



Ca' Foscari
University
of Venice

Master's Degree programme

in Language and
Management to China
"Second Cycle (D.M.
270/2004)"

Final Thesis

**ITALIAN AND CHINESE CORPORATE
GOVERNANCES OF "LIMITED" COMPANIES**

Supervisor

Prof. Renzo Riccardo Cavalieri

Graduand

Federica Crescenzi
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引言

这些年来公司治理的涵义扩大。现在的公司治理不仅仅是各公司参与机构之间的严格结合,比如说经理、主管和股东(这些机构的目的是尊重股东的创造、保护),同时也是在公司周围的很多机构、利害关系人之间的结合。虽然关于公司治理的意思有很多界定,但是在这篇论文中将着重强调公司治理是一个专注于股东要求的系统,这个系统的目的是指导和控制公司。由于这个原因我将解释对意大利和中国内部治理机构的深入研究,也就是说股东大会、行政机构和监理委员会。

一九九零年以来在发达国家公司治理是一个研究的对象。许多事实使公司治理变得非常重要,比如说由于持续的经济全球化、关于董事会效率和政治压力的公众舆论反面越来越多。在意大利关于公司治理的意思曾有大量研究,例如一九九八年有 Airoidi 和 Forestieri 的研究,二零零二年有 Bruni 的研究。

近年来在中国,公司治理变成了学术、经济和政治讨论的中心主题。从公司实践开始中国不断采用西方体制的企业形式和实践。一九九四年“公司法”是对西方公司概念和法律的创新采用和改编,使用两种类型的英美系统公司,如有限责任公司和股份有限公司(私人有限责任公司和公共有限责任公司)。它还采用德国系统的双层板结构。然而,中国最初的创新采用和改编是一种混乱。这个情况造成公司治理的一些重要问题。

在本文中,我对有限责任公司(有限责任公司和股份有限公司)的意大利和中国公司治理进行了比较。我还将讨论意大利和中国的公司治理规范和主要机构,并且对中国和意大利的合资企业情况进行评估。

本篇论文分为两章,第一章将主要关注意大利的公司治理,第二章将关注中国公司治理。我将对中意两国在公司治理的各个方面进行比较,例如负责管理公司的每个机构的模型,角色和责任。在两章的结束,我还将讨论法律实施在公司治理过程中造成的问题。

在第一章的第一段中,我深入研究了国际公司治理的定义和发展,并对公司治理的概念由专家提出了很多不同的定义。事实上,公司治理的概念有很多解释,一些与公司的管理严格相关,比如股东,管理和监督机构,以及其他包括众多参与者,利害关系人,外部市场和政府政策。

在第二段中，我介绍了意大利公司治理和意大利公司法的发展，以便对意大利有限公司的立法结构进行解释。

第三段涉及根据公司需求可以使用的三种意大利公司治理模式。他们是“传统”，“一层”和“两层”的模式。

之后，我研究了在每个模式中公司治理的主要机关。根据不同的公司治理模式，这些机关会有不同功能。

在第五段中，我展示了意大利公司治理模式的主要问题，例如意大利上市公司的所有权和控制结构，少数股东保护以及意大利内部公司控制系统的规制超过限度。

在第二章中，我将讨论中国公司治理的情况。我将介绍中国公司治理和中国公司法的发展，中国公司治理的模型（它类似于德国的两层体系）及其主要机关任务。第二章的结构将与第一章一样。

第四段分析了在中国有限公司当前公司治理模式中存在的问题，如中国上市公司的国有企业集中度，监管委员会和内幕交易的弱势，中国公司信息披露相关的问题以及中国共产党对公司决策的影响。

在第五段中，我提到了中外企业的公司治理，也就是说合资企业的公司治理。在本段中，我强调了合资企业的主要特征，例如一致原则，股份转让批准和董事会（无股东大会）作为主要/唯一的行政机构。

最后，我做了一个结论，总结了之前讨论的内容并重点强调出中国和意大利公司治理之间的主要冲突方面。

根据所进行的研究，在法律的适用中意大利和中国有限公司的公司治理有一些问题。意大利公司提供不同的管理和控制系统的选择，如传统、一层和两层的系统。传统系统的特点是董事会作为行政机构和法定审计委员会作为监管体制。盎格鲁撒克逊一层系统的行政机构是董事会，管理控制委员会作为监管体制。德国两层系统提供管理委员会和监督委员会的共存。这个最后系统与在中国公司治理模型非常相似。在中国模式中，管理委托给董事会，控制委托给监事会；但是，董事会与监事会之间没有等级关系，事实上，在中国，这两个处于同一水平，其成员由股东任命。相反，德国监事会有权任命和撤销董事会成员。由于这个情况，大多数中国监事会在监督董事会面临巨大挑战，导致内幕交易问题。

在中国股东大会的作用也很有意思，因为它被认为是公司治理的最高权力。因此，董事会和监事会的权力，不是来自立法机构，而是来自股东。但是在意大利，董事会活动的特点是自主性和排他性。股东大会与全国人民代表大会相比较，这种公司治理制度类似于中国宪法所表达的政治治理理念，其中全国人大是最高国家权力，所有其他国家机关都是在下面。通过强大的股东大会，董事会的角色施展非常有限。合资企业法解决了这种情况，因为没有股东大会的存在，所以董事会是唯一的行政机构。“上市公司治理准则”和“公司法”强调董事对股东的忠诚和勤勉义务；但是，董事会的任务是值得怀疑，因为它们通常由母公司、党委书记、政府官员的代表主导。因此，这些机关缺乏独立性和能力，因为只有少数董事是专业人士（律师，会计师或财务专家）。

意大利和中国的公司治理有一个关于少数股东缺乏保护有关共同问题。他们经常成为控股股东滥用权力的受害者。这是因为意大利和中国的董事会都是在多数原则的基础上工作的。中国公司法第一百三十三条规定：“股东大会决议应当由出席会议的股东所持表决权的一半以上采纳。但是，关于修改公司章程、增加或减少注册资本、或合并、分立、解散、变更公司的公司形式，股东大会决议应当由出席会议的股东所持表决权的三分之二以上采纳”。

根据意大利公司法，普通股东大会也以会议上出席的法定人数 50%+ 1 的比例结算，而特别股东大会以 2/3 的多数票结算。

根据合资企业法，一致原则提供了对小股东保护的一种否决权，从而减少了大股东主张其管理的能力。事实上，它指出通常董事会是基于多数原则性来执行工作，但所有重大决策都需要达成一致，例如资金的增加，股份的转让和合资企业的解散。

一九九三年的中国公司法，随着一些变化，特别是二零零五年的变化，它适应了持续的社会经济变革。特别是，成员的自主权在构成阶段和公司管理方面都有所增加。通过这种方式，它减少了强制性规则的数量和范围、最低资本，并增加了少数股东的保护、沟通的透明度。尽管多年来的变化削弱了，但是法律中包含的部分规则的公共足迹仍然具有相关性。

有条款规定每家资本公司都应遵循“共产党活动的条件”。中国共产党的章程将这些活动定义为“保证和控制”党的政治路线的应用和“支持”公司的股东大

会、董事会和监督管理。正是中国共产党对公司决策的影响导致公司自身缺乏独立性和自主性。

中国公司治理体系与西方公司治理体系之间的差异似乎很明显，这主要是在法律的实施中。在这些情况下，投资者成员与管理之间的关系，即公众（以及由他们指定的董事）与私人股东之间的关系，管理的低效率和不透明性以及腐败、内幕交易的现象相互叠加。一方面，公司的管理不受任何严肃和可信的内部和外部控制，另一方面，它对于一系列外部主题的业务选择还没有完整的决策自主权。在中国，甚至银行、金融公司和审计公司的监管能力似乎也相当薄弱：新闻和舆论报道的腐败和渎职案件很多。

近年来，商业方面受到中国立法者的调整。中国法律形式和内容越来越类似于西方法律。但是它的特点还是行政机构的作用，公共领导对经济活动的影响，以及执法风格的特殊“色彩”的作用。

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INTRODUCTION

The concept of corporate governance (公司治理 Gongsì zhìlì) has expanded over the years, not just as a strict dependence among the various corporate actors (managers, directors and shareholders) focused on the creation and protection of shareholder value, but extending the stake of the interested parties with the inclusion of a multiplicity of actors and stakeholders. Despite the existence of many definitions about the concept of corporate governance, it is important to underline the corporate governance as a system or a process of directing and controlling the corporation focused on the needs of the shareholders. For this reason, I will explain a deeper study of Italian and Chinese internal governance bodies such as shareholder's general meeting, administrative and supervisory boards.

Corporate governance has been an object of attention in developed countries since the 1990s. In fact continuous economic globalization, as well as increasing negative public opinion about boards effectiveness and political pressure have been the reasons why corporate governance is now relevant. In Italy there have been numerous studies regarding the concept of corporate governance, such as those of Airoldi and Forestieri in 1998 and those of Bruni in 2002.

In China corporate governance has recently become a central subject in academic, economic and political discussions. From the beginning of corporate practice, China has constantly adopted corporate forms and practices from Western systems. The 1994 Company Law is an innovative adoption and adaptation of Western corporate systems and laws. It adopts two form of companies of the Anglo-American systems: limited liability companies and companies limited by shares (private limited companies and public limited companies). It also adopts the German board structure that is the two-tier board system. However, China's adaptation and adoption was a mishmash, causing some of the major issues of corporate governance.

In this dissertation I make a comparison between Italian and Chinese corporate governances of limited companies (limited liability company and company limited by shares). I also discuss Italian and Chinese corporate governance specifications and the

major bodies, assessing the situation of a Chinese and Italian Joint Venture (中外合资企业 Zhongwai hezi qiye).

I have split this dissertation into two chapters, with the first one focused on the Italian corporate governance and the second one on the Chinese corporate governance. I also compare every aspect of corporate governance, such as models, roles and liabilities of each body responsible for managing the company. At the end of both chapters, I then discuss various problems created by the implementation of laws or a gap in the legislative system.

In the first paragraph of the first chapter in particular, I examine in depth the definition and development of corporate governance at international level with several and different definitions of the concept made by experts. In fact, the concept of corporate governance has several interpretations, with some strictly related to the management of the corporate, such as shareholders, management and supervisory bodies; and others that include also a multiplicity of actors, stakeholders, external markets and government policies.

In the second paragraph I focus on the development of the Italian corporate governance and the Italian Company Law, in order to have an explanation of the legislative structure of Italian limited companies.

The third paragraph deals with the three Italian models of corporate governance that can be used depending on companies' needs. These are the "traditional", the "one-tier" and the "two-tier" systems.

I then study the corporate governance's main bodies in each system, since their function changes from one system to another.

In the fifth and last paragraph I demonstrate the main issues of the Italian corporate governance models, such as the ownership and control structure in Italian listed companies, the minority shareholders' protection and the Italian phenomenon of regulatory overshooting of internal corporate control system.

In the second chapter, I focus my study on the Chinese corporate governance, using the same structure of the first chapter by looking at the development of corporate governance, its model (similar to the German two-tier system), and its main bodies tasks. The fourth paragraph analyses the main issues in the current corporate governance model in Chinese limited companies such as the concentration of state ownership in Chinese listed companies, the most serious problem of weak supervisory board, insider

trading deficiencies, the “undue” influence of the Chinese Communist Party in the company’s decision and opacity related to information disclosure of Chinese listed companies.

In addition, in the fifth paragraph I mention the corporate governance of Sino-foreign enterprise like the Equity Joint Venture. In this paragraph, main features that identify the EJV are underlined, such as the unanimity principle, the approval for transfer of shares and the board of directors (no shareholders’ meeting) as the only administrative body.

At the end I make a personal conclusion summarising what discussed before, underlying the major aspects of conflict between Chinese and Italian corporate governances.

1. Corporate governance in Italy

1.1 Definition and development of corporate governance

Corporate Governance is currently one of the most debated topics at international level but it is important to understand what it refers to.

Corporate Governance was not a relevant matter until the 1980s. As a result of the stock market smash of 1987 there was a considerable number of corporate collapsing caused by global corporate bankruptcy. Corporate Governance has since captured worldwide attention. Since the 1990s, the debate of Corporate Governance has become intensive due to economic globalization, issues related to the board capability and new regulatory and political pressure¹.

The meaning of the concept of Corporate Governance is easily understandable: governance applied to the company refers to that system of rules and institutions that direct and control the corporation. Nonetheless, this is a very articulate theme and characterized by numerous sources of discipline. It is therefore evident that depending on the aspects taken into account, various descriptions and definitions can be found. The issue of Corporate Governance within international analyses has expanded significantly over the years, coming to take into consideration the concept, not just as a strict dependence among the various corporate actors (managers, directors and shareholders) focused on the creation and protection of shareholders' value, but extending the stake of the interested parties with the inclusion of a multiplicity of actors and stakeholders².

Some studies defines Corporate Governance as a set of rules, at all levels (laws, regulations, etc.), which regulate the management and performance of a company or a public or private body. Instead, other studies define it as an organizational sub-system consisting of an organic set of structures (decision-making and control), rules, processes

¹ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.37.

² MALLIN, Christine A., *Handbook on international corporate governance*, country analyses, 2006, p.45.

of intermediation between the interests of Shareholders³ and Stakeholders⁴. Above all, in regards to this last definition, opposing lines of thinking have developed. Many theories in fact state that Corporate Governance is primarily aimed at protecting exclusively the interests of shareholders⁵, while others, on the other hand, that Corporate Governance must cover the interests of all the Stakeholders⁶.

Despite this incredible theoretical development around the concept of Corporate Governance, for a long time Italy has remained anchored to the principles of business administration, which emphasize the prominence on the logic of governance and the needs of the owners.

Numerous studies have been developed in our country around Corporate Governance. Among the most important are those of Bruni, which highlights that "Corporate Governance concerns the system of rights, processes and control mechanisms established, both internally and externally, in relation to the administration of an enterprise at order to safeguard the interests of the stakeholders"⁷.

Very important is also the definition elaborated by Coda, which states that with the term 'governance' it is intended as "the set of characteristics of structure and functioning of the governing bodies (Board of Directors, Chairman of the Board, Committees) and control (Board of Statutory Auditors and External Auditors) in relationships between them and in relations with the members of the property and with the managerial structure"⁸.

Fortuna defines Corporate Governance as "the set of institutions and rules (legal and technical) with the aim of ensuring an effective and efficient government, but above all correct towards all the subjects interested in the life of the company, with particular regard to the protection of minority shareholders"⁹. Furthermore, Airoidi and Forestieri

³ Shareholder are the shareholders of the company, those who own the shares of capital.

⁴ The Stakeholder of a company are the stakeholders who revolve around the organization. They represent the universe of people and entities interested in the products, services, status and well-being of the organization. Once they were identified with customers, investors, suppliers and employees of the company. Today we tend to widen the mix of stakeholders, including regulators, public opinion and media, community, competitors, potential employees, potential investors, partners and others.

⁵ SHLEIFER A. –VISHNY R., *A survey of corporate governance*, in Journal of Finance, Vol. 52, 1997, p. 737.

⁶ SALVATORI Carlo, *La corporate governance nelle banche: riflessioni e problemi aperti*, Rivista politica economica, 2001, p.93.

⁷ BRUNI (2002), LEPORE, Luigi, *Corporate governance e shareholder protection*, FrancoAngeli, 2018, p.24.

⁸ CODA (1997), *Ibis.*, p.24.

⁹ FORTUNA, F., *Corporate governance: soggetti, modelli e sistemi*, Milano, 2002, p.46.

state that the term Corporate Governance refers to "the set of rules and restrictions that regulate the relations between shareholders and management and that ensure that the company is managed in the interests of the former"¹⁰.

Finally, the same Airoidi introduces the concept of "institutional set-up", which seems to be able to include the previous definitions.

Airoidi's definition somehow recalls the ones of Daily, Dalton and Cannella, which defines the governance "as the determination of the broad uses to which organizational resources will be deployed and the resolution of conflicts among myriad participants in organizations"¹¹.

Similarly, Huse (2006) defines the company as a set of resources and relationships and, in particular, Corporate Governance as "the interactions between coalitions of internal actors, external actors and the board members in directing the value-creation"¹².

These last three definitions are very similar, as they consider governance not exclusively as a relationship between predefined classes of subjects (managers, shareholders and directors) and oriented towards a single purpose (the protection of shareholder value), but rather as a multiplicity of actors gravitating around the enterprise in the direction of a changing end.

The existence of so many definitions concerning the concept of Governance, which in varying degrees differentiate the operating perimeter of the institution, shows us how heated and open the debate that has been in recent years concerned the issue of Corporate Governance.

Despite the existence of many definitions regarding the concept of Corporate Governance, what is important to underline and what I will discuss in this dissertation is that the Corporate Governance is a system or a process of directing and controlling the corporation focused on the needs of the shareholders. Therefore a deeper study on the internal corporate governance bodies such as shareholders' general meeting, board of directors and supervisory board becomes really important and interesting.

¹⁰ FORESTIERI, G., *Corporate governance*, Milano, 1998, p.38.

¹¹ DAILY, C.M., DALTON, D.R. and CANNELLA, *Corporate Governance: Decades of Dialogue and Data*, *Academy of Management Review*, 28,2003, pp. 371-382.

¹² HUSE, *Boards, Governance and Value Creation: The Human Side of Corporate Governance*, Cambridge University Press, 2007, p.63.

1.2 Company Law and development of corporate governance in Italy

Company Law is a branch of commercial law which studies situations related to corporate life and its relationship with the members. In Italy the legislative ordinance of 17 January 2003, n. 6 has massively innovated the Italian company law discipline, exercising a delegation granted by the Parliament which also introduced new or simplified company figures.

With the Legislative Decree 17 January 2003, n. 6, the delegated legislator, implementing the Law of 3 October 2001, n. 366, introduced into the Italian legal system the new regulation of limited companies. Since the entry into force of the Civil Code (c.c.) of 1942, it is undoubtedly not only the most important reform of Italian Company Law, but also the most important intervention in the field of the whole Italian private Law.

The new regulation came into force on 1 January 2004, after almost a year of *vacatio legis*¹³. Legislative Decree no. 6 completely reforms parts of Book V of the Civil Code, in particular corporations and mutual societies, changing the pre-existing legislation, adding new institutions, renewing others, unifying the regulation of the extinction of companies. This provision constitutes the epilogue of a long process of reform, riddled with unsuccessful attempts and partial reforms, such as the law n. 216 of 1974 which established, *inter alia*, the CONSOB¹⁴ and savings shares.

The legislative objectives of the reform of 2003 were the simplification of the regulation of limited companies, the introduction of a system articulated in flexible models, the valorisation of statutory autonomy and the discipline of group of companies. From now on, the company limited by shares, which can also be formed as a single-person company, will be able to acquire different financial instruments; the protection of the members will be guaranteed not by the system of challenging the shareholders' resolutions but by obligations for compensation for damages. Finally, it will assist in a

¹³ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona, pp.1-2.

