INSTITUTIONALIZING POLITICAL INFLUENCE IN BUSINESS: PARTY-BUILDING AND INSIDER CONTROL IN CHINESE STATE-OWNED ENTERPRISES*

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ABSTRACT

The United States (U.S.) government and judiciary have long been trying to understand the state-backed or state-influenced actions behind Chinese enterprises that threaten U.S. businesses and economy. This Article takes advantage of a recent "party-building" (dangjian) reform in Chinese state-owned enterprises (SOEs) to dissect the power struggle between the Chinese Communist Party (CCP) and SOEs and shed light on the opaque terrain of political influence in business in China. By presenting the four-year party-building charter-amendment data from 2015 to 2018, this Article documents the voting responses of external shareholders and finds evidence of insider control in SOEs and SOE managerial resistance against political influence.

Foreign and minority shareholders expressed their concerns about enhancing the party's influence by voting against the amendments. However, their power is limited given the state's dominating shareholding in SOEs. This Article also finds resistance from SOE managers. High-level, nationally important central SOEs are more likely to resist party order. Even after multiple amendment requests from the government, resisting SOEs still adopted fewer party-building provisions than other adopting SOEs. Resisting SOEs are also less profitable and less internationally competitive, suggesting that they might suffer from insider-control problems. This Article thus argues that the writing-in of party-building provisions is not just putting something already in practice into written words, as conventionally believed. The charter amendment illustrated the power struggle between the CCP and SOE managers and was, in fact, a political renegotiation in which the CCP regained its control over SOEs by institutionalizing party organizations in business. However, the charter amendment does not warrant power shifting; it is just the first step. It remains to be seen whether institutionalizing party influence in business makes real changes in business decision-making.

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ABSTRACT.....441
INTRODUCTION.....442
I. THE PARTY-BUILDING REFORM.....445
A. The Party and the Business in History.....445
B. The Reform.....449
C. Major Party-Building Provisions.....453
II. CHARTER AMENDMENT OF LISTED SOES.....457
A. Current State of Amendments.....458
B. Do Minority Shareholders Speak Out?.....461
C. Support from Foreign Institutional Shareholders?.....466
III. ANALYSES AND IMPLICATIONS.....469
A. A Political Renegotiation Process.....469
B. Characteristics of Resisting SOEs.....473
C. Other Corporate Governance Concerns.....476
CONCLUSION.....479

INTRODUCTION

China's rapid economic growth has attracted much of the world's attention. Its socialist ideology has made the Chinese economy and the way business works there unique. The socialist market economy, which upholds the public sector and state-owned enterprises (SOEs), deeply affects the behavior and internal governance of Chinese enterprises. In fanciful terms, many scholars have been treating Chinese business as a monolithic "China, Inc." And scholars have called for changes in world trade regulations due to the intertwining relations among government, party, and business—and due to the strong push from the state on business to follow the national economic strategy.[1] Others are concerned about the policies and state force behind cross-border mergers and acquisitions initiated by Chinese enterprises and have proposed multilateral solutions.[2]

Amidst the trade war between the United States (U.S.) and China, the U.S. White House maintains that China has been using corporate governance

1. *See, e.g.*, Mark Wu, *The "China, Inc." Challenge to Global Trade Governance*, 57 HARV. INT'L L. J. 261, 264–66 (2016) (calling on the World Trade Organization to better balance interests in retaining Chinese involvement in the organization to improve the organization's longevity).

2. *See* Jeffrey N. Gordon & Curtis J. Milhaupt, *China as a "National Strategic Buyer": Toward a Multilateral Regime for Cross-Border M&A*, 2019 COLUM. BUS. L. REV. 192, 192–93 (2019).

tools, such as establishing party committees inside businesses, to achieve its industrial policy and national strategy. Specifically, "corporate governance has become a tool to advance China's strategic goals, rather than simply, as is the custom of international rules, to advance the profit-maximizing goals of the enterprise."[3] The U.S. government is particularly concerned about the penetration of Chinese business with state backing or state influence into the key technology and innovation sector of U.S. businesses.[4] Hence, the corporate governance of Chinese firms not only affects the investment decisions of overseas investors, but also the consumers and national interests of countries around the world upon which Chinese firms leave their footprints.

