his demand for access to corporate documents. The theory behind this is that shareholders with large or long-term commitments to the corporation are more likely to have proper motives for their exercise of inspection rights. Indeed, without the 5% ownership requirement and the six-month holding requirement, inspection rights might be abused by some persons who can strategically buy a symbolic number of shares just before requesting for access to corporate documents. However, the concern is whether the requirements may unfairly harm the rights of shareholders, particularly minority shareholders.

In Delaware, as the statute contains no minimum ownership or holding period requirements, the courts have traditionally disallowed a corporation to contractually impose such conditions on the inspection rights of its stockholders. For instance, the Delaware Court of Chancery held void a 25% minimum ownership requirement for inspection rights contained in the certificate of incorporation. Conceivably, the 25% ownership requirement set the bar too high to be reasonable, but how about 5%, or even 1%? Indeed, before 2008, the Model Business Corporations Act had a 5% ownership or six months holding requirement for the inspection rights, which are still adopted in some states in the U.S. However, after 2008, the MBCA dropped the ownership and holding requirement, which has been followed by some states. In short, the states in the U.S. are divided on this issue and the debate is in a state of flux.

Hence, it is a very difficult issue to determine the validity of contractual restrictions on inspection rights. Inevitably, the court needs to exercise discretion with regards to the form and effect of the restriction in individual

63. *See* discussion *supra* part II.B.
64. *See* Loew’s Theatres, Inc. v. Commercial Credit Co., 243 A.2d 78 (Del. Ch. 1968).
cases. As shown by the empirical study of the cases in China, it is not yet common to impose restrictions on the inspection rights through the company bylaws and shareholder resolutions, and no sample case was found to have restrictions by way of the ownership and holding period requirement. Hence, at present, it does not seem to be a pressing issue in China over what constitutes “substantial deprivation.” This may change in the future, however, as the inspection right becomes more frequently used, and thus more companies may choose to restrict the exercise of this right through constitutional provisions or shareholder agreements.

V. Conclusion

Shareholder inspection rights provide an important channel for shareholders to gain access to relevant documents of their company, thus enabling them to engage in corporate governance to monitor the management and if necessary, take appropriate action. Drawing upon overseas experiences, notably the US, China has introduced the legal regime for shareholder inspection rights in the early stage of development of its company law. Over the years, China has provided more details on the relevant legal provisions and made amendments intended to better suit the local conditions.

Apart from the law, this paper also conducts an empirical study of how the law has been applied in practice by examining relevant cases adjudicated from 2012 to 2017. These main findings include:

1) Recently, a fair amount of shareholder inspection rights have been utilized, with a significant increase in the cases filed in recent years.

2) This means a much smaller number of “subsequent” cases are filed by the same plaintiff against the same defendants, when compared to the U.S. This shows the inspection right in China plays a less important role as a tool to collect relevant evidence to bring subsequent cases. Furthermore, within the small number of subsequent cases, class actions and derivative actions represent a high proportion of cases in the U.S. but are absent in China.

3) The appeal rate of inspection cases is significantly higher than the overall appeal rate for corporate law cases, indicating that they involve contentious issues.

66. See discussion supra Part III.D.2.
4) A vast majority of inspection cases were brought by individual shareholders as opposed to corporate shareholders, suggesting that inspection rights are of particular value to small and vulnerable shareholders. Furthermore, the plaintiffs with a shareholding level between 10% and 30% filed most of the inspection cases.

5) Up to 94.81% of inspection cases were found in the context of the limited liability company, which corresponds to the private company or the close corporation in overseas jurisdictions. In contrast, a small number of cases were brought in the context of SOEs, while most cases were found in the context of small companies because they generally have weaker corporate governance.

6) The information requested can be broadly divided into four categories, and there has been a clear trend towards the request of accounting materials, including accounting books and original accounting vouchers.

7) In a very small number of cases, the company successfully refused shareholder inspection rights by proving the “improper purpose” of the requesting shareholders. Among the four types of “improper purpose,” the first one, “the shareholder is engaged in any business in substantial competition with the main business of the company,” is most likely to get the court’s support.

8) In only three cases, the company sought to restrict the shareholders’ inspection right through the bylaws or the shareholders’ agreement, and in only one case, the restriction was found to constitute “substantial deprivation” and thus invalid.

The paper reveals that there are similarities and differences between China and the U.S. (as represented by Delaware) in the area of shareholder inspection rights. Despite the different types of agency problems in corporate governance between China and the U.S., shareholder inspection rights are similarly useful in mitigating informational asymmetry and facilitating shareholder engagement. Some of the differences, such as those on the number and types of subsequent litigation, can be explained by the different patterns of corporate governance strategies as well as different corporate litigation regimes between the two jurisdictions.

This paper also discovers that there are some significant differences in the key elements of the legal framework for shareholder inspection rights between the two jurisdictions, and based on this, sets out improvement suggestions for China. For instance, this paper suggests China to consider
adopting the Delaware experience to allow the shareholder of a parent company to inspect the relevant materials of the subsidiary company; China is also advised to allow more flexibility in the use of agents to inspect corporate documents in line with the Delaware practice; it is also suggested that China should introduce a general provision on the scope of corporate documents that can be inspected. There are some issues that may need further research in the future, such as the issue of what constitutes “substantial deprivation” of shareholder inspection rights through constitutional provisions or shareholder agreements.
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