¹⁴ CONSOB (Italian Companies and Exchange Commission) is the government authority of Italy responsible for regulating the Italian securities market. This includes the regulation of the Italian stock exchange, the Borsa Italiana.

weakening of the powers of the assembly to the full advantage of the administrative body, moreover it will benefit from the constitution of assets destined for a specific business.

The limited liability company will undergo a transformation that is perhaps even more radical. It will in fact become a limited liability company losing the previous characteristic of a small corporation. The wide freedom in terms of contributions, the extension of the right of withdrawal, the possibility of issuing debt securities, albeit reserved for subscription to institutional investors, the right to increase the share capital with the exclusion of the option duty are some of the innovations which bring down the barriers in terms of access of the limited liability company to the financial system. We can reasonably believe that the limited liability company will become, in the near future, the basic model for small and medium-sized collective enterprise. The traditional types of limited companies have different functions assigned: the limited liability company, given the different system of operation and organization, becomes the main instrument for the establishment of companies, although with fractional capital among few members. The company limited by shares is typically the company appealing to the public savings, the legal form of the company which intends to be listed on regulated markets¹⁵.

The statutory autonomy is also valued by the reform: when allowed, if only the interests of the members are involved, the legislator leaves space to the needs of shareholders and allows different options (for example, in terms of administration and control): in essence, the reform makes the possibility to create "tailor-made suits" (in the sense of society) possible. For the first time, the legislator regulates, with general and non-sector regulations, the situation where a group of companies faces the principle of direct responsibility of the parent company towards the members of the subsidiaries with complication for the profitability and for the value of social participation¹⁶.

With regard to the company's administration and control systems, the reform legislator has made significant interventions and offered operators the choice among different systems of administration and control. To the traditional structure, founded on the administrative body, delegated bodies and board of statutory auditors, the legislator has

¹⁵ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.7-8.

¹⁶ BALZARINI Paola, *La riforma del diritto societario*, Mondadori, 2003, pp.3-4.

flanked the German two-tier system, based on a supervisory board, appointed by the assembly, and a management board, made up of different people and nominated by the supervisory board. The legislator has also included the Anglo-Saxon one-tier system, in which control over the board of directors is exercised by a committee for management control, appointed within the board itself.

The traditional or ordinary model, typical of the Italian tradition, so called because applicable in the absence of the statutory adoption of another system, is characterized by the presence of an administrative body, a single person (single administrator) or made of several people (board of directors); a control body, the board of statutory auditors; the shareholders' meeting (body of the company representative of the will of the shareholders), which appoints both the board of directors or the sole director, and the board of statutory auditors.

The dualistic or "two-tier" model, typical of the German tradition, contemplates the co-presence of two necessarily collegial organs. They are positioned in the area of administrative functions, the management board and the supervisory board. The latter controls functions similar to those of the board of statutory auditors in the ordinary system.

The monistic or "one-tier" model, typical of the Anglo-Saxon tradition, is characterised by the impossibility of having a single administrator. This system contemplates the presence of a single administrative body: the board of directors, which is supported by a committee composed of non-executive and independent directors, and the management control committee, which takes charge of the typical functions of the board of statutory auditors. As for the assembly, it almost has a similar role to the one of the ordinary system¹⁷.

¹⁷ *Ibis.*, pp.7-8.

1.3 Italian corporate governance models

As it has been analysed during the previous paragraph, the 2003 Corporate Law reform introduced significant changes also in the area of corporate governance. In fact, from January 17, 2003, with Legislative Decree No. 6, the law recognizes that companies can choose between three different systems, which art. 2380 calls for administration and control, also called governance models: the traditional model, the dualistic model and the monistic model.

The importance in the diversification of the three models resides in the competence regarding the election of managers and controllers. If in the ordinary system everyone is appointed by the assembly, in the other two the assembly task is reduced. On the one hand in the dualistic system, the assembly only appoints to the controllers (i.e. the members of the supervisory board), which then are responsible for the appointment of managers. On the other hand, the one-tier program, the shareholders appoint the members of the board of directors (who perform the management functions), and nominates the auditors (i.e. the members of the control committee) within it¹⁸.

Another very important news concerning all three systems is represented by the introduction of art. 2409-bis in the Italian Civil Code, which exclusively assigns the legal audit of the accounts to an external auditor. Before the quoted reform took place, the accounting control of the companies belonged to the board of statutory auditors. Moreover, the 2nd paragraph of the art. 2409-bis c.c. established that only the bylaws of companies that do not use the risk capital market and are not required to prepare consolidated financial statements may restore the competence of the statutory audit of the accounts to the board of statutory auditors. In this case, however, all auditors must be entered in the Register of auditors¹⁹.

As cited, only the Traditional model was already present in the law of public limited companies; the other two were introduced by the reform. In the intentions of the reformers, the Two-tier system should be able to meet the particular needs of companies with widespread capital, in which the managers enjoy a wide autonomy with respect to

¹⁸ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.9-12.

¹⁹ MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, pp.46-50.

ownership and their work is promptly and actively monitored by a professional and independent body (i.e. supervisory board). The Monistic model should guarantee companies to increase transparency and circulation of information between management and control bodies, in a context of greater simplicity and flexibility.

Furthermore, It is possible to move from one system to another, even during the life of the company. The 2nd paragraph of the art. 2380 c.c. states that the change in the system takes effect from the date in which the shareholders' meeting is called to approve the financial statements for the following year. However, It is not clear whether the decision must in any case be taken by the extraordinary assembly, as it is necessarily amending the bylaws, or if statutes permitting the application of different systems are admissible, assigning this task to the ordinary assembly. Starting from the fact that the choice of one or the other model can affect the powers of the shareholders' meeting and in any case involves a change in the company's organizational composition, it seems preferable to consider that a resolution of the extraordinary shareholders' meeting is always necessary²⁰.

The various governance models will be analysed individually and more specifically, emphasizing the characteristics of each one for a better understanding of the differences between them.

²⁰ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona , pp.11-12.

1.3.1 The “traditional” system

In the traditional system, the legislator confers to the directors exclusive power of management of the company and new competencies, such as the issue of bonds and the establishment of separate assets for a specific business. The board of directors may delegate part of its powers to one or more managing directors or to an executive committee. The reform also states conditions to the auditors from the statutory board such as a general duty to monitor compliance with the law and the bylaws, compliance with the principles of proper administration - with particular regard to the adequacy of the organizational, administrative and accounting structure of the company, concrete functioning of this structure - the obligation to participate in the meetings of all the corporate bodies, to replace the directors in the exercise of the duties imposed on them, and to express opinions.

The auditors from the statutory board must also be heard in the occasion of an appointment with an external auditor, with whom it has the obligation to exchange information. Moreover, it has the power to convene the assembly -if it recognizes serious reprehensible facts and there is an urgent need to provide a solution - , and may propose to the court pursuant to art. 2409. In this system, all the matters of accounting control are entrusted to the auditor (natural person or auditing company), to be exercised on the financial statements and on the consolidated financial statements, if prepared; the auditor is responsible for drawing up the report on the financial statements and for expressing opinions, for example on mergers following acquisition with debt. The auditor, in order to perform its duties, can carry on inspections, request information from administrators, or exchange information with auditors. In companies that do not use capital risk and are not required to prepare consolidated financial statements, the accounting control can be entrusted to the board of statutory auditors, composed of auditors²¹.

This model of administration and control is adopted in the absence of a different statutory choice and is based on the separation between a management body (i.e. sole director or board of directors) and a supervisory body (i.e. board of statutory auditors).

²¹ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona, pp.17-18.

As already mentioned, in companies limited by shares a role of considerable importance is played by the directors, as they, with their functions, occupy a central position within the organizations of the aforementioned companies.

With reference to this system, the competence for the appointment of these subjects is headed by the ordinary shareholders' meeting (Article 2383, paragraph 1 of the Civil Code), which is also responsible for determining the exact number of directors if the statute indicates only a maximum and a minimum number. However, there are four exceptions to this rule:

- the first directors are appointed in the constitutive act of the company (Article 2383, paragraph 1 of the Italian Civil Code).
- the statute may reserve the appointment of an independent member of the board of directors to the holders of financial instruments issued pursuant to articles 2346, paragraph 612 of the Italian Civil Code, and 2349, paragraph 2 of the code c.13.
- the law or the statute may reserve to the State or to public bodies, including non-shareholders, the appointment of one or more directors with the same rights and obligations as the others, except for the fact that they can be revoked only by those who appointed them;
- the same directors shall appoint the members of the board of directors who failed during the financial year, with a resolution approved by the board of statutory auditors (co-optation), provided that the majority is always constituted by directors appointed by the shareholders' meeting and the by-laws do not provide the termination of certain directors, the entire board ceases (simul stabunt vel simul cadent). The co-opted directors remain in office only until the next meeting, which will have to organise a new appointment to decide whether it intends to replace or confirm them. In the cases excluded from the co-optation, the immediate competence of the meeting remains unless otherwise provided by laws.

Article. 2386 c.c. states that if all the directors (or the sole director) should be absent, the convocation is urgently made by the board of statutory auditors, who may in the meantime perform all the ordinary administrative acts²².

Furthermore, the directors who do not necessarily have to be shareholders (Article 2380-bis of the Italian Civil Code), are appointed for a period not exceeding three financial years (Article 2383, paragraph 2 of the Italian Civil Code), so that the shareholders' meeting may, periodically, exercise the power of appointment without the administrative body being in any way compromised, and expire on the date of the meeting called for the approval of the financial statements relating to the last financial year of their office²³.

Finally, the directors, as the 3rd paragraph of the art. 2383 of the Civil Code, may be re-elected for an indefinite number of times, unless the bylaws provide otherwise.

With regard to the lawsuits for ineligibility and forfeiture of the office, the law provides for a precise regulation envisaged by art. 2382 of the Civil Code, where it is stated that "he cannot be appointed as a director, and if appointed, his interdict, the incapacitated, the bankruptcy, or who has been sentenced to a penalty that imposes the interdiction, even temporary, from public offices or the inability to exercise management offices ". In addition to these specific requirements, the bylaws can provide for special administrators requirements of integrity, professionalism and independence.

There are also grounds for incompatibility, which prohibit the holding of the office of director at the same time as a certain office (for example a member of CONSOB) or to perform certain functions or activities (for example a lawyer).

Before the end of the period of appointment, the directors cease from the office:

- for revocation at any time and for any reason by the meeting, except for the right to compensation for damages if the just cause is missing. The shareholders' meeting has the right to revoke the directors appointed in the deed of incorporation, but not those appointed by the State and public bodies and not even those appointed by holders of financial instruments;

²² VIETTI Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.196-198.

²³ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona, p.20.

- for renunciation communicated in writing to the board of directors and the chairman of the board of statutory auditors;
- for forfeiture;
- by death;
- for the registration in the company register of the appointment of liquidators;
- by the merger of the company;
- for other reasons provided for by the statute²⁴.

In order to start the administration relationship, the appointment must be followed by the acceptance of the persons called to hold the office. Once the position has been assumed, the directors must request, within thirty days from the news of their appointment, the registration in the register of companies, indicating for each of them the surname and the name, place and date of birth, domicile and citizenship, as well as to which among them the representation of the company is attributed, specifying whether severally or jointly²⁵.

²⁴ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.214-215.

²⁵ FORTUNA, F., *Corporate governance: soggetti, modelli e sistemi*, Milano, 2001, pp.56-60.

1.3.2 The “two-tier” system

In the two-tier system, which in the introduced discipline only partially reflects the original German model, the shareholders' meeting is joined by the supervisory board and the management board are. The supervisory board puts itself between the shareholders' meeting and the management board. It assumes some of the powers that, in the Latin model, are assigned to the meeting and, for the rest, the control functions performed by the board of statutory auditors. In fact, among the powers reserved for the meeting there is the appointment and revocation of the supervisory directors only, the appointment of the auditor and the resolution concerning the distribution of profits resulting from the financial statements (Article 2364-bis of the civil code). On the other hand, the supervisory board is responsible for the appointment and revocation of the members of the management board and the approval of the annual and consolidated financial statements, as well as the performance of the functions pursuant to art. 2403 c.c. and the exercise of the liability and the reporting of serious irregularities (Article 2409-terdecies of the civil code)²⁶.

In general it is up to this body to perform the functions typical of the board of statutory auditors (Article 2409-quaterdecies of the civil code). The management of the company is the responsibility of the management board, in turn appointed by the supervisory board. The members of the management board cannot be appointed supervisory board members (Article 2409-novies c.c.). The rules on the directors of limited companies referring to the Latin model (articles 2380, paragraph 3, and 2409-undecies c.c.) apply to the management board, unless otherwise stated. The right to exercise responsibility for the management board members lies not only within the company and its members, but also with the supervisory board (Article 2409-decies c.c).

The two-tier system is widespread, as well as in Germany, also in France, Netherlands and Portugal. The German law is the only one providing the two-tier system as the only system; in France, as in Italy, the dualistic model is optional, while in Netherlands it is mandatory for large companies.

²⁶ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.411-13.

Unlike the models found in other jurisdictions (such as the German model, or the aforementioned European models), the Italian regime does not allow the participation in the supervisory body or members of minority shareholders or other non-members (as workers or creditors), if not by virtue of specific statutory clauses²⁷.

Looking at the whole picture, the adoption of the two-tier system, in the context of statutory autonomy, makes a significant shift, in favour of the two aforementioned board members²⁸.

²⁷ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.8-9.

²⁸ FORTUNA, F., *Corporate governance: soggetti, modelli e sistemi*, Milano, 2001, pp.73-78.

1.3.3 The “one-tier” system

In the one-tier system, the assembly retains the functions of the ordinary system, the board of directors has the same powers as the one existing in the traditional system, there is also the management control committee set up, performing the functions of the board of statutory auditors in the ordinary system and exercising the accounting control, unless otherwise stated by the statute. Even here, if the statute permits it, the accounting control can be entrusted to an external auditor, with duties, functions and duties as described above.

The one-tier model results from Anglo-Saxon and it is linked to one of the peculiarities that characterize the large US and British companies, in which the main role of the board of directors is identified not so much in the management of the company, but rather in monitoring the work of the directors invested with executive functions (executives) and senior management. This management control is exercised by non-executive directors, using an internal committee (audit committee) to which the monitoring functions on the internal control and auditor control system are essentially delegated.

The one-tier system presents itself as a simpler and more flexible model of governance, which tends to favour the circulation of information between administrators and controllers, achieving savings in terms of time and costs and a high degree of transparency among the administrators of the company and the ones exercising the control functions²⁹.

Although it is less distant from the traditional model than the two-tier system, due to the substantial correspondence between the powers of the assembly and the administrative body, nevertheless the one-tier system presents some typical and unique features.

1. The first and most evident difference compared to the traditional system is considered by the elimination of the board of statutory auditors, by the management control committee.

²⁹ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.507-509.

2. A second element of the one-tier system compared to the traditional one, and common to the two-tier system, is considered by the necessary subjection of all the companies that adopt this model, with no possible exceptions, to the auditing of an auditor (natural person or auditing firm) registered in the Ministry of Justice.
3. Thirdly, it is important to highlight the collegial nature of the administrative body, and therefore the impossibility of entrusting the administration to a single administrator.
4. Finally, the premise for the realization of this analysis is considered. The one-tier system is in fact made up of a solid and necessary division of powers between the administrative body as a whole, such as the management of the company on an exclusive basis (article 2409-septiesdecies, paragraph 1 of the Civil Code), and the committee was appointed internally, called to exercise the functions of control over the management reserved to it by law (article 2409-octiesdecies, penultimate paragraph cc)³⁰.

³⁰ FORTUNA, F., *Corporate governance: soggetti, modelli e sistemi*, Milano, 2001, pp.84-88.

1.4 Corporate Governance framework in Italian limited company

The most important bodies of internal corporate governance are the shareholders' general meeting, the administrative board and the supervisory board.

1.4.1 Shareholders' general meeting

In companies limited by shares, as well as in limited liability company, the shareholders' general meeting uses the majority principle to appoint and remove directors.

However, in limited liability company, management is usually entrusted to the quota-holders (unless is provided by the company's statute).

The article 2351 of the ICC³¹ states that each share gives the right to vote. The statute may provide for the creation of shares without voting rights, shares with voting rights limited to specific matters or shares with voting rights subordinated to the income of certain conditions not simply dependent on the exercise of individual rights. The total value of these shares cannot exceed one half of the capital³².

According to article 2380-bis of the ICC, the board is characterized by independence and exclusivity. Therefore the shareholders cannot get involved in the management of the company. They can only remove the directors or choose not to re-elect them when their term expires.

In companies limited by shares, the ordinary shareholders' meeting shall:

- approve the annual financial statements (only in traditional and one-tier system)
- appoint and remove directors and auditors (appoint and remove representatives of the supervisory board in the two-tier system),
- state their remuneration, if not stated in the statute,
- define their liability,

³¹ ICC (The International Chamber of Commerce) is the largest, most representative business organization in the world. Its 6 million members in over 100 countries have interests spanning every sector of private enterprise. ICC has three main activities: rule setting, dispute resolution, and policy advocacy.

³² MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, pp.52-53.

- define other matters entrusted to the meeting (only in traditional and one-tier system),
- define the distribution of profits (only in the two-tier system).

In company limited by shares the extraordinary shareholders' meeting shall to deliberate on amendments of the statute, on the appointment, on the replacement and powers attributed to liquidators and on any other task attributed to it by the law.

In limited liability companies, the quota-holders decide:

- the approval of the financial statements and the distribution of profits,
- the appointment of the directors,
- the appointment of the auditors,
- the amendments of the statute,
- the decision that may create amendments to the company's purpose or to the quota-holders' rights,
- other matters attributed to them by the statute³³.

³³ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

1.4.1.1 Shareholders' rights

Shareholders have two types of rights:

1. Patrimonial rights, such as the right to obtain dividends and the right to withdraw from the company.
2. Administrative rights, such as the right to join and to vote in general meetings and the right to be informed about the company performance³⁴.

Company limited by shares can issue distinct types of shares out of the ordinary ones. In limited liability companies, quota-holders have rights balanced to the quota owned³⁵. The company's statute and shareholders' agreements can limit, modify, cancel some rights, and can create specific rights to some shareholders subject to mandatory legal provisions. In addition, there are some cases where the range to which the rights may be limited or modified is set out by the law, such as constrains to the transfer of the shares³⁶.

Regarding information disclosure, the section 113 of the Italian Company Law states that any company must disclose all information necessary to understand the company performance such as assets and liabilities, profits and losses, financial situation and expectations³⁷.

³⁴ MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, pp.53-54.