Since 2015, the Chinese government has undertaken a new round of SOE reform that aims to address the insider-control problem and revitalize the public sector. A key measure to enhance monitoring and state control is the so-called "party-building" (*dangjian*) reform, which aims to strengthen the control of the Chinese Communist Party (CCP) over business and the economy. President Xi pointed out that party leadership and party-building is the "root" and "soul" of Chinese SOEs.[5] Specifically, the CCP and the state require all SOEs to amend their corporate charters to formally include corporate party organizations in the governance system, allowing the CCP to influence material business and even personnel decisions.[6] Internal corporate party organizations have long existed in SOEs and even in large privately owned enterprises (POEs) in China, but they were almost invisible in the

3. WHITE HOUSE OFF. OF TRADE & MFG. POL'Y, HOW CHINA'S ECONOMIC AGGRESSION THREATENS THE TECHNOLOGIES AND INTELLECTUAL PROPERTY OF THE UNITED STATES AND THE WORLD 11 (2018). In remarks delivered in October 2018 on the administration's policy towards China, Vice President Mike Pence expressed concern about the CCP's increasing influence on sino–foreign joint ventures, underscoring the fact that American joint ventures operating in China have been required to establish party organizations and give the CCP a voice in hiring and investment decisions. *Vice President Mike Pence's Remarks on the Administration's Policy Towards China*, HUDSON INST., https://www.hudson.org/events/1610-vice-president-mike-pence-s-remarks-on-the-administration-s-policy-towards-china102018 (last visited May 10, 2021).

4. OFF. OF THE U.S. TRADE REPRESENTATIVE, FINDINGS OF THE INVESTIGATION INTO CHINA'S ACTS, POLICIES AND PRACTICES RELATED TO TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY, AND INNOVATION UNDER SECTION 301 OF THE TRADE ACT OF 1974 5–6 (Mar. 22, 2018); OFF. OF THE U.S. TRADE REPRESENTATIVE, UPDATE CONCERNING CHINA'S ACT, POLICIES AND PRACTICES RELATED TO TECHNOLOGY TRANSFER, INTELLECTUAL PROPERTY, AND INNOVATION 3–4 (Nov. 20, 2018), https://ustr.gov/sites/default/files/enforcement/301Investigations/301%20Report%20Update.pdf.

5. *Xi Stresses CCP Leadership of State-Owned Enterprises*, XINHUA NEWS AGENCY (Oct. 11, 2016), http://www.xinhuanet.com//politics/2016-10/11/c_1119697415.htm.

6. Zhonggong Zhongyang Guowuyuan Guanyu Shenhua Guoyou Qiye Gaige De Zhidao Yijian (中共中央、国务院关于深化国有企业改革的指导意见) [Guiding Opinions of the CPC Central Committee and the State Council on Deepening the Reform of State-Owned Enterprises] (promulgated by Central Comm. CPC & St. Council, Aug. 24, 2015), XINHUA NEWS AGENCY [hereinafter 2015 Guiding Opinions], http://www.gov.cn/zhengce/2015-09/13/content_2930440.htm (China).

formal corporate governance system.[7] Little was known about their real operations and influence on companies' business decisions. The unprecedented charter amendment exercise presents an opportunity to closely examine the role of party organizations in each SOE. By examining the responses of outside shareholders and SOE managers during the charter-amendment process, this Article aims to unravel the power dynamics of political control over business in China.

Enhancing party control over SOEs, on the one hand, curbs managerial opportunistic behavior and decreases agency costs; on the other hand, it shifts the goal of business decisions away from profit maximization to political/policy orientation and hampers shareholder wealth accrual. Party-building reform might benefit SOEs because enhanced party monitoring decreases the agency costs arising from the insider-control problem. However, outside shareholders and SOE managers might not welcome the amendment. The existing literature has examined the characteristics of early adopting firms and the extent to which party-building provisions are adopted.[8] However, no prior study has examined the voting process or how shareholders and managers responded to the amendment proposal. This Article fills in this gap by documenting the voting behavior of different shareholders and managerial resistance to the amendment.

This Article collects data in relation to the charter amendments of all 3,537 A-share listed companies in China between January 1, 2015 and December 31, 2018.[9] During this four-year period, one-third of Chinese listed companies formally included party organizations in their corporate charters—and 84% of the adopting firms were SOEs.[10] This Article finds resistance from both outside shareholders and SOE managers to these adoptions. The approval rate of minority and foreign shareholders on party-building amendments is much lower than the overall rate, at 77.16% and 52.95% respectively, suggesting that minority and foreign shareholders are voicing their concerns regarding the party's interference in business.[11] In particular, international proxy-advisory firms have suggested that

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7. Curtis J. Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 GEO. L. J. 665, 684 (2015); Curtis J. Milhaupt, *Chinese Corporate Capitalism in Comparative Context*, *in* THE BEIJING CONCENSUS? HOW CHINA HAS CHANGED WESTERN IDEAS OF LAW AND ECONOMIC DEVELOPMENT 275, 287 (Weitseng Chen ed., 2017).