³⁵ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

³⁶ CORSETTI Barbara, GAMBINI Luca, PERES Federica, *Corporate Governance and Directors' Duties: Italy*, Q&A guide to corporate governance law in Italy, Portolano Cavallo Studio Legale.

³⁷ Italian Company Law, section 113.

1.4.2 Administrative body

In Italy compares to the one-tier and two-tier system, the majority of the limited companies adopts the traditional system.

In general, directors have the sole responsibility of managing the company, and their first task is achieving the corporate's goal. The law and the statute impose upon directors some duties and they must fulfill them with the diligence required by the nature of their appointment. They are liable towards the company for damages caused by the non-observance of such duties.

According to paragraph 4 of article 2380-bis of the ICC, if the statute indicate only the maximum and the minimum number of directors without issuing a specific number, the shareholders' general meeting determines the number.

In unlisted companies a sole director and a number of directors may be appointed, while in listed companies a board of directors must be appointed.

The board of directors selects its chairman among its members³⁸.

The number of members of the board of directors is usually chosen according to the company requirements. Usually, small and medium-sized companies have a board of directors composed by three or five members, while in listed companies the average is thirteen members.

Those who have been convicted with a sentence that involves legal sanctions, even temporary, or are unable to exercise managerial functions, cannot be appointed as directors³⁹.

For listed companies, the Code states that the board shall be composed by executive and non-executive directors. These non-executive directors (not less than two) shall be independent. This means that they do not have any business relationships with the company, in order to avoid influences in their judgement.

For listed companies, the statute must ensure a balance between men and women for the appointment of the board of directors. The less represented gender must obtain at least one-third of the appointed positions.

³⁸ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.54-57.

³⁹ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp. 8-9.

According to article 2386 of the ICC, if during the fiscal year there is a vacancy for one or more directors, the others determine their replacement by resolution approved by the board of statutory auditors. The majority is always composed by directors appointed by the meeting. If vacancies occur for the majority of the directors appointed by the meeting, the others shall call the meeting to fill the vacancies⁴⁰.

⁴⁰ CORSETTI Barbara, GAMBINI Luca, PERES Federica, *Corporate Governance and Directors' Duties: Italy*, Q&A guide to corporate governance law in Italy, Portolano Cavallo Studio Legale.

1.4.2.1 Administrative body in the traditional system

In the Traditional system the administrative body is the board of directors. As mentioned above, in the ordinary system the management power and the other administrative powers can be concentrated in the hands of a single director. However, when the administration is entrusted to more people for a better combination of interests and greater weighting in decisions, the board of directors is formed. In this case the collegial method is applied for the deliberative activity; moreover, the directors are characterized, on a related basis, by joint and several liability; in addition, the members of the board must act in an informed manner, motivating analytically their decisions. The chairman of the board of directors, chosen by the meeting or by the board among the directors, must be appointed; finally, it is forbidden to exercise on the board of directors the voting by representation, and for the validity of the resolutions there are a quorum constitutive (the majority of the directors in office) and a decision (the absolute majority of those present)⁴¹.

A relevant subject regarding the board of directors is the power of representation, which is the power to act in the name of the company expressing its will towards third parties. The representation refers to the administrative activity as required by law (in this sense we can speak of legal representation, but does not coincide with the management power, which, in fact, relates to the internal phase of the management of the company and to assumption of the related decisions); however the power of representation refers to the external phase of the manifestation of these decisions to third parties with appeal to the company. Secondly, the power of representation, unlike the management, is does not belong to all the directors, but only those indicated in the constitutive act. The law also provides that the power of representation attributed to the directors by the bylaws (statute) is general, including all the deeds to be performed in the name of the company, and considering effective with respect to third parties the acts carried out by directors with representation or if they are extraneous to the corporate purpose (c.d. acts *ultra vires*), whether made in the absence of the relative management power or otherwise in

⁴¹ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona, pp.17-20.

violation of the rules of the internal decision-making phase. The law provides, *inter alia*, that the invalidity of the appointment of directors with representation cannot be opposed to third parties once the related publicity has been made, unless the company proves that the third parties were aware of the cause of nullity or annulment.

Important provisions have also been drawn up regarding the responsibility of the administrative body; the directors are civilly responsible for the non-observance of the duties imposed on them by the law and by the statute.

They are obliged to fulfill these duties towards the company, which they respond contractually; with regards to compliance with the obligations inherent to the preservation of the integrity of the company's assets, the directors also respond to the social creditors; the organic relationship, finally, does not exclude the personal responsibility of the same for violation of the general duty of *neminem laedere* ⁴².

There are many specific duties that the law assigns to the administrative body; for example, the prohibition of competition (Article 2390 of the Civil Code), the truthful and correct representation of the annual accounts or the obligation to inform the management and control bodies about each personal or third-party interests of which the director is a bearer in relation to a given company transaction.

However, the liability of the directors is configurable beyond the violation of one or more duties specifically provided for and regulated by the law or by the articles of association. More generally, it pertains to the realization of their functions, and is therefore, first of all, related to the violation of the general duty of proper administration. The responsibility of the directors is, as mentioned, does not extend to the administrator who proves to be immune from fault. ⁴³.

⁴² VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.51-54.

⁴³ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

1.4.2.2 Administrative body in the two-tier system

In the two-tier model the administrative body is the management board. The management board is made of no less than two directors, including non-members, whose first ones are listed in the deed of incorporation and, subsequently, by the supervisory board, (which also quantifies the compensation, unless the by-laws attribute this competence to the assembly) which also has the competence to determine the number, within the limits established by the by-laws. For example, if the statute is expected to have two to four management board members, the supervisory board may decide, when it is the right time, to appoint two, three or four members of the board. The art. 2351 of the Civil Code, which is the last paragraph, recalls the possibility that the financial instruments issued in favour of shareholders or third parties (Article 2346, paragraph 6 of the Civil Code) should be reserved for the appointment of an independent member of the Board of Directors, in this case the Management Board or of the supervisory board. According to the provisions of Articles 2449 c.c. and 2450 cc, moreover, the law or the by-laws can attribute to the State or public bodies the appointment of one or more directors or statutory auditors or members of the supervisory board, even if the shareholding is missing⁴⁴.

To guarantee the mutual independence of the two bodies, the law states that the members of the management board cannot be appointed supervisory board members. Moreover, the 2nd paragraph of the art. 2373 c.c. contemplates a hypothesis of conflict of interest ex lege, according to which the members of the management board, if shareholders, cannot cast their vote on the resolutions of the ordinary meeting concerning the appointment, revocation and responsibility of the supervisory board members .

Many of the aforementioned provisions set out for directors are applied to the management directors, with particular reference to: the causes of ineligibility and forfeiture (Article 2382 of the Civil Code); to the rules on advertising (article 2383 of the civil code); any requirements of integrity, professionalism and independence required by the bylaws or by special laws for the exercise of particular activities (Article

⁴⁴ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.7-8.

2387 of the Civil Code); the prohibition of competition (Article 2390 of the Civil Code)⁴⁵.

Once their appointment has been completed, the management board members remain in office for the time established in the appointment deed, and in any case for a period not exceeding three financial years. Their deadline is set to the date of the meeting of the supervisory board convened for the approval of the financial statements (which in the two-tier system is the responsibility of the supervisory board, rather than the assembly) in the last year of their office.

Unless otherwise expressed in the statute, the directors are among other things re-eligible without limits and the revocation can only be ordered by the supervisory board, even if the appointment was made in the constitutive act, except for the right to compensation for damages if the revocation happens without just cause. However, the supervisory board cannot compete for the revocation of directors appointed by the state or public body, given that in these cases the revocation is carried out by the bodies responsible for the appointment⁴⁶.

The supervisory board is also responsible for the replacement of the members of the management board that failed during the year; and the law also believes that the members so appointed remain in office until the same deadline established for the original components.

With reference to the functions of the body, a distinction must be made between legal tasks and additional statutory tasks, that is to say, exceptionally assigned to the management board by the articles of association.

Considering, first of all, the legal regime, the law provides that the management board has exclusive power over the management of the company, with relative power / duty to perform all the operations necessary to implement the corporate purpose. There are also specific legal competences, such as those concerning: the convening of the shareholders' meeting, either on their own initiative or in the cases required by law; the appeal of the cancellable shareholders' resolutions, and the adoption under their own responsibility of the measures obtained by the cancellation; and generally the execution of other duties

⁴⁵ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.483-486.

⁴⁶ FORTUNA, F., *Corporate governance: soggetti, modelli e sistemi*, Milano, 2001, pp.151-153.

state by the provisions which, in the regulation of the ordinary management system, are referred to the directors⁴⁷.

As for the additional powers, they can be subtracted from the bylaws to the meeting and assigned to the management board, to ensure streamlining and more efficient and timely adoption of resolutions on particular activities, such as the merger for incorporation of companies held internally or at 90%, the establishment or elimination of secondary offices, the indication of directors with powers of representation or the reduction of the share capital in the event of withdrawal of the shareholder.

It is also possible to state that under Article 2380-bis c.c, the management board chooses the president among its members, who will still have similar powers to those expressed by art. 2381 of the Italian Civil Code, despite an explicit reference to this resolution, which are considered, by consolidated opinion, typical properties of the president of a collegiate body: refers to the powers of summoning the organ by setting the relative agenda, direction and coordination of the collegiate works, of the proclamation of the relative results, of opening and closing of the session⁴⁸.

⁴⁷ HUSE Morten, *Boards, Governance and Value Creation: The Human Side of Corporate Governance*, Cambridge University Press, 2007, pp.96-100.

⁴⁸ PULLANO, L., *Nuove forme di corporate governance*, Roma, Aracne editrice, 2009, pp.124-127.

1.4.2.3 Administrative body in the one-tier system

In the One-tier system the administrative body is the board of directors. In the context of the particular functional compartmentalization that characterizes the administrative body in the One-tier system, the law codifies a double distinction: non-executive directors and executive directors, and independent directors and non-independent directors .

Under the first profile, those directors who "are not members of the executive committee and to whom no delegations or particular duties are assigned are not considered to be non-executive, and who in any case do not carry out functions related to the management of the company or companies that control or are controlled "(Article 2409-octiesdecies, paragraph 2 of the Italian Civil Code).

The qualification of executive directors must be assigned, on a residual basis, to the members of the board of directors who, on the basis of a formal investiture or even just de facto, exercise these functions⁴⁹.

Under the second profile, the members of the board of directors are "in possession of the independence requirements established for the statutory auditors by art. 2399, paragraph 119 of the Italian Civil Code, and, the statute says, of those envisaged by codes of conduct drawn up by trade associations or companies managing regulated markets (Article 2409-septiesdecies, paragraph 2 of the Italian Civil Code).

The definitions now mentioned assume a direct applicative value and determine important deductions on the structure of the board of directors and the management control committee.

As far as the board of directors is concerned, the law requires that at least one third of its members to be independent (Article 2409-septiesdecies, paragraph 2 of the Civil Code). Except for this particularity in the composition, the administrative body is shaped by the discipline dictated for the board of directors in the Ordinary system, of which all provisions are recalled, with the sole exception of those concerning general manager and judicial control (art. 2409-novies-decies, paragraph 2 of the Civil Code).

⁴⁹ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.502-505.

As regards to the competences, the law reiterates that the management of the company lies exclusively on the board of directors (Article 2409-septiesdecies, paragraph 1 of the Italian Civil Code)⁵⁰.

⁵⁰ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

1.4.3 Supervisory body

1.4.3.1 Supervisory body in the traditional system

The control and supervision of the management of the company were entrusted to an internal body of the same company, called 'the board of statutory auditors'. The institute has always been the subject of discussions and disagreements, both as regards to certain generality of functions, and in relation to the system of appointment, composition and functioning.

Many adjustments have been made to the discipline and many important changes have been made to the overall structure of the internal control system and the functioning of the board of statutory auditors.

First of all, it should be mentioned that in the new company law the statute can opt for administration and control systems that do not provide the board of auditors, whose functions, for the most part, are assigned to the supervisory board in the two-tier system, or to the management control committee in the monistic one, which we will elaborate later on⁵¹.

The function of the board of statutory auditors remains, for all the companies limited by shares essentially that of monitoring the legality and correctness of the functioning and administration of the company.

The evolution of the institute's discipline has entailed, moreover, a clarification of the function itself, both in the sense of specifying its duties, and usually canceling the accounting control to assign it to an auditing company or a single auditor. Only closed companies which do not required to prepare consolidated financial statements may require by-laws, if they adopt the ordinary system, that the statutory audit of accounts is exercised by the board of statutory auditors. Even in companies where the audit is entrusted to an external company or external auditor, the board of statutory auditors remains the holder of supervisory and intervention obligations regarding accounting matters, since this is part of the general function of legitimacy control⁵².

⁵¹ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona, pp.21-22.

⁵² MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, p.53.

The composition of the board of statutory auditors is different for companies with listed and unlisted shares. For the latter, the institution may be composed of only three or five effective members (who may be shareholders or non-shareholders) and two alternate auditors must necessarily be appointed; it is also possible that the control body is composed of a single statutory auditor. In companies with listed shares, the number of statutory auditors must not be less than three and that of alternate auditors, but the maximum limit is provided by the statute⁵³.

Article 2397 c.c. dictates the personal requirements that individual members must possess in unlisted companies: "at least one effective and one alternate member must be chosen from among the statutory auditors registered in the appropriate register. The remaining members, if not registered, must be chosen from among those registered in the professional registers identified by decree of the Minister of Justice, or among tenured university professors, in economic or juridical subjects ". In companies with listed shares, however, the requirements of professionalism and also of integrity of the members of the college are sanctioned by decree of the Minister of Justice, together with the Minister of Economy, after hearing the supervisory authorities of competence (Bank of Italy, CONSOB and IVASS).

In addition to the requisites of professionalism or integrity, the appointment as statutory auditor of a company limited by shares is subject to the lack of grounds for ineligibility, which also constitute grounds for forfeiture (such as the failure to meet the aforementioned personal requirements) when they occur after the appointment.

In this regard, it is opportune to keep in mind that those who are bound by relationships, kinship or affinity within the fourth degree with the directors of the company or other group company, cannot be part of the board of statutory auditors, as well as those who have an employment relationship with the company or professional advice which limits their independence⁵⁴.

With regards to the appointment of statutory auditors, they are firstly appointed through the deed of incorporation and secondly by the ordinary shareholders' meeting, with the majority required for the related resolutions, like for the appointment of directors:

⁵³ CORSETTI Barbara, GAMBINI Luca, PERES Federica, *Corporate Governance and Directors' Duties: Italy*, Q&A guide to corporate governance law in Italy, Portolano Cavallo Studio Legale.

⁵⁴ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.57-60.

therefore, the shareholders that appoint the directors have the right / power to appoint mayors as well. The latter remain in office for three financial years and cease to hold office only on the date of the shareholders' meeting, called to approve the financial statements for the third year and effective from the time the board was re-established. The discipline changes with respect to the administrators when it comes to revocation or replacement of the members of the college. The mayors, in fact, can be revoked by the assembly only when a just cause is evident and the resolution must be accepted by the court by decree, with the opinion of the concerned mayor⁵⁵.

In the event of death, resignation or revocation of the statutory auditor, alternate members will be in charge: however, those members remain in office until the next meeting, which will appoint the new statutory auditor and new alternate members (where the originally became an effective member), necessary to rebuild the integrity of the college.

Finally, the body must meet at least quarterly, and the resolutions must be adopted by a majority of the presents.

With regards to the functions of the board of statutory auditors, they are divided into powers and duties. The latter are governed by art. 2403, paragraph 1 of the Civil Code, which states that the board must monitor "compliance with the law and the bylaws, compliance with the principles of proper administration and in particular the adequacy of the organizational, administrative and accounting structure adopted by the company and its concrete functioning ". The auditors therefore have the task of verifying not only the correct functioning of the law and of the articles of association, but the correctness of the management and the proper performance of the company in its multiple articulations⁵⁶.

Regarding the powers of the institution, the art. 2403-bis that outlines them: the auditors may carry out at any time inspection and control both collegially and individually, except that any assessment made must result from the mandatory book of meetings and the decisions of the board of statutory auditors. The auditors are also entitled to request information from the directors on the progress of the company transactions or on certain

⁵⁵ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.7-8.

⁵⁶ CATTURI G., *L'azienda universale, L'idea forza, la morfologia e la fisiologia*, CEDAM, Padova, 2003, p.59.

businesses. In companies with listed shares, however, there is a specific disclosure obligation on directors to the board of statutory auditors; they must report to the latter at least quarterly and, in accordance with the procedures set out in the deed of incorporation, activities carried out and the most important economic, financial and equity transactions related the company or its subsidiaries⁵⁷.

In addition to the ordinary functions, the auditors are required to perform various tasks, which can be described as extraordinary, as they relate to relatively exceptional facts or circumstances in the life of a company. First of all, the art. 2406 c.c. states that the board of statutory auditors is required to convene the assembly and execute the publications established by law in cases of omission or unjustified delay by the directors. The article goes on to add that the board may, after communicating to the chairman of the board of directors, call the meeting if, in the performance of its duties, it sees reprehensible facts of significant gravity and there is a need of urgent intervention.

According to the art. 2386 of the Civil Code, last paragraph, another important hypothesis in which it is possible to convene an assembly by the board of statutory auditors is that of the termination of the sole director or of all the directors, for the appointment of the new sole director or of the whole council⁵⁸.

The responsibility of the members of the board of auditors is articulated by the legislator on two levels: the one related to the duties and duties pertaining to the function (exclusive responsibility) and to the solidarity due to the facts or omissions of the directors (concurrent responsibility). The same legislator then identifies two more specific duties for mayors, such as the truth of their attestations and professional secrecy. Violating one of these duties falls on the responsibility of the members of the board of statutory auditors, regardless of the actions of the directors (exclusive responsibility). The responsibility they face is different when it is ascertained that they have not effectively supervised the activities of the directors and this has undermined the obligations and duties incumbent on them, with consequent damage to the company, shareholders or third parties (responsibility competitor).⁵⁹.

⁵⁷ HUSE Morten, *Boards, Governance and Value Creation: The Human Side of Corporate Governance*, Cambridge University Press, 2007, pp.143-146.

⁵⁸ PULLANO, L., *Nuove forme di corporate governance*, Roma, Aracne editrice, 2009, pp.176-180.

⁵⁹ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

1.4.3.2 Supervisory body in the two-tier system

Next to the management board, as mentioned above, the dual governance system envisages the co-presence of a second board body, the supervisory board. It is therefore characterized by: extraneousness to the tasks of active administration; control function on the management board; attraction in its jurisdiction of many of the functions pertaining to the traditional system to the assembly, as well as the tasks of the board of statutory auditors, the latter body absent, in fact, from the model in question.

The members of this body, which must not be less than three, with the greater number provided by the statute, are appointed, even among non-members, as regards to the former in the deed of incorporation and subsequently by the shareholders' meeting, which determines their number each time limits set by the statute.