8. John Zhuang Liu & Angela Huyue Zhang, *Ownership and Political Control: Evidence from Charter Amendments*, 60(105853) INT'L REV. L. ECON. (2019); Lauren Yu-Hsin Lin & Curtis J Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance,* J. LEGAL STUD. (forthcoming) [hereinafter Lin & Milhaupt, *Party Building*].

9. *See* Part II.A.

10. *See* Part II.A and Table 2.

11. *See* Table 3.

institutional shareholders vote against proposals that lack transparency and accountability.

This Article also finds that resistance from SOE managers manifests in the insider-control problem that the SOE reform aimed to address. A total of 14.16% of adopting firms amended their party-building provisions more than once. [12] Recognizing that listed companies do not propose charter amendments lightly, multiple amendments are signs of resistance from SOE insiders against party intrusion and control. A careful look into the content of the amendments shows that the centers of these battles are provisions relating to personnel-decision rights, which are considered more intrusive to firm management. Even after multiple amendments, resisting SOEs still adopted much fewer party-building provisions than others.

Further regression analysis finds that resisting SOEs tend to be high-power, nationally important central SOEs whose managers have the political resources to resist party control. However, these resisting SOEs are less profitable and internationally competitive than non-resisting SOEs, suggesting signs of tunneling or insider control. Contrary to the conventional belief that writing is no more than putting something already practiced into words, this Article argues that writing-in is actually a political renegotiation process between the CCP and SOE managers who have *de facto* control over business decision-making. However, a charter amendment does not warrant power shifting; it is just the first step. It remains to be seen whether institutionalizing party influence in business makes real changes in business decision-making.

Part I discusses the historical relationship between the party and business and introduces the party-building reform. Part II presents data on the statuses of amendments and the voting behavior of minority and foreign shareholders. Part III analyzes the power struggle between the party and SOE managers and examines the characteristics of resisting SOEs. Finally, the Article concludes by reviewing key findings and suggesting future directions for research.

I. THE PARTY-BUILDING REFORM

A. The Party and the Business in History

To understand the CCP's influence on SOEs, it is essential to delve into the history of SOE reform in China and the evolving role of corporate party organizations in SOEs. Like other former socialist economies, the initial

12. *See* Part III.A.

forms of SOEs in China were government agencies directly owned and managed by the state.[13] SOEs' main governance organs were the party committee, the workers' congress, and the workers' union, which were later called the "old three meetings" (*laosanhui*), in contrast to the modern governance structure—a board of directors, a board of supervisors, and shareholders.[14] Since managers and enterprises have little incentive to enhance profitability under the planned economy, the main objective of enterprise reforms between 1979 and 1993, under the "Reform and Opening Up" policy, was to dissociate the government and party from enterprises to enhance enterprise autonomy and increase retained profits.[15] To achieve that goal, a corporatization program was introduced in which SOEs were granted separate legal personalities and obtained the right to own property and enter into contracts.[16] Furthermore, the government promoted a so-called "contract responsibility system" (*chengbaozhi*) to govern the relationship between the state and SOEs.[17] Under this system, a contract was entered into between the state and SOEs whereby SOEs could retain excess profits and undertake their own losses.[18] With the decline of the party-state's intervention in management, enterprise autonomy has greatly expanded, and incentives were given to SOE managers to maximize profits.[19] Under the new system, the role

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13. Nicholas Calcina Howson, *China's "Corporatization without Privatization" and the Late Nineteenth Century Roots of a Stubborn Path Dependency*, 50 VAND. J. TRANSNAT'L L. 961, 968 (2017).

14. The new-three-meeting, what we know as modern enterprise system, did not exist until 1993 after the 14th National Congress. For discussions on new-three meeting and old-three meeting, see, e.g., Changchong Lu, *Corporate Governance Structure and the Relationship Between Olde and New Three Meetings*, 11 ECON. RES. J. 10, 10 (1994); Xinhua Jian, *How to Coordinate the Old and the New Three Organizations*, 10 CHINA ECON. & TRADE HERALD 18, 18 (1999) (comparing the old triad of company structure to the new triad); Ligang Song, *State-Owned Enterprise Reform in China: Past, Present and Prospects*, *in* CHINA'S 40 YEARS OF REFORM AND DEVELOPMENT: 1978–2018 345, 361 (Ross Garnaut et al. eds., 2018) (describing the transition of SOEs from state to private control).