The delicate functions of control assigned to the organ correspond to its professional connotation, and emphasize the need for suitable qualities of independence and integrity, as well as professionalism, of its members. It is in fact required that at least one effective member of the board to be chosen from among those in the register of auditors established at the Ministry of Justice. Additional requirements of professionalism, as well as independence and integrity, for the assumption of office can be set by the articles of association⁶⁰.

Still referring to the subjective requirements plan, the same causes of ineligibility and forfeiture established for the directors system are envisaged (Article 2382), with the addition of the following : the quality of a member of the management board, always safeguarding the mutual independence of the two boards; the existence of employment relationships, or collaboration, or any relationship of a financial nature with the same company, or with parent companies or subsidiaries or members of the same group, able to compromise the independence of the tied component from such reports.

Supervisory advisers the hold office for three financial years, terminating on the date of the first ordinary shareholders' meeting called by law, within 120 days of the close of the third financial year or in the longer term, in any case not exceeding 180 days, as required by the bylaws (pursuant to articles 2364, paragraph 2 of the Italian Civil Code,

⁶⁰ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, pp.415-419.

and 2364-bis, paragraph 2 of the Civil Code). The old components can also be re-elected without limits, unless otherwise stated in the by-laws. If during the course of the financial year one or more councilors, for any reasons (renunciation, death, and revocation), are missing, the assembly shall proceed without delay⁶¹.

From the point of view of the general balance of the governance structure in question, the discipline of the revocation of the members of the body is very important. Like the act of appointing, it competes with the ordinary meeting, given the favourable vote of at least one fifth of the share capital, and without prejudice to the right to compensation for damages in favour of the director without right cause.

The chairman of the supervisory board is elected by the assembly, rather than by the same members of the board. This is done to attribute to this figure a special relief, giving it a stable and independent position, which cannot be removed by the board itself. This is all done to have a more efficient and independent exercise of the powers of direction and coordination of the council activities. These powers are determined by the statute. Even in the absence of such a statutory provision, it is however to be considered that the President is in any case at least equivalent to those already seen by the chairman of the board of directors and the management board.⁶²

The broad powers assigned to the supervisory board, in the comparison between the dualistic and the traditional system, on one side significantly erode those of the ordinary assembly; on the other hand they replace those of the board of statutory auditors. Thus, following what the law states, the supervisory board appoints and revokes the members of the management board and determines their remuneration, unless the latter is attributed by the statute to the shareholders' meeting. The supervisory board is also responsible for approving the financial statements and, when drawn up, for the consolidated financial statements and accounting documents.

The articles of association may also provide that, in the event the financial statements are not approved by the supervisory board, the competence for the approval of the same balance is attributed to the assembly⁶³.

⁶¹ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, p.8.

⁶² CATTURI G., *L'azienda universale, L'idea forza, la morfologia e la fisiologia*, CEDAM, Padova, 2003, p.75.

⁶³ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

The exercise of the supervisory functions is another task of the supervisory board, which in the ordinary model are headed by the board of statutory auditors. Following the full reference to art. 2403, paragraph 1, already mentioned above, the supervisory board "monitors compliance with the law and the statute, compliance with the principles of proper administration and in particular the adequacy of the organizational, administrative and accounting structure adopted by the company and the its concrete functioning".

The rules concerning specific activities apply to the supervisory board and its members, with the usual compatibility limit: publicity of the appointment and remuneration; powers to request information from the directors; meetings, resolutions and relative minutes; convocation of the meeting in case of omission of the administrative body or of urgent need to provide for serious censurable facts; exchange of information with the people in charge of the accounting control⁶⁴.

Furthermore, the supervisory board has other legal powers: the task of convening the meeting at the request of minority shareholders (Article 2367, paragraph 2 of the Civil Code, the legitimacy to challenge the unlawful shareholders' resolutions, adopting the measures resulting from the cancellation (Article 2377, paragraphs 1 and 6 of the Civil Code), as well as appealing the resolutions of the management Board (Article 2409-undecies, paragraph 2 of the Civil Code).

Regarding the liability regime of the members of the supervisory board, it is prescribed that they fulfill their duties with the diligence required by the nature of the appointment. Therefore a high degree of diligence is required, equal to that imposed on the directors or, in the Two-tier system, to the management board members, and commensurate with the activity carried out.

Given this, it is expected that the members of the supervisory board will respond jointly with the members of the management board for the facts or omissions of the latter, in the event that the damage would not have occurred if they had supervised in accordance with their obligations charge.

Finally, the accounting control is invariably entrusted in the Two-tier system to an external auditor, natural person or auditing company, according to the general rules on such control dictated by the legal regime of company limited by shares.

⁶⁴ HUSE Morten, *Boards, Governance and Value Creation: The Human Side of Corporate Governance*, Cambridge University Press, 2007, pp.150-152.

While in the Traditional system it is possible in some cases that the board of statutory auditors performs accounting control (Article 2403, paragraph 2 of the Civil Code), this is never possible in the dualistic administration system. All companies adopting this model are therefore subjected to the auditing of the aforementioned auditor, registered in the Register established at the Ministry of Justice. Article.2364-bis, paragraph 1, no. 5 of the Civil Code, states that in company limited by shares with supervisory board, the appointment of the auditor is the responsibility of the shareholders' meeting⁶⁵.

The latter, in this system, is emptied of its traditional prerogatives, which are attributed to the supervisory board. Taking into account the role played by the latter and all of its functions, the power of the shareholders' meeting (Article 2364-bis, paragraph 1 of the Civil Code) is:

- to appoint and remove supervisory advisors;
- or to determine the compensation due to them, if not indicated by the statute;
- or to deliberate on the responsibility of the councilors;
- or to deliberate on the distribution of profits;
- or to appoint, as mentioned, the person to whom the accounting control is required .⁶⁶.

⁶⁵ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, p.9.

⁶⁶ *Corporate Governance Code*, Corporate Governance Committee, July 2015.

1.4.3.3 Supervisory body in the one-tier system

In very specific terms, the composition, powers and functioning of the management control committee are outlined. Following paragraph 2 of the art. 2409-octiesdecies c.c., the committee must be fully composed of independent and non-executive directors. Furthermore, the members must possess the requisites of integrity and professionalism established by the articles of association. The third paragraph of the aforementioned article also requires that at least one of the members of the committee must be chosen from among those registered in the register of auditors.

The committee itself elects the president internally, with the favourable vote of the absolute majority of the members.

The law, in addition, does not require any particular limit regarding the number of members of the body, if not for the open companies, for which a minimum number of three members is mandatory. In order to meet this limit, the determination of the number and the appointment of the members of the management control committee are usually held by the board of directors. The law, however, contemplates the possibility of a different statutory provision, which for example predefines the number of members of the committee or even remits to the meeting the identification of directors (in possession of the related requirements) intended to be included. The statute may also reserve holders of financial instruments pursuant to articles. 2346 and 2349 c.c. the appointment of an independent member of the board of directors; holders of such instruments may therefore also be given the power to appoint one of the members of the control committee⁶⁷.

In the cases of death, resignation, revocation or forfeiture of a member of the committee, the law requires the board of directors to proceed without delay to replacement, choosing among the other directors meeting the requirements set for this purpose. In any case, the term of office of the control committee coincides with the one of the board of directors.

⁶⁷ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013, p.545.

In listed companies adopting this model, the statute must provide clauses that reserve for minorities the possibility of appointing at least one member of the board of directors, who must meet the requirements of integrity and independence⁶⁸.

Further, each member of the management control committee is granted the power to request from other directors information about the course of management or to convene the board of directors and the executive committee on certain affairs, to request the collaboration of employees of the company for the performance of its functions and to solicit the convocation of the control body to the president, who can refuse it only if there are valuable reasons, which must be communicated in time to the applicant and illustrated to the body.

The committee, or a member of the same delegation, can also proceed at any time to inspection, control and exchange information with the bodies of the subsidiaries regarding the administration and control systems and the general performance of the company's activities (Article 151-ter, paragraph 4 of the TUF)⁶⁹.

The management control committee, or just two members, may also convene the board of directors or the executive committee, upon notice to the chairman of the board of directors (151-ter, paragraph 4, TUF)⁷⁰.

As for the duties of the organ, they are identified by the penultimate paragraph of the art. 2409-octiesdecies, pursuant to which the committee is called to supervise "the adequacy of the organizational structure of the company, the internal control system and the administrative and accounting system, as well as its suitability to correctly represent operating events". The committee also carries out "the additional tasks entrusted to it by the board of directors with particular regard to relations with the persons in charge of the accounting audit".

Considering the comparison with the board of statutory auditors, it should be noted, the failure to extend the general duty of control over compliance with the law and the statute by the directors and compliance with the principles of correct administration. This difference is explained considering that the members of the committee are

⁶⁸ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate, Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, p.8.

⁶⁹ TUF (Single text of the provisions on financial intermediation, also called Single text of Finance or Draghi Law) is the main source of legislation in force in the Italian Republic on Finance and Financial intermediation.

⁷⁰ CATTURI G., *L'azienda universale, L'idea forza, la morfologia e la fisiologia*, CEDAM, Padova, 2003, p.82.

administrators for all purposes, who participate as such fully in the decisions of the board of directors.

The operating rules of the management control committee are largely modelled on the discipline of the board of statutory auditors; even the committee must meet at least every ninety days and resolve by an absolute majority of those present (article 2421, paragraph 1, n 5 cc)⁷¹.

The members of the committee are also extended the duty to attend the meetings of the executive committee, as well as the meetings of the board of directors to which they belong. Unlike the statutory auditors, the non-attendance at these meetings, as well as the failure to intervene during the year at least two committee meetings, does not result in forfeiture from the office⁷².

⁷¹ *Corporate governance*, Global Legal Group, 2018, www.ICLG.com.

⁷² HUSE Morten, *Boards, Governance and Value Creation: The Human Side of Corporate Governance*, Cambridge University Press, 2007, pp.181-183.

1.5 Issues in the current corporate governance model in Italian limited company

The corporate governance system of Italian companies is characterized by irregularities which affect the work to guarantee transparency and protection of investors. The corporate governance is characterized high degree of risk of collusion between the ownership and the management, which causes damages to the minority shareholders' interests.

Troubles with Corporate Governance grow when there is a gap between those who should benefit from the company's decision and who actually benefit from them. In Italy, this causes a conflict of interests between majority and minority shareholders. Therefore, in Italy the key Corporate Governance issue has often been referred to the lack of protection of minority shareholders, who are often injured party of abuse of power by the majority shareholders.

In 1994 La Porta et al. stated that Italy, was among the industrialized countries with lowest legal protection for investors. Weak managers and unprotected minority shareholders' summarize the key corporate governance issues in Italian companies. CONSOB⁷³ and the bank of Italy stressed the need of a reform to improve the corporate governance system in Italy, which led to a series of reforms⁷⁴.

⁷³ CONSOB (Italian Companies and Exchange Commission) is the government authority of Italy responsible for regulating the Italian securities market. This includes the regulation of the Italian stock exchange, the Borsa Italiana.

⁷⁴ MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, pp.45-46.

1.5.1 Ownership and control structure in Italian listed companies

Italian listed companies are characterized by a high level of concentration of ownership structure. Despite the share percentage held by the major shareholder has decreased over time, in 2005 CONSOB reports that the average major shareholder still holds about 33% of total share capital⁷⁵.

The owners' identity reveals that families, coalitions and other companies play an important role, while financial institutions hold a very limited number of shares. The state plays an important role in some important companies, but has now lost its relevance. The overwhelming majority of the company's control structure is characterized by the dominant position of a major shareholder acting as a block.

Block-holders have significant control over management due to their high level of direct ownership and due to some expedients, such as pyramid groups, the issue of non-voting shares and shareholders' agreements.

In pyramidal groups, the holding company controls the majority of the voting rights of the companies. The structure of these groups is complex and although there are rules related to the company's disclosure, their control structure is difficult to record, especially at the international level⁷⁶.

The issue of non-voting shares is widely spread among Italian companies. With this structure, senior management has a different source for corporate financing, which is without risk for company control, because it has no voting rights.

Shareholder agreements are a fundamental device. The reform of Dragons has modified their regulation, with the aim of weakening their function of maintaining control of the company by an alliance between block-holders.

In 2016, institutional investors held a total of 75 holdings (with an average size around 6% of the company's share capital), the lowest value since 2010. This value is consistent with the decline in holdings (especially Italian) of banks and insurance companies (56 in 2010 and 12 in 2016), only partly compensated by the growing presence of foreign asset managers. In fact, in the last year the number of holdings held by asset managers

⁷⁵ MALLIN, Christine A., *Handbook on international corporate governance, country analyses*, 2006, p.46.

⁷⁶ MELIS, Andrea, *Corporate governance in Italy*, Blackwell, Volume 8, Number 4, October 2000, pp. 348-350.

(mostly foreign) decreased significantly from 55 to 44, while the holdings of other institutional investors increased from 13 to 19.

Consistent with the limited contestability of control on the Italian market, the average share held by the largest shareholder at the end of 2016 is 47%, substantially stable compared to the value of 2010 (46.2%). Instead, the average shares held by the other major shareholders and the market continue to deviate from the levels of 2010, with the former recording a decrease of five percentage points to 12.8% from 17.7%.

The largest controlling agent continues to be a family in most companies listed mainly in the industrial sector (in detail, 146 companies account for 33% of market capitalization). The state or local authorities control 21 companies, which represent 36% of the total market value, mainly active in the services sector. Finally, almost 18% of companies (26.5% of the market capitalization), mainly operating in the financial sector, are not controlled or controlled by an uncontrolled entity⁷⁷.

At the end of 2016, institutional investors became major shareholders in 61 listed companies, representing about 26% of the market. This value confirms the decline in the number of investee companies registered in the last two years. This decline derives from two partially compensating trends, with the shareholdings of Italian institutional investors continuously decreasing since 2011 and the foreign holdings stabilizing from 2015 onwards, after the constant growth recorded in previous years. At the end of 2016, the average share of capital held by major institutional investors is 7.5%, slightly lower than the previous levels⁷⁸.

⁷⁷ DORTHE, FELDBORG, CHRISTIAN VON, PEIN, LARS, CHRISTENSEN, LOUISE, ØSTERGAARD, *The Corporate Governance System in Italy*.

⁷⁸ *Report on corporate governance of Italian listed companies*, Statistics and analyses, CONSOB, 2017.

1.5.2 Minority shareholders' protection

In Italy, the functioning of the assembly is governed by the principle of the majority, where the will of the majority expresses the social will and therefore imposes itself on the dissenting minority. The majority method, although essential, (the unanimity rule would in fact risk paralyzing the functioning of society), bears the thorny problem of protecting the social interest and the protection of the minority, as it conceals the possibility that, in the shareholders' resolutions, the interests of the majority prevail to the detriment of the company or other shareholders.

This problem is not easy to solve, given that there is no provision in our company code that specifically identifies a type of abuse in the shareholders' resolutions adopted by a majority. Indeed, a normative hypothesis of repression of the abuse of the right to vote is contemplated by the art. 2373 of the Civil Code, which regulates, however, the purposes of exercising the right to vote, only the conflict of interests between the shareholder and the company, while the matter under discussion concerns the conflict of interests between the various shareholders. In such cases, therefore, the uncertainty of systems of protection of minority shareholders in the face of the fraudulent maneuvers of majority members becomes an important subject.

The case of the abuse of the majority rule occurs, therefore, when an assembly resolution is arbitrarily and fraudulently preordained by majority shareholders for the sole purpose of undermining the position of minority shareholders in the company. Fraudulent behaviour must therefore emerge both as an intentionality of the prejudice and awareness on the part of the majority shareholder to be able to exploit its own position of advantage, and as an effective infringement of the resolution. In these cases, therefore, there is no contrast between the interest of the shareholder and the interest he has in the company, but between the different interests of the members within the company; this contrast makes possible to conclude that the resolution is adopted to damage the minority⁷⁹.

In the corporate law, the lack of a normative reference referred to a prohibition of abuse of the majority rule would seem to suppose the absence of a conflict of interests among

⁷⁹ MALLIN, Christine A., Handbook on international corporate governance, country analyses, 2006.

the members. In reality the latter often pursues different and opposing interests, which give rise to real and own conflicts. The solution of these conflicts - entrusted to the application of the majority principle - can be translated into an instrument that allows the control group to pursue its particular goals or resolve in favour of conflicts inherent to social management⁸⁰.

The code regulations include a provision (Article 2373 of the Civil Code) which allows the suppression of majority abuses in a situation of conflict of interest with the company, but not a rule that deals with cases in which the majority behaves in vexatious behaviour to the damage of the minority, without prejudice to the social interest. The cases of abuse of the majority against the minority are often deduced in practice and the increase in paid capital is the situation in which the recurrence of this abuse is most often found. In fact, some of the shareholders can take advantage of the need for new investments in the company to increase their strength on the other shareholders, increasing the gap between the percentages of participation in the share capital.

The transaction also allows the value of the shares of the other shareholders to be subtracted, elevating the proportional increase in the nominal share capital by rising the value of the shareholding itself.

In such cases, the capital increase, albeit economically productive, may reduce the participation of minority shareholders - taking advantage of their temporary impossibility to subscribe to the new shares - to profits and social assets or may reduce their ability to exercise the forms of control referred to in Articles 2408 and 2409 of the Civil Code, thus preventing the minority from constituting a serious alternative to an increasingly strengthened majority⁸¹.

The cases in which the abuse of the voting right (or of the majority) is also carried out through deliberations of early dissolution of the company which can prove instrumental to the pursuit of indirect advantages to a possible abusive nature are also frequent. This may occur, for example, when the company, whose dissolution is decided, is in a position of rivalry with respect to one or more transactions pursued by the majority through another company; or when the dissolution has been fraudulently preordained by the majority for the sole purpose of being able to acquire for its own exclusive benefit,

⁸⁰ VIETTI, Michele, *La governance nelle società di capitali, a dieci anni dalla riforma*, Egea, 2013

⁸¹ MERUZZI Giovanni, *La corporate governance in Italia dopo la riforma delle società di capitali*, Università di Verona.

during liquidation, assets, customers, market opportunities, etc. of society; again, when the resolution was adopted in view of the subsequent re-establishment of another company, after the ousting of unwelcome shareholders. From the examination of case studies on the subject of abuse of the majority, there are numerous hypotheses of repeated provision of pre-reserve profits to depress the market value of the shares and thus induce the minority shareholder to sell their securities, allowing the majority to buy them at a discount price. The configurability of the majority abuse also with reference to the resolution to determine the remuneration of the directors, has been identified, then, in many judicial rulings that have identified the existence in the attribution to the administrator of an unreasonable fee.

Less frequent are the cases of appeal against the abuse of power of the resolution approving the action of responsibility towards the directors, and this for the obvious reason that the administrative body is usually the expression of the majority. The deliberation of the action of responsibility thus supposes the lack of trust between the majority and its manager. It is no coincidence that the deliberations in question were challenged for abuse of power only in the hypotheses where the manager was not at all expression of the majority.

Alongside the hypotheses highlighted so far, which occur more frequently in practice, the doctrine did not fail to point out other situations of corporate life, which lend themselves to instrumental purposes to the detriment of the minority⁸².

Consider, for example, the merger, a transaction that allows the majority to seriously affect the interests of the minority both in terms of the prerogatives of participation in management (as it changes, as a rule, the percentages of participation), both from a financial point of view (because it combines the destinies of two different risk investments).

Other cases, which lend themselves to possible abuse by the majority are represented in the transformation operations. It should however be noted that these are resolutions that increase the value of the company's assets, or in any case maintain it intact, therefore the potential damage to the company's assets is missing, but an injury occurs only for minority shareholders who, for example, are not able to subscribe to new shares in the event of a capital increase, or are penalized by the establishment of an unfair exchange

⁸² MALLIN, Christine A., Handbook on international corporate governance, country analyses, 2006.

ratio in the event of a merger, reducing participation in the company. It should also be noted that the resolutions in question affect the legal situations of the minority shareholders available, in principle, by the company. The resolution adopted by a majority that would prejudice a real subjective right of the minority shareholder would, in fact, be invalid or ineffective for this alone, without the need to resort to a specific prohibition on the abuse of the majority rule. Therefore, the problem takes place when it's checked whether the law offers the means to protect the minority in the face of fraudulent maneuvers by majority shareholders or not. In particular, the Supreme Court has pointed out that although there is a general rule in our system that represses the abuse of the law, it cannot put in doubt that there is a general principle which prohibits such practice; in several sectors, in fact, the Legislator prohibits behaviours that are the sole result of emulating intent or taking advantage of a situation of supremacy⁸³.

⁸³ Alvaro, S., D'ERAMO, D., GASPARRI, G., Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive, Quaderni giuridici, CONSOB, 2015.

1.5.3 The Italian phenomenon of regulatory overshooting of the internal corporate control system

Following the approval of the reform of Company Law - the last real intervention in the corporate law system - Italy has experienced (especially in the internal control system) a long period of non-organic regulatory interventions often considered occasional, sometimes characterized from a questionable legislative technique, other times consisting in the uncritical "transplantation" of principles and institutes derived from foreign systems. As has been remarked, it is not "revocable in doubt [...] that upstream there are legislative interventions sometimes unrelated, sometimes not activated or developed in the awareness of the existing regulatory context". These interventions have often been the legislative response to failures of large listed companies, which, although aggravated by the general market crisis, have been attributed to specific weaknesses in the internal control mechanisms⁸⁴.

The result was that, in terms of corporate control, the Italian system (which includes both primary and secondary standards and best self-regulation practices) is now characterized by multiple fragmented and disorganized rules, which have often generated inefficiencies and overlaps of the functions entrusted to various bodies responsible for internal controls, imposing excessive constraints and costs on companies. The number of key players in the internal control function within the traditional corporate governance model of listed companies has also considerably increased. In this regard, considering, first of all, the role of the board of directors, if on the one hand, the law assigns to this body the exclusivity of the management function (Article 2380-bis of the Civil Code), the same is also invested, in its plenum, with functions of control over the work of the delegates, in the case of delegating its powers to an executive committee or to one or more of its members. On the basis of the information received from the same delegated bodies, the Board assesses the adequacy of the organizational, administrative and accounting structure of the company and, on the basis of the reports prepared by the delegates, assesses the general performance of operations (Article 2381

⁸⁴ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.25-26.

of the Civil Code). The TUF does not contain specific provisions regarding the assignments and functions of the administrative body. It follows the importance, in addition to civil law, of self-regulation rules (contained in the Corporate Governance Code and in international best practices), as well as the provisions contained in the sector supervisory regulations.

The internal committees of the board also perform control functions, among which the control and risk committee, governed by art. 7 of the Corporate Governance Code, and the board of auditors, which, in the traditional model of governance, plays the central role of the control body. This body, since freed from audit tasks, has the function of overseeing compliance with the law and the statute, compliance with the principles of correct administration, and the adequacy of the organizational, administrative and accounting structure [art. 2403 of the Civil Code, art. 149, lett. b) and c), TUF], on the internal control system (and on the reliability of the latter in correctly representing the management facts and the methods of concrete implementation of the corporate governance rules provided for by the codes of conduct), on the adequacy of the instructions given by the company to the subsidiaries [art. 149, lett. c), c-bis), d)]. In the companies defined as "bodies of public interest", Legislative Decree no. 39/2010 also attributes to this body the qualification and functions of the committee for internal control and auditing⁸⁵.

Other bodies also appear among the actors, such as: the supervisory and control body pursuant to Legislative Decree no. 231/2001 (whose functions can now be entrusted to the board of statutory auditors), which has the task of supervising the organizational models for preventing crimes involving the administrative responsibility of the entity (ie the company); the manager in charge of preparing the accounting and corporate documents (Article 154-bis of the TUF, introduced by Article 14, paragraph No. 262/2005); independent directors (also organized in the committee), which have specific powers of direction and control in relation to transactions with related parties and interested parties; the subjects who perform the corporate control functions (i.e., risk management, compliance and internal audit). Many have pointed out that the Italian regulatory system for internal controls has now become a system (rectius, a "lattice")

⁸⁵ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, pp.26-27.

affected by "overshooting" and "normative elephantiasis", characterized by excessive stratification and legislative overlap regulatory.

Therefore, the above-summarized framework, with particular reference to listed companies, is fragmented, disorganized and overabundant. The complex legal and regulatory apparatus scattered in various sources and chaired by various bodies makes it difficult to frame the relationships and functions pertaining to each organ, as well as making it difficult to determine the content, frequency and type of information flows between various subjects, to the detriment of the incisiveness and effectiveness of internal control mechanisms. Since this system is characterized by a «polycentric control with a reticular structure», it is not excluded that there are «risks of operational overlapping» between the various organs. In this regard, we have seen, for example, that in addition to the delegated bodies, which are responsible for ensuring the adequacy of the assets, the manager in charge of preparing the corporate accounting documents is also involved in this function. Furthermore, it is not easy to draw a balanced dividing line between the verification activities of the board of directors and the board of statutory auditors, since both structures are called upon to examine the existence of an internal organization appropriate to the characteristics of the company, effective and efficient models and procedures⁸⁶.

In the listed companies that adhere to the Corporate Governance Code, the control and risk committee also intervenes in the framework of the control of the structures outlined by the delegated bodies and its activity appears to be able to interfere with that of the board of statutory auditors. In addition, the functions of the supervisory body may present segments of intersection with the tasks of the corporate bodies, which, in various capacities, oversee the organizational set-ups.

Therefore, it is possible to state that, in this way, the spirit of the 2003 Corporate social reform was also betrayed, making corporate governance and the internal control system rise to the rank of objectives per se, losing sight of the function of means of stimulating greater competitiveness and efficiency of companies (as well as facilitating their access to the capital market). This would be achievable bearing in mind: the clear and precise definition of the tasks and responsibilities of the corporate bodies, the simplification of the discipline of the companies ("in order to eliminate the costs and the structural and

⁸⁶ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, p.28.

operational rigidities not adapted to the modern reality of economic activity", in order, above all, to make the operations of the company competitive, also at an international level », the expansion of the areas of private and statutory autonomy), the greater possibilities for the companies and their members can choose the organizational structure most suited to their interests. Given the current physiognomy of the entire system, therefore, many companies, more than benefiting from organizational synergies and information flows between the various bodies responsible for internal control, have suffered a tightening and an overload of the functions and compliance costs. In other words, if insufficient rules on controls can create imbalances in the market, excessively severe rules risk not being suitable either to safeguard the efficiency and competitiveness of companies (as well as to promote their listing), nor to prevent opportunistic or illicit behaviour⁸⁷.

⁸⁷ Alvaro, S., D'ERAMO, D., GASPARRI, G., *Modelli di amministrazione e controllo nelle società quotate Aspetti comparatistici e linee evolutive*, Quaderni giuridici, CONSOB, 2015, p.29.

2. Corporate governance in China

2.1 Company Law and development of corporate governance in China

At the end of nineteenth century some Chinese intellectuals introduced corporate concepts into Chinese society. By adopting Western corporate systems and practices, they have promoted the adoption of a company system in China. They believed that the business system could increase the strength of a nation and the wealth of society leading to the modernization of China.

During the Qing (清朝 Qingchao)⁸⁸ period the earliest Chinese corporations and the first Chinese Company Law (公司法 Gongsi fa) of 1904 were established. Subsequently, corporate concepts such as legal personality and limited liability were adopted by the Chinese company law. However, for many external purposes (weak economic structures, political corruption and social imbalance) and internal purposes (difference between western corporate experience and Chinese culture) corporate practices had some brakes. There were numerous situations of abuse of power by directors, as well as, numerous situation of inefficacy of the shareholders' general meeting (股东会 Gudong hui).

During this period the Qing government tried to control corporate practice by establishing government-controlled companies, monopolizing some businesses.

Later the Kuomintang (中国国民党 Zhongguo guomindang)⁸⁹ government promoted State capitalism in order to reduce the monopoly of important sectors by private companies. On the contrary, the state monopolies and state-controlled companies became instrument for government officials to make personal profits.

As a result, the public sector has undermined the development of the company system in China.

In 1949 the Chinese Communist Party (中国共产党 Zhongguo gongchandang) came to power. China adopted the planned economic system, in which all private enterprises

⁸⁸ The Qing dynasty, also known as the Qing Empire, was the last imperial dynasty of China, established in 1636 and ruling China from 1644 to 1912. It was preceded by the Ming dynasty and succeeded by the Republic of China.

⁸⁹ The Kuomintang of China, often translated as the Nationalist Party of China, is a major political party in the Republic of China on Taiwan. It was founded in China in 1912, it ruled most of China, under the leadership of Chiang Kai-shek (蒋介石 jiangjieshi) from 1928 until 1949.

were transformed into state-owned enterprises. During this period the underperformance and inefficiency of state-owned enterprises came to light.

When in 1979 the Communist Party promoted the economic reform (经济改革 Jingji gaige), most of the Chinese enterprises were state-owned enterprises, better known as SOE (国有企业 Guoyou qiye)⁹⁰.

In 1979, the State promulgated some rules to reform the enterprises' management system. These new rules had the aim to change the relationship between the state and its enterprises, to give SOE managers more autonomy and freedom, and to replace direct administrative control of the state on SOEs with a functional management model. In 1984, for the first time the concept that the ownership and management of state-owned enterprises could be disjointed was proposed⁹¹.

In the period 1990-2001, China's access to Western legislative and organizational models, especially in civil and commercial matters, became complete, with the rules which began to stabilize, to be applied more regularly and frequently by an administrative apparatus and judiciary technically increasingly competent, to be studied and discussed in universities, as well as be practiced by a new professional class of professional lawyers⁹².

In December 1993 The Company Law was promulgated. The Company Law introduced the two main types of companies of Western tradition, namely the limited liability company (有限责任公司 Youxian zeren gongsi) and the company limited by shares (股份有限公司 Gufen youxian gongsi).

The Chinese Company Law provided legal support for the establishment of a modern enterprise system and laid the foundations for the Chinese corporate governance framework. A basic framework composed by the article of association, the shareholders' general meetings, the board of directors, and the supervisory board.

In the following years the law was amended three times, in 1999, in 2004 and in 2005, above all in order to limit the powers of the administrators of the society, which too often took advantage of the acquired social autonomy without their clear responsibility in the against members, creditors and the market. With the new law the ideological

⁹⁰ *Ibis.*, pp.109-112.

⁹¹ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.14.

⁹² CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca foscarina, 2016, p.76.

diversification of the forms of enterprise is no longer based on their property which still characterized the first reformist decade: from a terminological point of view, the China made of enterprises, (qiye ,企业) becomes China made of companies (gongsi,公司). These subjects now lack of an ideological connotation, endowed with a full juridical personality and a true and perfect patrimonial autonomy, operating in a free market context.⁹³.

Another major innovation brought by the law is the introduction of a system of companies' approval which goes beyond the principle that the establishment of any form of business had to be approved, on the merits, by some competent administration. The regime of the two forms of limited companies closely resembles the one of the homologous continental European institutes, in particular the German one.

Likewise constitution, underwriting and payment of capital, the rules to protect the integrity of capital itself (even if these, in truth, less stringent than those in force in most Western countries) and, to a certain extent also those on administration, entrusted to the triarchy of shareholders, board of directors and supervisory advice to the German, except in the case of limited liability companies "with few shareholders or small company ", which can opt for a single administrator and for a sole supervisor.

However, since in this case the law is the result of careful comparative work aimed at identifying the most appropriate models for "Chinese specificities", the law also contains several original regulatory formulas, sometimes influenced by Hong Kong's common law, for example in the remarkable weight attributed to the *intuits personae* in the discipline of the limited liability company, whose shareholders, among other things, cannot be more than fifty⁹⁴.

In 2001, China joined the World Trade Organisation (世界贸易组织 Shijie maoyi zuzhi) and adopted the OECD (Organization for Economic Cooperation and Development, 经济合作与发展组织 Jingji hezuo yu fazhan zuzhi) principles of corporate governance and improved corporate governance of Chinese listed companies (上市公司 Shangshi gongsi).

⁹³ WEI YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, pp.113.

⁹⁴ CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca foscarina,2016, p.77.

In January 2001, the CSRC (中国证券监督管理委员会 Zhongguo zhengquan jiandu guanli weiyuanhui)⁹⁵ issued the “Code for Corporate Governance of Listed Companies”. The Code is applicable to all Chinese listed companies. Its purpose is to protect interests and rights of investors, to set up rules of conduct and moral standards for directors, supervisors and managers. Therefore, if there are some problems with the corporate governance structure of Chinese listed companies, these codes can help the company to correct its performance. The Code contains chapters concerning the shareholders' meeting and shareholders, listed company and its controlling shareholders, directors and board of directors, supervisors and supervisory board and disclosure of information and transparency⁹⁶.

With the changes made, and in particular that of 2005, the 1993 Company Law was adapted to the ongoing socio-economic change. In particular, the autonomy of the members has increased both in the constitutive phase and in the management of the company, reducing the number and extent of the mandatory rules, the minimum capital has been lowered and the protection of minority shareholders, the transparency of social acts and communications has been increased and perfected.

In any case, although the changes occurred over the years have partially reduced it, the public footprint of part of the rules contained in the law is still sensitive. For example, there is a clear orientation to make use of administrative sanctions rather than civil law instruments to protect companies and shareholders from unlawful conduct by directors, and there is still a provision which provides that every capital company should internal "conditions for the activity of the communist party", activities that the Chinese Communist Party's statute define as "guarantee and control" of the application of the party's political line and "support" of the shareholders' meetings, the boards of directors and supervision and management.

Currently in China there are two stock exchanges (证券交易所 Zhengquan jiaoyisuo), in Shanghai and Shenzhen. However, the Chinese financial system(金融系统 Jinrong xitong) is still far from the progress achieved by the commercial sector. Despite the

⁹⁵ CRSC (China Securities Regulatory Commission), The code for corporate governance of listed companies is based on the OECD Corporate Governance Principles.

⁹⁶ *Provisional Code of Corporate Governance for Securities Companies*, CSRC, 2003.

progress made, in China still exist some issues regarding transparency and control of decision-making system⁹⁷.

⁹⁷ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011.

2.2 The Chinese corporate governance model

The 1993 Company Law introduced the two main types of companies of Western tradition, namely the limited liability company (有限责任公司 Youxian zeren gongsi) and the company limited by shares (股份有限公司 Gufen youxian gongsi).

The Chinese Company Law provided legal support for the establishment of a modern enterprise system and laid the foundations for the Chinese corporate governance framework. A basic framework composed by the article of association, the shareholders' general meetings, the board of directors, and the supervisory board⁹⁸.

The Chinese corporate governance model seems similar to the German model, and therefore similar to the Italian Two-tier model (双层委员会制 Shuangceng weiyuanhui zhi). The Corporate Governance in Chinese limited company includes the shareholders' general meeting, which is the power and decision-making organ of the company and has decision making power on major issues, and also the administrative boards composed by the board of directors and the supervisory board.

In Germany, the company is managed by a board of directors and a supervisory board. The board of directors takes care of the day-to-day activities of the company, while the supervisory board takes care of appointment, control and advice of directors.

In the Chinese corporate governance model, management is entrusted to the board of directors while control is entrusted to the supervisory board. Similar to the German co-management model, the Chinese supervisory board includes employees representatives. However, in the Chinese model there is no hierarchical relationship between the board of directors and the supervisory board. The German supervisory board has the authority to appoint and dismiss members of the board of directors, but in China the two boards are on the same level and the members of both are appointed by the shareholders. This type of structure creates a problem because the supervisory board does not have the power to control the work of the board of directors⁹⁹.

There are six characteristics that make the Chinese Corporate Governance model different from the others: the undue influence of the Chinese Communist Party in the

⁹⁸ WEI YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, pp.106.

⁹⁹ *Ibis.*, p.113.

company' decisions, the concentration of state ownership, the dysfunction of the board of supervisors, insider trading issues, problems related to the company's information disclosure and the lack of protection of minority shareholders¹⁰⁰.

¹⁰⁰ Larry LI, Tony NAUGHTON, Martin HOVEY, *A review of corporate governance in China*, p.5.

2.3 Corporate governance framework in Chinese limited company

The Chinese corporate governance model seems similar to the German model, and therefore similar to the Italian Two-tier model (双层委员会制 Shuangceng weiyuanhui zhi). The Corporate Governance in Chinese limited company includes the shareholders' general meeting, which is the power and decision-making organ of the company and has decision making power on major issues, and also the administrative boards composed by the board of directors and the supervisory board.

The board of directors is responsible for the shareholders' general meeting and has decision-making power under the authority of the shareholders' general meeting.

Furthermore, the board of directors may, according to the resolution of the shareholders' general meeting, establish special committees, such as the strategic committee, the audit committee, the nomination committee, the remuneration committee, etc.

The supervisory board monitors whether directors and managers violate the laws or the company bylaws. All three are engaged in the functioning of the company and are directly responsible for its governance¹⁰¹.

However, in the Chinese model there is no hierarchical relationship between the board of directors and the supervisory board. This type of structure creates a problem because the supervisory board does not have the power to control the work of the board of directors.

¹⁰¹ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.29.

2.3.1 Shareholders' general meeting

In both limited liability companies and companies limited by shares, the shareholders' meeting (股东会 Gudong hui) is the highest corporate decision-making body, while the board of directors is the executive organization of shareholders' meetings.