15. Yingyi Qian, *Reforming Corporate Governance and Finance in China*, *in* CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES: INSIDER CONTROL AND THE ROLE OF BANKS 3 (Masahiko Aoki & Hyung Ki Kim eds., 1994) [hereinafter Qian, *Corporate Governance*].

16. Quanmin Suoyouzhi Gongye Qiye Fa (全民所有制工业企业法) [State-owned Industrial Enterprises Law] (promulgated by Standing Comm. Nat'l People's Cong., Apr. 13, 1988, effective Aug. 1, 1988); STANDING COMM. NAT'L PEOPLE'S CONG. GAZ., Apr. 13, 1998, art. 2 (China) ("The enterprise shall enjoy the rights to possess, use, and dispose of, according to law, the property, which the state has authorized it to operate and manage. The enterprise shall obtain the status of a legal person in accordance with law and bear civil liability with the property, which the State has authorized it to operate and manage. The enterprise may, in accordance with the decision of competent government agencies, adopt contract, leasing, or other forms of systems of managerial responsibility.").

17. Song, *State-Owned Enterprise Reform in China, supra* note 14, at 349.

18. Quanmin Suoyouzhi Gongye Qiye Chengbao Jingying Zeren Zhi Zanxing Tiaoli (全民所有制工业企业承包经营责任制暂行条例) [Interim Regulations on the Contracting Management System of State-Owned Industrial Enterprises] (promulgated by St. Council., Feb. 27, 1988, effective Mar. 1, 1988), http://www.gov.cn/gongbao/content/2011/con-tent_1860724.htm (China).

19. Qian, *Corporate Governance*, *supra* note 15, at 4.

of the party organization was to support SOE managers' leadership and to serve a political role rather than a managerial one.[20] Party organizations indirectly exercised their leadership by ensuring that SOEs implemented relevant policies issued by the party or the state, participated in material decision-making, and supervised managers who were also party cadres.[21]

The corporatization process was accelerated by the promulgation of the first Company Law in China in 1994,[22] which transformed SOEs into modern corporations. Corporatized SOEs introduced the modern corporate governance structure—a board of directors, a board of supervisors, and the shareholder meeting (also called the "new three meetings" (*xinsanhui*) in China),[23] while the "old three meetings" remained. According to Article 17 of the 1993 Company Law, a company shall establish an internal party organization if there are at least three CCP members in the company.[24] Depending on the size of the SOE, those party organizations can be named as a party group (*dangzu*), a party committee (*dangwei*), or a party branch (*dangzhibu*).[25] Therefore, a twin governance structure emerged consisting of both typical Western corporate governance institutions and political governance organs with Chinese characteristics.[26] Since then, one of the greatest challenges in the corporate governance of Chinese SOEs has been reconciling the role of party organizations as the political lead, on the one hand, and a board of directors as the management lead under the modern corporate governance structure on the other.[27]

Another major issue in the SOE modernization process is *insider control*. Insider control is a common challenge faced by transitional economies in the process of corporatization or privatization. Insider control refers to the capture of substantial control rights or insider interests by the

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20. ZHONGGUO GONGCHANDANG DI SHISAN CI QUANGUO DAIBIAO DAHUI SHANG DE BAOGAO: YANZHE YOU ZHONGGUO TESE DE SHEHUI ZHUYI DAOLU QIANJIN (中国共产党第十三次全国代表大会上的报告: 沿着有中国特色的社会主义道路前进) [WORK REPORT OF THE 13TH NATIONAL CONGRESS OF THE CCP: ADVANCE ALONG THE SOCIALIST ROAD WITH CHINESE CHARACTERISTICS], passed on Oct. 25, 1987, by the 13th National Congress of the Communist Party of China.

21. Jin Sun & Zelin Xu, *Conflict and Coordination Between the Party Committee and the Board of Directors of State-Owned Enterprises*, 2019(1) L. SCI. 124, 125 (2019) [hereinafter Sun & Xu, *Conflict and Coordination*].

22. Gongsi Fa (公司法) [Company Law] (promulgated by Standing Comm. Nat'l People's Cong., Dec. 29, 1993, effective July 1, 1994) STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China).

23. *See supra* note 14 and accompanying text.

24. Gongsi Fa, *supra* note 22.

25. Jiangyu Wang, *The Political Logic of Corporate Governance in China's State-Owned Enterprises*, 47 CORNELL INT'L L. J. 631, 655 (2014).