In article 98 of Chinese company law, the shareholders' general meeting is considered the supreme power of corporate governance. In fact it states that the shareholders' general meeting shall be the organ of the authority of the company and shall exercise its functions and powers in accordance with the law. All the powers of the board of directors and of the supervisory board derive from the power of the shareholders' general meeting¹⁰².

Comparing the meeting of shareholders to the National People's Congress, this corporate governance system reminds the political governance system of the Chinese Constitution, where the National People Congress (NPC, 全国人民代表大会 Quanguo renmin daibiao dahui) is the supreme State power and all other state organs are below its power.

In accordance with the Company Law, a limited liability company must have no more than 50 shareholders, while a company limited by shares must not exceed 200 shareholders.

The article 37 of Company Law states that the shareholders' general meeting shall exercise the following tasks:

1. to determine company policy and investment plan,
2. to elect and replace directors and supervisors, and to decide on matters concerning their remuneration,
3. to accept reports of the board of directors,
4. to accept reports of the supervisory board,
5. to accept the annual financial plan of the company,
6. to accept plans for profit/losses distribution,
7. to accept resolutions to increase/reduce the registered capital;

¹⁰² Article 36 of the Chinese Company Law, Section 2, Organizational structure. Article 98 of the Chinese Company Law, section 2, General meeting.

8. to accept resolutions to issue company bonds;
9. to accept resolutions on event such as company merger, separation, change, dissolution and liquidation,
10. to modify the articles of association;
11. to exercise other powers provided by the statute¹⁰³.

As a central power in corporate governance, the shareholders' general meeting should effectively reflect the interests of shareholders. In this way, shareholders feel assured as the majority rule ensures that their ideas and thoughts will then be transformed into business decisions.

One of the main goals of corporate governance is the protection of minority shareholders. Therefore, the article 22 of Company Law states that any resolution adopted by the shareholders' meeting or by the board of directors, violating laws and the statute, must be null and void. Moreover, if the convocation or the method of voting of the shareholders' general meeting and the board of directors go against the laws and the statute, shareholders can bring a suit to the court¹⁰⁴.

Pursuant to Article 100 of the Chinese Companies Law, the shareholders' general meeting is bound to meet once a year, except in the following circumstances in which an extraordinary meeting must be convened within two months:

- when the number of directors is less than two thirds,
- when the non-offset losses of the company exceed one third of the effective capital,
- at the request of shareholders holding 10% or more of the company's shares,
- when this is deemed necessary by the board of directors or the supervisory board,
- in other circumstances, specified by the articles of association¹⁰⁵.

A shareholders' general meeting is convened by the board of directors and presided by the chairman of this board. If the president is unable or unwilling to perform his duties, the meeting is chaired by the vice-chairman of the board. If the vice-chairman of the

¹⁰³ Article 37 of Chinese Company Law, section 2, Organizational structure.

¹⁰⁴ Article 22 of Chinese Company Law, chapter 1, General provisions.

¹⁰⁵ Article 100 of Chinese Company Law, section 2, General meeting.

board of directors is unable or unwilling to perform his duties, the meeting is chaired by a director appointed jointly by more than half of the directors.

Moreover, if the board of directors is unable or unwilling to convene the general meeting, the meeting is convened and chaired by the board of supervisors in a timely manner¹⁰⁶.

Article 102 of the Company Law states that in the case of convening a general meeting, all shareholders must be informed 20 days before the meeting, regarding the time, venue and topics. In the case of an extraordinary general meeting, shareholders will be informed 15 days before the meeting. In addition, the article specifies that shareholders holding 3% or more of the company's shares may submit a written proposal to the board of directors at least 10 days prior to the general meeting. The board of directors informs the other shareholders within two days of receiving the resolution and submits the extraordinary resolution to the general meeting. The content of the extraordinary resolution must be adapted to the functions of the general assembly and must be clear and with specific arguments. However, it is difficult for small and medium-sized investors to make their voices heard in the assembly. In addition, in recent years, participation in the general shareholders' meetings in China has been very low and dominated by controlling shareholders. Most shareholders have chosen not to attend general meetings because their votes have very limited influence on company choices¹⁰⁷.

Regarding the voting method of the shareholders' general meeting, the article 103 of the Company Law states that the general decision rule of the meeting is one share, one vote (一股一票 Yigu yipiao). To be adopted, a resolution must win at least half of the voting rights at the meeting. For important matters, such as changes to the company's statute, mergers and acquisitions, a two-thirds majority of the voting rights are required¹⁰⁸.

The principle of one vote one share is firmly established by the Chinese Company Law. Unlike some legal systems that allow companies to issue non-voting shares (UK, France, Japan) or allow them to issue non-voting preference shares (Germany, Italy), Chinese company law does not mention none of the two. However, article 134 of the Chinese

¹⁰⁶ Article 101 of Chinese Company Law, section 2, General meeting.

¹⁰⁷ YONG, KANG, LU, SHI, ELISABETH, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, p.12.

¹⁰⁸ *Ibis.*, pp.12-13.

Company Law establishes that the State Council may adopt separate regulations (not provided by the statute) to issue other types of shares.

A major revision in the 2013 Company Law is the article 105. In the case of election of directors and supervisors of a general meeting, it permits a company to implement a cumulative voting system. According to the cumulative voting system (累积投票制度 Leiji toupiao zhidu), the number of voting rights attributed to each share is the same as the number of directors or supervisors to be elected, and the voting rights held by a shareholder may be exercised collectively¹⁰⁹. This new rule is very important in China, where shareholders can often control a large number of shares. In fact, the cumulative voting system offers greater strength to small investors in the selection of the board¹¹⁰.

Regarding information disclosures, the Chinese Company Law states that shareholders of a company have the right to inspect and obtain a copy of the company statute, the report of the shareholders' meetings, the meetings of the board of directors and the meetings of the supervisory board, the financial information concerning the company and the company's accounting books. In order to inspect the accounting books, a shareholder must present a written request to the company indicating the purpose of such inspection. If the company believes that the shareholder's purpose of inspecting the books is unsuitable, and may affect the rights and interests of the company, the company may refuse to allow the inspection and must, within 15 days, provide a written response to the shareholder stating the reasons for the refusal to grant the inspection. If the company refuses to authorize inspection, the shareholder can ask the people's court to constrain the company to permit inspection.

In China one of the main problems of corporate governance is precisely linked to the disclosure of company information, because there are many risks of hidden liabilities that are difficult to identify without due legal, financial and tax diligence.

Another major revision of the Chinese Company Law is the proxy voting (代表投票 Daibiao toupiao). The Article 106 of the Company Law states that shareholders may now entrust delegates with attendance at the general meeting and exercise their voting rights by authorization. The proxy voting is very important as it can help minority

¹⁰⁹ Article 105 of Chinese Company Law, Section 2, General Meeting.

¹¹⁰ Yong Kang, Lu Shi, Elizabeth D. Brown, *Chinese Corporate Governance: History and Institutional Framework*, p.12.

investors to act collectively and make their voices heard. However, the law does not specify how to apply and monitor proxy voting.

2.3.1.1 Shareholders' rights

In Chinese company law the rights of shareholders (股东权 Gudong quan) can be divided into "self-benefit rights" and "co-benefit rights". The first one refers to the right of shareholders to acquire economic benefits, such as the right to ask for the distribution of dividend or unused assets, the right to transfer shares and the right to ask for shared purchases. While the second one refers to the right of shareholders to participate in the corporate governance, such as the right to vote, the right to ask for shareholders' general meetings, the right to annul or accept repeal of provisions of the shareholders' meeting, the right to annul or accept repeal of provisions of the board of directors and inspection and cumulative voting rights¹¹¹.

There are two kinds of conflict of interest in Corporate Governance, one between majority and minority shareholders and the other between managers and shareholders. When ownership is divided between many shareholders, the conflict of interest between management and shareholders prevails, while when ownership is split between a few shareholders, the conflict of interests between majority and minority shareholders prevails.

Although after the non-negotiable capital market reform of 2005, the level of concentration of ownership has declined, Chinese listed companies still show high concentrated ownership structures. For this reason, one of the major problems of corporate governance in China is the conflict of interest between majority and minority shareholders. In recent years this topic has become central in China in order to guarantee fair treatment of shareholders¹¹².

In the Chinese legislature there are three aspects concerning the fair treatment of shareholders.

Firstly, there is equal voting power, inspection and investigation rights, cumulative voting rights and the right to submit proposals.

Secondly, there are mechanisms to prohibit or regulate the operations of majority shareholders, such as the withdrawal of voting rights from shareholders as warranty for

¹¹¹ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.29.

¹¹² WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.113.

the parties, the prohibition of loans to related parties and the obligation to compensate the damaged party.

Thirdly, there are mechanisms to guarantee compensation when the rights of minority shareholders are violated, such as the right to request cancellation or revocation of resolutions of the shareholders' general meeting and the boards of director.

They can also request compensation for damage caused by controlling shareholders, compensation for damages caused by directors or managers of the company¹¹³.

¹¹³ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.41.

2.3.2 Administrative body

Chinese Corporate governance of limited companies have a two-tier board, composed by the boards of directors (董事会 Dongshihui) and the supervisory board (监事会 Jianli shihui). The board of directors is the administrative body of the company.

The two-tier board structure in China seems to resemble the German structure, where the board of directors makes decisions about day-to-day operations and the supervisory board controls the board of directors and approves the main business choices.

Daily business management is carried out by the company manager. The board of directors and the manager represent the management of the company. This characteristic distinguishes the board of directors of a Chinese company from that of a German company, since in the German one the board of directors is the sole managerial body of the company. In addition, the shareholders' general meeting is considered the supreme power of corporate governance. All the powers of the board of directors and of the supervisory board derive from the power of the shareholders' general meeting, therefore the board of directors have a very limited role.

Regarding provisions concerning director's qualifications, Chinese company law states that cannot be directors : a person who has no civil capacity, who has been imprisoned and who has suffered and has been held responsible for bankruptcy. However, there is not a limit of age regarding directors¹¹⁴.

Limited liability companies must have a board of directors consisting of a minimum of 3 and a maximum of 13 members, but a company with few shareholders can have one executive directors as alternative to the board.

Companies limited by shares must have a board of directors consisting of a minimum of 5 and a maximum of 19 members.

The election of directors must be organized in a free, clear, open and fair manner.

Information about potential candidates for the role of director must be communicated before the shareholders' general meeting. The elected directors should fulfill their duties according to the interests of the company and the shareholders. The board of directors is

¹¹⁴ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.117.

responsible to the shareholders, it must treat all shareholders in the same way and ensure that the listed company acts according to the law.

The article 109 of Chinese Company Law states that the board of directors must have a chairman and may have a vice-chairman, which both of them must be elected by more than half of all directors. The chairman of the board of directors convenes and chairs the meetings of the board of directors and monitors the implementation of the resolutions of the board of directors¹¹⁵. A meeting can only be held when more than half of all directors are present, and a resolution of the board of directors must be approved by more than half of all directors, where each member must have one vote. With regard to limited liability companies, the voting rules and procedures of the board of directors are established in the statute. Instead, as regards companies limited by share, the board of directors shall convene at least two meetings a year. All directors must be informed 10 days before the meeting. An extraordinary meeting also may be proposed by shareholders at least representing 10% of the voting rights or at least one third of directors¹¹⁶.

Some of the powers that previously belonged to the chairman of the board of directors were deleted in 2005 by the legislator with the aim of preventing the abuse of power. As a result, the chairman of the board of directors has the following tasks:

1. to preside the meeting of the board,
2. to suggest the resolution project to the board,
3. to oversees the application of the resolution by the board,
4. to act as legal representative on behalf of the company pursuant to the articles of the constitution¹¹⁷.

Chinese Company Law states that if a director violates the law or company bylaws and goes against the interests of shareholders, shareholders can appeal to the court and ask for compensation¹¹⁸. However, the role of boards of directors is questionable, as they

¹¹⁵ Article 109 of Chinese Company Law, Section 3: Board of Directors and Manager.

¹¹⁶ Article 110 of Chinese Company Law, Section 3: Board of Directors and Manager.

¹¹⁷ JUNHAI, LIU, *Chinese corporate law and corporate governance*, European Business Law Review, 2014, p.116.

¹¹⁸ Article 152 of Chinese Company Law, Chapter VI: Qualifications and Obligations of Directors, Supervisors and Senior Officers of Companies.

are often dominated by representatives of parent companies and party secretaries. In addition, board members with professional skills are rare¹¹⁹.

The article 46 of Chinese Company Law states that the board has the following tasks:

1. to convene shareholders' meetings and present reports on the matter,
2. to put into action resolutions adopted by the shareholder's general meeting,
3. to determine business and investment plans,
4. to prepare annual financial statements,
5. to prepare profit/losses plans,
6. to prepare plans to increase/reduce registered capital, or to prepare plan for the issuance of company,
7. to draft plans to merger, to divide, to change, to dissolve the company,
8. to determine company management structure,
9. to appoint or remove the manager, to decide to remove or appoint the deputy manager and person with the task of dealing with the company's financial affairs according to the manager's recommendations and their remuneration,
10. to formulate the basic management structure,
11. to exercise other tasks defined by the statute¹²⁰.

In 2001 the CSRC requested for each listed company that the independent directors constituted at least one third of the board of directors. This is a solution to mitigate insider-trading issues. The independent directors of a listed company should have at least basic knowledge of its tasks and the relevant laws and regulations. They should also be truthful and believable¹²¹.

Although the proportion of independent directors has significantly increased in recent years, this solution has been difficult to implement in China because there are not enough people qualified to cover the role of independent directors. Moreover, despite their legal power, independent directors have been rather weak in their ability to

¹¹⁹ Larry, LI, Tony, NAUGHTON, Martin, HOVEY, *A review of corporate governance in China*, p.21.C.

¹²⁰ Article 46 of Chinese Company Law, section 2: Organizational structure.

¹²¹ C. CLARKE, Donald, *The independent director in Chinese corporate governance*, 2006, Delaware journal of corporate law [Vol. 31] p.136.

influence or control corporate management, as well as, it is uncertain how well they represent the interest of minority shareholders¹²².

¹²² YONG, KANG, LU, SHI, ELISABETH, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, p.14.

2.3.3 Supervisory body

Limited liability companies and companies limited by shares must have a supervisory (监事会 jianli weiyuanhui) board composed of no fewer than three supervisors.

However, small limited liability companies or limited liability companies with few shareholders can have one or two supervisors instead of a supervisory board¹²³.

Although it has been substantially changed, China has taken the concept of supervisory board from Germany. In fact, unlike the German board of directors, the Chinese board does not have the power to appoint and dismiss administrators, but is simply a body responsible for supervising the board of directors and corporate operations.

Article 53 of Chinese Corporate Law states that the board of supervisors shall exercise the following tasks:

1. to analyse corporate financial affairs,
2. to supervise the acts of senior officers and directors according to their duty, and to remove directors and senior officers that violate laws and company's statute,
3. to request to director or senior manager to make rectifications if his act was against the company's interests,
4. to propose the convening of extraordinary shareholders' meeting, and convening and presiding over shareholders' meeting when the board of directors does not perform its duty to preside and convene it,
5. to present proposals at shareholders' meeting,
6. to initiate proceedings against directors or senior managers,
7. other tasks defined by the statute¹²⁴.

Due to the lack of these powers, Chinese board of the supervisors encounter many difficulties to supervise the board of directors and the management¹²⁵. In addition, they often lack of knowledge and experience to supervise them¹²⁶.

¹²³ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.115.

¹²⁴ Article 53 of Chinese Company Law, Section 2: Organizational Structure.

¹²⁵ JUNHAI, LIU, *Chinese corporate law and corporate governance*, European Business Law Review, 2014, pp.116-117.

The board of supervisors must have a chairman and a vice-chairman who are elected by more than half of all supervisors. The task of the chairman of the supervisory board is to convene and chair supervisory board meetings¹²⁷.

The Board of Supervisors should convene a meeting every six months, and may convene an extraordinary meeting. The deliberation method and voting procedures of the supervisory board are specified in the company statute and resolutions must be adopted by more than half of the supervisors¹²⁸.

Regarding the supervisory board of listed companies, it must monitor company finance, monitor the performance of directors and protect the interests of the company and shareholders. Supervisors should be able to fulfil their duties independently and efficiently and they may require to directors or to managerial staff to attend the supervisory board meeting and to answer questions on which the board is concerned¹²⁹.

¹²⁶ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.116.

¹²⁷ Article 117 of Chinese Company Law, Section 4: Board of Supervisors.

¹²⁸ Article 119 of Chinese Company Law, Section 4: Board of Supervisors.

¹²⁹ Larry, LI, Tony, NAUGHTON, Martin, HOVEY, *A review of corporate governance in China*, pp.21-22.

2.4 Issues in the current corporate governance model in Chinese limited company

Chinese corporate governance shows many malfunctions. These are caused by the structure of the Chinese legislative system which has weak supervisory board and protection of minority shareholders, but also by the poor enforcement of the law which causes insider trading and issues related to the disclosure of company information.

However, the main reason that links all these problems is the influence of the Chinese Communist Party. The undue influence of the Chinese Communist Party on the company's decisions causes lack of independence and autonomy of the company itself. The second issue of Chinese companies which causes some problems in the corporate practice is the concentration of state ownership.

The third major problem and the most important in corporate governance is the efficiency of the supervisory board and the related solution of independent director.

The fourth problem is insider trading. Although the Chinese government has policies against these practices, the main reason of this problem is the absence of effective control of companies from their directors and supervisory boards¹³⁰.

The fifth issue is the company's information disclosure because in China there are many risks deriving from potential liabilities hidden in the company, therefore a deep legal, financial and tax due diligence is necessary.

The sixth problem is the lack of protection of minority shareholders, because they are often victims of abuse of power by controlling shareholders.

¹³⁰ Larry, LI, Tony, NAUGHTON, Martin, HOVEY, *A review of corporate governance in China*, pp.24-25.

2.4.1 The “undue” influence of the Chinese Communist Party

Despite the disappearance, in the 1982 Constitution, of the assertion of the absolute primacy of the Communist Party over the organs and activities of the State, it does not prevent this dominance from continuing to exist (it is clearly stated in the «preamble»), allowing to the CCP the capability of overlapping and even confusing itself with the law of the state. A clause (art.19) is still present today in the Company Law, provided that each limited company must follow "conditions for the activity of the communist party", activities that the Chinese Communist Party's statute defines as "guarantee and control" of the application of the party's political line and "support" of the shareholders' meetings, the boards of directors and supervision and management of the company. In fact, often the management of the company does not have whole decision-making autonomy regarding the company's choices¹³¹.

The dominance of the CCP in the company's choices comes from historical reasons. In fact, when the Communist Party decided in 1978 to introduce economic reforms (经济改革 Jingji gaige), most of the Chinese enterprises were state-owned enterprises. The government and therefore the Chinese Communist Party, as the main shareholder, were able to manage and control the company's decisions. Although the State promulgated some rules to reform the enterprises' management system in 1979, with the aim to change the relationship between the state and its enterprises, giving SOE managers more autonomy and freedom, and replacing direct administrative control of the state on SOEs with a functional management model, the undue influence of the CCP in the company's decisions still exists¹³².

Many companies are still owned by strong local and provincial governments that have many connections within the party. For this reason regulators are afraid to pursue local and provincial governments for possible repercussions and sometimes they do not have the power to go deeper¹³³.

¹³¹ CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca foscarina, 2016.

¹³² WEI YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, pp.109-112.

¹³³ Yong, KANG, Lu, SHI, ELISABETH, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, pp.27-30.

Politicians and state-controlling owners sit on most boards and committees because of the still highly concentrated state-ownership structure. As a result, these boards and committees lack independence. Eighty percent of directors on Chinese boards are closely connected to the government, and only few are professionals (lawyer, accountants or finance experts).

According to the Company Law, the shareholders' meeting has the right to appoint and dismiss directors. However, since the law does not specify the nomination process, it is easy for the main shareholders (who as we said before is often the Chinese government) to appoint all the directors of a company. Therefore, given the influence of the government on the boards of directors, the supervisory board does not play a relevant and functional role. In addition, the members of the supervisory board have little say in the main business decisions because their supervisory role on the board of directors is defined in a general way in Chinese Company Law. No law allows the supervisory board to have the right to set up legal dispute against directors or senior managers, when they identify corporate misconduct¹³⁴.

Today the Chinese Communist Party seeks to influence corporate decisions, not only in state-owned enterprises, but also in private companies and joint ventures with foreign partners. Under President Xi Jinping (习近平), the party has become more assertive and Beijing is opting for greater control by the party and the state on the economy. Foreign investors must be aware that their Chinese partners often respond to the Chinese Communist Party, making relations more difficult than usual and adding opacity to daily operations. It could also increase the risk that people are promoted based on party activities rather than their ability. Furthermore, company decisions that were previously handled by managers within the company are now being routed to the party, causing delays at the operational level¹³⁵.

¹³⁴ JUNHAI, LIU, Chinese corporate law and corporate governance, European Business Law Review, 2014, p. 117.

¹³⁵ Archie ZHANG, *Communist party asserts control over China Inc*, Financial Times, 3 Ottobre 2017.

2.4.2 Concentration of state-ownership in Chinese listed companies

When the Communist Party decided in 1978 to introduce economic reforms, most of the Chinese enterprises were state-owned enterprises. In 1979, despite the State promulgated some rules to reform the enterprises' management system, with the aim of changing the relationship between the state and its enterprises and privatizing Chinese companies, most of the Chinese enterprises are still state-owned enterprises. The same state which influences the company decisions and creates lack of independence of the company's management.

An annual report from the Shanghai Stock Exchange in 2007 showed that 65% of listed companies were state-owned. More than two-thirds of China's Gross Domestic Product come from state-owned enterprises with non-tradable shares.

Foreign investment bankers continue to believe that the primary function of the Chinese stock market is to direct money to state-owned companies. This practice has discouraged minority investors from engaging in long-term investment. In fact, the main negative consequence from state-ownership concentration is that the main state shareholder tends to divert resources from the company itself¹³⁶. This create a damage to minority shareholders.

In recent years, the protection of minority shareholders has become increasingly important within corporate governance. However, the interests of minority shareholders have not been adequately protected because minority shareholders do not have the right to disagree with the majority shareholder.

State-dominant ownership concentration also creates the weakness of institutional investors. In 1998, mutual funds entered in the Chinese equity market, but they recorded slow growth compared to the listed companies which have instead increased enormously.

For example, pension funds could not invest in the stock market because they did not have the authorization by the Chinese government and private equity were not

¹³⁶ Yong, KANG, Lu, SHI, ELISABETH, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, p.27.

recognized as legal entity. As a result, when mutual funds entered in the Chinese stock market, only a few of them could join companies' boards of directors¹³⁷.

These following examples show that, in the Chinese legal context, the involvement of institutional investors also does not guarantee the protection of minority shareholders' interests.

In 2007, PetroChina (中国石油天然气股份有限公司 Zhongguo shiyou tianranqi gufen youxian gongsi)¹³⁸ surprised the world with his IPO¹³⁹ in the Shanghai stock exchange reaching the first market capitalization in the world. However, this created losses among minority shareholders in PetroChina's subsidiaries.

In 2005 PetroChina launched an offer to repurchase all the tradable shares of its subsidiaries listed in Shanghai, with bid prices slightly higher than the market prices of 2005. As this announcement was made after a reform required all listed companies to distribute their non-negotiable shares, the repurchase offer made by PetroChina Group was considered as an action with the aim of robbing minority shareholders of their due demand for investment returns. Since minority shareholders held less than 20% of the equity of these subsidiaries, they could not prevent PetroChina of removing its subsidiaries from the Shanghai Stock Exchange.

In 2005, there were 200 million of negotiable shares of Liaohe Oilfield¹⁴⁰, one of PetroChina's listed subsidiaries. Since these shares accounted for only 18.18% of Liaohe Oilfield's total market capitalization, PetroChina needed to obtain 35 million tradable shares to complete the repurchase and removal operation. However, three weeks after the announcement, the group obtained consent from less than 10% of the 35 million shares needed. Fortunately, more than 30 million shares subsequently accepted the repurchase offer, meeting the conditions for repurchase.

¹³⁷ SHI DANG JING 石景光, WANG YINGJIE 王瑛杰, “

Gudong biaojuquan xianzhi ji gongsifa dui zhongxiao gudong quanyi de baohu, 股东表决权限制及公司法对中小股东权益的保护, (Shareholders' voting rights and company law on protection of minority shareholders' rights and interests), Beijinghuagongdaxue, 2008, p.1.

¹³⁸ PetroChina Company Limited is a Chinese oil and gas company and is the listed arm of state-owned China National Petroleum Corporation (CNPC), headquartered in Dongcheng District, Beijing.

¹³⁹ Initial public offering (IPO) or stock market launch is a type of public offering in which shares of a company are sold to institutional investors and usually also retail (individual) investors.

¹⁴⁰ The Liaohe oil field is an oil field located in Liaoning Province (Bohai Basin) in China. It was discovered in 1958 and developed by China National Petroleum Corporation. It began production in 1970 and produces oil.

A speculation of the equity repurchase model was that PetroChina reached some agreements with institutional investors to get the buyback, but the company refused to comment. Two years after PetroChina reacquired Liaohe Oilfield shares with a P/E¹⁴¹ of 15.7, it opened its IPO with a P/E of 65. Given the increase from 2005 to 2007, it is reasonable to assume that PetroChina's action was predatory towards minority shareholders of the branches. All this demonstrates the dominance of state ownership in China.

The second example of Baosteel's¹⁴² shows the weakness of institutional investors in China.

In 2004 Baosteel Group announced a plan to transform the entire group into a listed company. Its subsidiary Baosteel Co. Ltd. was an important state-owned company listed in the Shanghai stock exchange. However, its announcement did not specify the exact ratio of tradable shares and non-tradable shares. In addition, Baosteel Co. Ltd. did not specify its plan for a secondary share offer for current shareholders.

This situation caused the anger of the minority shareholders of Baosteel Co. Ltd., and for this reason two important Chinese financial media submitted a petition to the authority against the Baosteel plan.

On one hand, institutional investors in Baosteel would have preferred more favorable conditions from Baosteel Co. Ltd.; on the other hand, Chinese financial analysts had expected that the September general meeting of shareholders would have provided a veto to minority shareholders. However, unlike one would have expected, no institutional investor voted against the plan during the September meeting.

As a result, the plan was approved and minority shareholders suffered a relevant damage. After a period of time, the press revealed that Baosteel had promised commissions to fund managers in order to avoid an unanimous veto from institutional investors¹⁴³.

¹⁴¹ P/E is equal to price/earnings ratio. It is the ratio of a company's stock price to the company's earnings per share. The ratio is used in valuing companies.

¹⁴² Baosteel (China Baowu Steel Group Corp., Ltd., commonly referred to as Baowu Steel) is a state-owned iron and steel company headquartered in the Baosteel Tower in Pudong, Shanghai, China. Baosteel is the fifth-largest steel producer in the world measured by crude steel output, with an annual output of around 35 million tons.

¹⁴³ Yong, KANG, Lu, SHI, Elisabeth, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, pp.28-29.

2.4.3 The most serious problem of weak supervisory board

A direct result of ownership concentration is the lack of independence among board directors. According to the Company Law, the shareholders' meeting has the right to appoint and dismiss directors. However, since the law does not specify the nomination process, it is easy for the main shareholders (who is often the Chinese government) to appoint all the directors of a company¹⁴⁴.

In a 1999 survey of listed companies, it appeared that only 3.1% of all directors had independence from the government, while the majority of directors remained under the influence of the Chinese government. If the directors do not have their independence, the request of fiduciary duties and the duty of care will be unsuccessful. Therefore, to ensure that directors can effectively perform their tasks, a change in the structure of the boards of directors of Chinese companies is necessary¹⁴⁵.

Therefore, given the influence of the government on the boards of directors, the supervisory board does not play a relevant and functional role. In addition, the members of the supervisory board have little say in the main business decisions because their supervisory role on the board of directors is defined in a general way in Chinese Company Law. No law allows the supervisory board to have the right to set up legal dispute against directors or senior managers, when they identify corporate misconduct¹⁴⁶.

Furthermore, supervisors are usually chosen by company employees who are often former communist cadres in the state-owned enterprise. So their financial interests are determined directly by the same people who should supervise them. Statistics show that usually the members of the supervisory board are less educated than members of the board of directors and most supervisors do not have sufficient experience in accounting and management to control the board of directors.

¹⁴⁴ JUNHAI, LIU, *Chinese corporate law and corporate governance*, European Business Law Review, 2014, p. 117.

¹⁴⁵ Yong, KANG, Lu, SHI, Elisabeth, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, pp.29-30.

¹⁴⁶ JUNHAI, LIU, *Chinese corporate law and corporate governance*, European Business Law Review, 2014, p. 118.

In China, unlike common law jurisdictions and civil law jurisdictions, it is mandatory to establish both the supervisory board and the independent directors (独立 董事 Duli dongshi) in all listed companies. In fact, in the common law jurisdictions, there is the presence of independent directors, but there is no supervisory board, while in the civil law jurisdictions, there is the presence of the supervisory board, but not the independent director.

In 2001 the CSRC requested for each listed company that the independent directors constituted at least one third of the board of directors. This is a solution to the powerlessness of the supervisory boards; in fact the apparently impartial role of the independent directors could serve as a complement to the supervisory board. Although the supervisory board and the independent directors play a very similar supervisory role, they have different tasks. The supervisory board allows employees to participate in corporate governance, as employee representatives must have at least one-third of the seats in the supervisory board; independent directors instead should protect public investors¹⁴⁷.

Anyway, this solution has been difficult to implement in China because there are not enough people qualified to cover the role of independent director. Moreover, despite their legal power, independent directors have been rather weak in their ability to influence or control corporate management¹⁴⁸.

¹⁴⁷ JUNHAI, LIU, *Chinese corporate law and corporate governance*, European Business Law Review, 2014, p. 117.

¹⁴⁸ Yong, KANG, Lu, SHI, Elisabeth, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, p.30.

2.4.4 Insider trading in Chinese listed companies

Article 67 of the Chinese Securities Law prohibits people with knowledge of privileged information about the company from using such information to trade securities. Those who are considered as people in possession of such information are directors, supervisors, directors, deputy directors, shareholders who hold no less than 5% of the shares and all those who have substantial information about the company¹⁴⁹.

However, the Securities Law does not mention anything about the responsibility for those involved in insider trading. Because of this, insider trading has become a major issue for companies listed in China. Furthermore, the punishment of insider trading cases in China tends to be irrelevant compared to the profit obtained from such deals. An example is a case in which a Chinese investment banker had to pay a fine of only 50,000 yuan after the CSRC had discovered its million-dollar deal.

There are two main factors that could create insider trading issues in China. These are the lack of the concept of fiduciary duty in Chinese culture and therefore the lack of understanding of it, and the failure to apply the law.

Although, from a regulatory point of view, the article 62 on companies limited by shares and limited liability companies states that members of the board of directors have a fiduciary duty (诚信义务 Chengxin yiwu), the notion of liability, having been imported from the common law, did not fit well with the Chinese civil law tradition. Therefore many Chinese shareholders and managers are not fully aware of the meaning and limitations of this term, and consequently they are not fully aware of the need to avoid conflicts of interest in the business context. Likewise, it is difficult for judges to say whether a person has respected or disobeyed fiduciary duty.

Regarding the failure to enforce the law, the Chinese courts generally lack the knowledge and experience to deal with daily business cases (due to the young age of the Chinese stock market), so they have even more shortcomings and problems in the most complicated cases, such as those involving insider trading.

¹⁴⁹ Yong, KANG, Lu, SHI, Elisabeth, D.BROWN, *Chinese Corporate Governance, History and Institutional Framework*, RAND corporation- center of corporate ethics and governance 2008, pp.30-31.

One reason why insider trading remains a problem is the absence of class action in the country. Unlike the United States, where the application of insider trading regulations considerably compensates shareholders damaged due to inadequate law enforcement, class actions in China are still strongly discouraged. Although in the recent years class actions have been applied in various types of civil litigation, bringing to light cases brought by lawyers against Chinese listed companies and accounting giants, they have not been able to find an application on investor protection. Moreover, unlike the United States, China has not created any incentive mechanism to encourage insider reporting, which could offset some of the risk implicated¹⁵⁰.

¹⁵⁰ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.202.

2.4.5 Company's information disclosure of listed companies

In China, listed companies are obliged to disclose company information. The disclosure of company information directly affects the transparency and efficiency of prices on the market.

During capital market development and corporate governance reform, all relevant Chinese legislative bodies and government agencies have emphasized the importance of the disclosure of company information and have seriously supported the improvement in quality and clearness.

Listed companies must assume responsibility for the truthfulness, accuracy and completeness of disclosed information. Article 63 of the Securities Law states that the information disclosed by listed companies must be authentic, accurate and complete and may not contain false statements, ambiguous statements, omissions. Listed companies take care of following principles in the disclosure of company information:

1. Principle of authenticity. The information must be fair, harmonious and standardized and cannot contain false statements.
2. Principle of accuracy. The information must be accurate and cannot use ambiguous statements that create disorientation.
3. Principle of completeness. Listed companies must publish their relevant information which cannot contain omissions.
4. Principle of timeliness. Listed companies must disclose relevant information in time.
5. Principle of fairness. Listed companies must not disclose information only to some investors and not to others¹⁵¹.

Although the OECD clearly defines the rules, in China one of the main problems of corporate governance is linked to the disclosure of company information. There are many risks of hidden liabilities difficult to identify without due legal, financial and tax diligence.

¹⁵¹ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.40.

When a foreign investor establishes a Joint Venture with a Chinese partner, as well as when he acquires shares in a Chinese company, he should not underestimate the importance of doing deep due diligence investigations on the Chinese partner, monitoring managers and company's performance in order to avoid common troubles. The most common problems encountered during due diligence investigations are poor transparency and inadequate documentation. It is therefore very important to carry out good due diligence work. so that any liabilities of the partner's company do not cause serious complications. However, in China, to achieve effective results, a much more practical due diligence approach is needed, such as focusing on business aspects as well as financial and legal aspects.

Since different interests of the parties create pressure and damage to the company, the success of a joint venture depends on mutual trust and good communication between the parties, in order to understand their business philosophies, expectations and practices. In addition, interviews with suppliers, customers and even competitors in order to know the reliability and reputation of the potential Chinese partner are also relevant¹⁵².

Other common problems are the under-reporting of taxes, complicated debts, security agreements and incomplete evidence of ownership of land and buildings. Once these problems are identified, they can be used as a lever during price negotiations and as deal-breakers, avoiding an expensive mistake from foreign investors.

¹⁵² *Establishment of a Joint Venture (JV) in China*, InterChinaConsulting, June 2011, pp. 5-6.

2.4.6 Minority shareholders' protection

There are two kinds of conflict of interest in Corporate Governance, one between majority and minority shareholders and the other between managers and shareholders. When ownership is divided between many shareholders, the conflict of interest between management and shareholders prevails, while when ownership is split between a few shareholders, the conflict of interests between majority and minority shareholders is more relevant.

Although after the non-negotiable capital market reform of 2005, the level of concentration of ownership has decreased, Chinese listed companies still show high concentrated ownership structures. For this reason, one of the major problems of corporate governance in China is the conflict of interest between majority and minority shareholders. In the recent years this topic has become more central in China in order to guarantee fair treatment of shareholders¹⁵³.

In the Chinese legislature there are three aspects concerning the fair treatment of shareholders.

Firstly, there is equal voting power, inspection and investigation rights, cumulative voting rights and the right to submit proposals.

Secondly, there are mechanisms to prohibit or regulate the operations of majority shareholders, such as the withdrawal of voting rights from shareholders as warranty for the parties, the prohibition of loans to related parties and the obligation to compensate the damaged party.

Thirdly, there are mechanisms to guarantee compensation when the rights of minority shareholders are violated, such as the right to request cancellation or revocation of resolutions of the shareholders' general meeting and the boards of director.

They can also request compensation for damage caused by controlling shareholders, compensation for damages caused by directors or managers of the company¹⁵⁴.

¹⁵³ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.113.

¹⁵⁴ *Corporate Governance of Listed Companies in China: Self-Assessment by the China Securities Regulatory Commission*, OECD Publishing, 2011, p.41.

The article 22 of the company law (2013) states that any resolution adopted by the shareholders' meeting or by the board of directors, violating laws and the statute, must be null and void. Moreover, if the convocation or the method of voting of the shareholders' general meeting and the board of directors go against the laws and the statute, shareholders can bring a case to the court . However, there is no requirement regarding a minimum number of the shareholders to bring a case. Other provisions such as liquidation and controlled administration are not available to Chinese shareholders.

The novelty of Chinese law is that shareholders can sue the decisions of the assembly and also the resolutions of the board, if considered unequal. This is because there have been cases in China where the rights of shareholders have been violated by the decisions of the board meeting¹⁵⁵.

Regarding the voting method of the shareholders' general meeting, the article 103 of the Company Law states that the general decision rule of the meeting is one share, one vote (一股一票 Yigu yipiao). To be adopted, a resolution must win at least half of the voting rights at the meeting. For important matters, such as changes to the company's statute, mergers and acquisitions, a two-thirds majority of the voting rights are required.

The principle of one vote-one share is firmly established by the Chinese Company Law. Unlike some legal systems that allow companies to issue non-voting shares (UK, France, Japan) or allow them to issue non-voting preference shares (Germany, Italy), Chinese company law does not mention none of them. However, article 134 of the Chinese Company Law establishes that the State Council may adopt separate regulations (not provided by the statute) to issue other types of shares.

A major revision in the 2013 Company Law is the article 105. In the case of election of directors and supervisors of a general meeting, it allows a company to implement a cumulative voting system. According to the cumulative voting system (累积投票制度 Leiji toupiao zhidu), the number of voting rights attributed to each share is the same as the number of directors or supervisors to be elected, and the voting rights held by a shareholder may be exercised collectively¹⁵⁶. This new rule is very important in China,

¹⁵⁵ WEI, YUWA, *Comparative corporate governance: a Chinese perspective*, Kluwer Law International, 2003, p.114.

¹⁵⁶ Article 105 of the Chinese Company Law, Section 2, General meeting.

where shareholders can often control a large number of shares. In fact, the cumulative voting system offers greater strength to small investors in the selection of the board¹⁵⁷.

Related to the Chinese Corporate Governance concerning the dominance of large shareholders, the independent director is also important in China. The independent directors should represent the interest of small shareholders and prevent the abuse of their power from majority shareholders. However there are many issues related to the independent directors' lack of power to protect the interest of small shareholders. The most important problem is that independent directors are a minority in the board and they are nominated by majority shareholders¹⁵⁸.

¹⁵⁷ Yong Kang, Lu Shi, Elizabeth D. Brown, *Chinese Corporate Governance: History and Institutional Framework*, p.12.

¹⁵⁸ C. CLARKE, Donald, *The independent director in Chinese corporate governance*, 2006, Delaware journal of corporate law [Vol. 31], pp.170-171

2.5 Sino-foreign enterprises

China recognizes a wide range of investment vehicles, some of which can only be used by Chinese investors, while others can also be used by foreign investors, albeit under the application of certain restrictions. The Chinese legislation on foreign investments involves the construction of various types of companies, known as foreign invested enterprises (FIE). The main types of FIE (外商投资企业 Waishang touzi qiye) are:

- Totally foreign corporations, better known as Wholly foreign-owned enterprise or WFOE (外商独资企业 Waishang duzi qiye);
- Holding companies (控股公司 Konggu gongsi);
- Companies limited by shares with foreign investment; and
- Joint venture companies, better known as joint ventures in the forms of Equity joint ventures (中外合资经营企业 Zhongwai hezi jingying qiye), a special type of limited company with fully legal subjectivity, established by at least one local partner and a foreign partner (25%), and Contractual joint venture (中外合作经营企业 Zhongwai hezuo jingying qiye), that is, a cooperation between a foreign and a Chinese partner, which does not necessarily involve the birth of a new legal entity. The latter is an uncommon form of investment, intended primarily to channel investments in the service sector or infrastructure, so this analysis will focus specifically on the Equity Joint Ventures¹⁵⁹.

To accommodate the practical interest of the Italian investor, I will focus on the most used and useful investment vehicles for the analysis on Corporate Governance, which is the Equity joint venture.

The equity joint venture is the best known form of foreign direct investment and finds its discipline in the law of July 1, 1979 and the related Implementing Regulation of September 20, 1983, both amended several times over the years, most recently in 2001, a few months before entering the WTO, in order to incorporate some of the new

¹⁵⁹ REUVID J., *Business Insights: China. Practical advice on operational strategy and risk management*, KoganPage, 2011.

commitments. This is a special type of limited liability company, with full legal subjectivity clearly distinct from those of the shareholders and constituted by at least one foreign person (natural or legal person) and a Chinese legal entity. The foreign partner must hold a share equal or greater than 25% of the share capital. The law does not contemplate a threshold of the foreign shareholding, provided that at least one Chinese venturer is in place.

The establishment of a joint venture is subjected to an administrative approval regime, entrusted, depending on the value of the investment, to the Ministry of Commerce (商业部 Shangye bu) or its local branches; nevertheless in the recent years, the approval mechanisms tend to be increasingly simpler and slimmer and the intervention by the authorities on the merits is to be considered quite exceptional.

The joint venture is based on an agreement (Shareholders' agreement, 股东协议 Gudong xieyi) that regulates the rights and obligations of the partners among themselves and towards the company constituting and which establishes the main elements of the operation. According to the Contract Law of 1999, which unified the previous contractual regulations, the parties are free to draft the contract, in writing, according to the style and the editorial technique that they prefer. They are also authorized to draft the contract in a language other than Chinese and to delegate the resolution of any disputes to arbitrators not even Chinese, while, unlike what happens for all other types of contracts, they are not free to choose a different applicable law from the Chinese one.

In addition to the Joint Venture contract (合资合同 Hezi hetong), a statute must be drawn up containing forecasts on the corporate purpose, governance, financial management, pre-emptive rights on the transfer of shares, on the amount of share capital, on the total investment and on the distribution of profits. Both the joint venture contract and the statute are subjected to the Chinese law without delay and must be approved by MOFCOM (中华人民共和国商务部 Zhonghua renmingongheguo shangwu bu)¹⁶⁰ or its peripheral offices.

¹⁶⁰ Ministry of Commerce of the People's Republic of China is a Cabinet-level executive agency of the State Council of China.

The joint venture, like all other forms of foreign-invested enterprises, must be funded with a capital adjusted to the size and the corporate purpose, calculated according to a certain ratio of the total investment¹⁶¹.

Chinese company law requires a minimum share capital of RMB 30,000 but, in practice, most of the FIEs have been established with a share capital significantly higher than this. In any case, capital must be "adequate" to the volume of business that the FIE is expected to generate and in line with the feasibility study.

The shareholders can confer the share capital in cash (at least 30% obligatory) or in kind (through industrial property rights, real estate, equipment, etc.). During the term of the JV it is not possible to reduce the share capital, unless specific legal requirements are met and there is the authorization of the competent authorities.

Profits must be distributed among the shareholders necessarily in proportion to their respective shares of capital and each of them will be liable to the EJV only within the limits of the subscribed share capital. The EJV will respond to its creditors with the entire company assets¹⁶².

The administrative and management structure of the equity joint venture encounters various constraints in the mandatory provisions of the law. The company is administered by a board of directors, and may not have a shareholders' meeting. The board resolves according to the majorities established in the contract and in the company by-laws; unanimity is however required by law for some fundamental resolutions, such as amendments to the statute, the transfer of shares or the increase in registered capital and the dissolution of the EJV. This in fact determines a power of veto by the minority shareholder on some strategic decisions of the company and consequently a reduced capacity of the majority shareholder to assert its management line. Moreover, it should not be forgotten that Chinese equity joint ventures are syndicated corporations, but they are also instrumental companies based on a joint venture contract in which the humanistic principle and the *intuitus personae* play a fundamental role.

¹⁶¹ CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca foscarina, 2016, p.71.

¹⁶² Quadro di riferimento legislativo e fiscale per gli investimenti stranieri in Cina, Studio legale Chiomenti, 2013, CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca foscarina, 2016, p.94.

2.5.1 Corporate governance of Joint Ventures and related issues

The equity joint ventures are governed by the equity joint venture law and the equity joint venture law implementing regulations. In 1979 the legislation of JV was an exceptional legislation only related to foreign investments. In 1993 China developed its own company law but the legislation of FDI, in particular JV, WOFE was not modified or deleted so there were two different and in conflict laws. One was covering domestic companies “the company law” and the other “JV law and WOFE law” covering companies owned by foreign investors.

In order to cover this difference, Chinese authorities said that the Company Law must be applied by all Chinese companies including foreign-invested companies. However, in case of conflict between provision of the Company Law and “special laws” related to foreign investments, the provision of the “special laws” would have prevailed. In fact, in relation to corporate governance, some differences are still present between the Company Law and special laws, which are privileged and more controlled.

For example, the company law did not required any specific majority for the transfer of shares, while JV law impose the unanimous approval of the decisions. Another example less stringent than the one of unanimity is the existence of shareholders meeting. The JV law doesn't contemplate the existence of the shareholders meeting; usually partners are between two or three, therefore there is no need to replicate the same governance in two different bodies. The company law of 1993 provides the existence of shareholders meeting. The coordination between the two systems of law has not always been easy in the case that there is not conflict but a different prospective in the organization¹⁶³.

The contract of a Joint Venture must define the structure of the management of the company, specifying also which party is responsible for the appointment of the General Manager and the other executives with strategic responsibilities.

The fundamental management body of the Joint Venture is the Board of Directors, consisting of at least three members. The law currently requires the mandatory establishment of a board of supervisors or supervisory committee (with a similar

¹⁶³ CAO ZHENKAI 曹镇韬, “*Yigu yiquan*” *Jiqi dui zhongguo gongsi fa deqishi*, “一股一权”及其对中国公司法的启示 (“One Share, One Vote” and Its Implications for the Construction of Chinese Company Law), *Nanjingdaxue*, 2013, p.1.

function, albeit with due differences, to those of our board of statutory auditors) made up of at least three members. In the case of small joint ventures (without prejudice to the approval of the competent authority) it will be possible to avoid the establishment of a college, merely appointing one or two supervisors.

The board of directors is chaired by the chairman who also covers the role of legal representative of the company. The most important strategic decisions are taken by the board of directors, while the general management of the company is entrusted to the general manager appointed by the board of directors.

The members of the board of directors of the EJV are appointed by the shareholders in proportion to the share capital subscribed and remain in office normally for four years (the position is anyway renewable).

The convocation of the board of directors must take place at least once a year, but extraordinary meetings can be convened (the quorum for the validity of the meeting must be two-thirds of the directors). The council meeting is chaired by the president or vice president, in case the president is unable to perform his duties.

Unlike what happens in Italy, Chinese law allows the possibility of conferring proxies for participation in the meetings of the board of directors to other directors and even to third parties. This possibility facilitates the direct involvement of the foreign investor in the management of the company.

The board can decide the decisions by simple or qualified majority depending on the matters, but when it comes to changes to the bylaws, liquidation or dissolution of the joint venture, increase or reduction of share capital, transfer of shares to third parties or merger or demerger society, the unanimity of the councilors attending and voting is required. These strengthened majorities constitute an obstacle to the "full" exercise of power by the majority shareholder and lend themselves to possible obstruction and obstructive behaviour by the minority which will have to be taken into account in the investment planning phase¹⁶⁴.

The board of directors appoints a general manager who is in charge of the ordinary management of the company. The articles of association or the board of directors can more precisely define the powers and responsibilities of the general manager and other managers. The parties may decide to support the general manager with one or more

¹⁶⁴ Quadro di riferimento legislativo e fiscale per gli investimenti stranieri in Cina, Studio legale Chiomenti, 2013, CAVALIERI, Renzo R., *Lecture di diritto cinese*, Venezia, Ca' Foscari, 2016, p.102.

deputy general managers (also in order to allow each party to take part, through the vice general manager of their own expression, to the ordinary management of the JV), to whom tasks may be assigned.

The discipline of the duties and responsibilities of directors and executives is completely inadequate, as it is limited to providing a general duty to act in accordance with the Articles of Association and protecting the interests of the company, as well as a prohibition to use funds for personal purposes or to constitute guarantees for members or other individuals. Such a lackluster regulatory framework helps to make uncertain the outcome of any type of liability action against directors and managers.

In addition to the rules on conflict of interest (which provide, *inter alia*, a non-compete obligation for the general manager and his deputies), there are rules that give the board the possibility to remove, even against the will of the party who appointed them, the general manager, the vice general manager and the other managers in the event that they are guilty of corruption or serious breaches of their duties. However, the practical applicability of these forecasts is not of easy application.

Furthermore, in terms of incompatibility, the company law states the prohibition of appointing directors, members of the supervisory committee or executives who have been convicted of crimes related to the administration of the company, held a position within the public Chinese administration, and have held the position of legal representative of a company whose business license has been revoked and to which it has been ordered to cease activities due to violations of the law of which they are personally responsible. This prohibition is valid for a period of three years from the date of revocation of the Business License (经营许可证 *Jingying xukezheng*)¹⁶⁵.

The success of a joint venture depends on mutual trust and good communication between the parties. Different interests of the parties create pressure and damage to the company. For these reasons, foreign investors should not underestimate the importance of doing deep due diligence investigations on the Chinese partner, monitoring managers and company's performance in order to avoid difficulties in achieving their set goals. Typical problems are the under-reporting of taxes, complicated debts, security agreements and incomplete evidence of ownership of land and buildings. The problems

¹⁶⁵ *Ibis.*, p.103.

identified can be used as a lever during price negotiations and can be used as deal-breakers, avoiding an expensive mistake for foreign investors.

Since China's corporate governance standards still present some problems, in order to establish a JV, a foreign investor should calculate the level of risk and uncertainty.

Establishing a WFOE clearly reduces risk exposure and necessity for due diligence, but, obviously, it causes some other problems regarding costs and adaptation¹⁶⁶.

¹⁶⁶ *Establishment of a Joint Venture (JV) in China*, InterChinaConsulting, June 2011, pp.4-6.

CONCLUSION

Based on the research carried out I can state that Italian and Chinese corporate governances of limited companies have some differences and some implications in the law in action. As I previously said, the Italian corporate offers the choice between different systems of administration and control such as the traditional, one-tier and two-tier systems. The traditional system is characterized by the presence of the board of directors as administrative body and the board of statutory auditors as supervisory board. In the Anglo-Saxon one-tier system the administrative body is the board of directors, with the management control committee as control over the board of directors. The German two-tier system provides the co-presence of the management board and the supervisory board. This last system is very similar to the Chinese corporate governance's model. In the Chinese model the management is entrusted to the board of directors and control is entrusted to the supervisory board; however, there is no hierarchical relationship between the board of directors and the supervisory board, in fact, in China these two boards are on the same level and their members are appointed by the shareholders. The German supervisory board instead has the authority to appoint and, if necessary, revoke the members of the board of directors. Due to the lack of these powers, most Chinese board of supervisors faces great challenges to supervise the board of directors and the management, causing insider trading issues.

The role of shareholders' general meeting is also interesting in China because it is considered the supreme power in corporate governance. Therefore the powers given to the board of directors and the supervisory board derive from the shareholders instead of the legislature, while in Italy the board activity is characterised by autonomy and exclusivity from shareholders. Comparing the meeting of shareholders to the National People's Congress, this corporate governance system reminds the political governance system of the Chinese Constitution, where the National People Congress is the supreme State power and all other state organs are below its power. With a powerful shareholders' meeting above, the board of directors has a very limited role. This situation is solved in Joint Venture law as the existence of the shareholders' meeting is not mentioned being the board of directors seen as the only administrative body.

Both Code on corporate governance for listed Companies and Company Law stress the duty of loyalty and diligence of the directors to shareholders; however the monitoring role of board of directors is questionable, as they are often dominated by representatives from parent companies and/or by party secretaries or government officials because of the highly concentrated ownership structure. As a result, these boards and committees lack independency and competences because only a few of directors are professionals (lawyer, accountants or finance experts).

The Italian and Chinese corporate governances have a common issue related to the lack of protection of minority shareholder. They have often been victims of abuse of power by the controlling shareholders. This is because both Italian and Chinese boards work on the basis of the principle of majority. The article 103 of the Chinese Company Law states that “Resolutions of the general meeting are adopted by more than half of the voting rights held by the shareholders present at the meeting. However, resolutions of the general meeting to change the articles of association, increase or reduce the share capital, merge, dissolve or change the corporate form of the company must be adopted by two thirds or more of the voting rights held by the shareholders present at the meeting”¹⁶⁷.

In Italian companies the ordinary shareholders' meeting also resolves with a quorum of 50% + 1 of the capital represented at the meeting, while the extraordinary shareholders' meeting resolves by a majority of 2/3. The favourable vote of members representing at least half of the share capital is required, for the approval of some particularly important decisions, such as the change of the article of association, the transformation of the company, the transfer of the registered office abroad.

In Joint Venture law, a sort of veto to the protection of minority shareholders and so a reduction of capacity of the majority shareholder to assert its management line is offered by the unanimity principle. In fact it states that the board generally works on the basis of the principle of majority, but unanimity is required for all major decisions such as capital increase, transfer of shares and dissolution of the JV.

With the changes made, and in particular those of 2005, the 1993 Chinese Company Law was adapted to the ongoing socio-economic change. In particular, the autonomy of the members has increased both in the constitutive phase and in the management of the

¹⁶⁷ Chinese Company Law, article 103.

company. In this way it reduced the number and extent of the mandatory rules, the minimum capital and also increased the protection of minority shareholders, the transparency of social acts and communications. In any case the public footprint of part of the rules contained in the law is still relevant, although the changes over the years have diminished its influence. In fact, there is a clear orientation to make use of administrative sanctions rather than civil law instruments to protect companies and shareholders from unlawful conduct by directors. There is also a clause providing that every capital company should follow "conditions for the activity of the communist party", activities that the Chinese Communist Party's statute defines as "guarantee and control" of the application of the party's political line and "support" of the shareholders' meetings, the boards of directors and supervision and management of the company. It is the influence of the Chinese Communist Party in the company's decisions that causes lack of independence and autonomy of the company itself.

Chinese company law adopts European corporate governance models, but the main problem for the Chinese is the application of company law.

It is therefore clear that it is mainly in the law in action that the differences between the Chinese corporate governance system and the western ones appear to be particularly evident, especially in the still very numerous public-owned companies. In these cases, the relationship between investor members and management, the one between public (and the directors appointed by them) and private shareholders, the inefficiency and opacity of management and the phenomena of corruption and insider trading and dealing that have so far characterized the Chinese economic reform, add up to each other: on one hand, the management of the companies is not subjected to any serious and credible form of control, internal and external, while paradoxically, on the other hand, it does not yet have a complete decision-making autonomy about the business choices with respect to a whole series of external subjects. In private companies these phenomena are less clear, although it is wrong to think that these are non-existent.

Although the situation is rapidly changing, for the time being the Chinese economic system remains characterized by an inextricable mix of private economic activity and administrative activity, the role of entrepreneurs and the role of public administrators, auditors and controlled companies. Even the monitoring capacities of banks, finance

companies and even audit firms appear to be rather weak in China: there are many cases of corruption and malfeasance reported by the press and public opinion .

In recent years, trade issues have been the most regulated by the Chinese legislator, through the production of hundreds of laws. Thanks to these regulations, Chinese law has assumed forms and contents that are increasingly similar to those of western laws, but it continues to be distinguished by the weak role of administrative bodies, the influence of political bodies on economic activity, and a particular and problematic application of the law.

In the nowadays global economy, competition exists not only between products but also between corporate governance systems. Therefore it is important to reform the current corporate legislation in order to reduce problems in practice. This will improve the performance of Chinese companies and will increase the ability of these companies to operate efficiently.

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