26. *Id.* at 637.

27. *See* Sun & Xu, *Conflict and Coordination*, *supra* note 21, at 125 (discussing the changing role of the party committee from management to political leadership).

managers of former SOEs.[28] Unlike former socialist economies in Eastern Europe and the Soviet Union, where mass privatization took place after the collapse of the communist regime, China chose the path of "corporatization without privatization" in its transition to the market economy, meaning that SOEs were incorporated in the forms of companies but the ownership was still controlled by the state.[29] Even though mass privatization did not happen in China, insider control is still a major challenge to the corporate governance of Chinese SOEs. SOE managers now enjoy great discretion over the use of state assets and the income so generated, and they benefit greatly from on-the-job consumption and perks, such as the assignment of better and larger apartments, private use of cars, use of corporate accounts for business lunches and dinners, entertainment, traveling, etc.[30] Some managers even divert state assets to their own or controlled business.[31]

Insider control in Chinese SOEs was partly ameliorated by the CCP's firm control over high-level SOE executives. Unlike Eastern Europe and Russia, the CCP continues to follow the standard *nomenklatura* process to appoint SOE senior management, even after corporatizing SOEs.[32] This is the principle known as "Party's authority over cadres" (*dangguan ganbu*).[33] Most SOE senior executives are party members whose appointment, dismissal, and even daily behavior are subject to party discipline.[34] The

28. Masahiko Aoki, *Controlling Insider Control: Issues of Corporate Governance in Transition Economies*, *in* CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES 3 (Masahiko Aoki & Hyung-Ki Kim eds., 1995).

29. Howson, *China's "Corporatization without Privatization"*, *supra* note 13, at 969–70.

30. Qian, *Corporate Governance*, *supra* note 15, at 4–5.

31. Opportunities for tunneling emerged from the reorganization process. During corporatization, a series of organizational transformations were effected by breaking up existing enterprises to form subsidiaries, joint ventures, limited liability companies, and joint-stock companies. SOE managers thus have the opportunities to divert state assets or transfer new business opportunities to their own private business. *Id.* at 5–7.

32. Howson, *China's "Corporatization without Privatization"*, *supra* note 13, at 971.

33. Yingyi Qian, *Corporate Governance Structure Reform and Financing Structure Reform*, 1 ECON. RES. J. 20, 22 (1995); Katharina Pistor, *The Governance of China's Finance*, *in* CAPITALIZING CHINA 35 (Randall Morck & Henry Wai-Chung Yeoung eds., 2012); *see* Li-Wen Lin & Curtis J. Milhaupt, *We Are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697, 737 (2013) (discussing cadre personnel management and nomenklature leadership selection); Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 2013 COLUM. BUS. L. REV. 743, 746–47 (2013) (noting the CCP's "tight control" over personnel rotations in SOEs and other government bodies).

34. Zhonggong Zhongyang Guanyu Yange Anzhao Dangde Yuanze Xuanba Renyong Ganbu De Tongzhi (中共中央关于严格按照党的原则选拔任用干部的通知) [Notice of the Central Committee of the Communist Party of China on Selecting and Appointing Cadres in Accordance with Party Principles] (promulgated by CPC Central Comm., Jan. 1, 1986) DANGNEI FAGUI XUANBIAN (China); Dangzheng Lingdao Ganbu Xuanba RenYong Gongzuo Tiaoli (党政领导干部选拔任用工作条例) [Regulations on The Selection and Appointment of Party and Government's Leading Cadres] (promulgated by CPC Central Comm., effective Mar. 3, 2019) XINHUA NEWS AGENCY,

CCP's control over personnel counterbalances managerial discretion and prevents state assets from being tunneled away at a faster pace, as seen in other transitional economies.[35] That being said, insider control is still a core issue in SOE reform today, the most common measure against which is enhancing party leadership and control over SOEs, or "party-building" (*dangjian*). The following Subpart delineates SOE reform measures relating to party-building.

B. The Reform

From 2013 to the present, a new round of reform measures has been underway. This has included classifying SOEs according to their functions in the national economy,[36] adjusting the State-Owned Assets Supervision and Administration Commission's (SASAC) supervision of SOEs from asset-focused to capital-focused,[37] encouraging mixed ownership by inviting private enterprises to invest in SOEs,[38] and most importantly, upholding the party's leadership by strengthening party-building in SOEs.[39] Under Xi's administration, although the reform is proclaimed to be market-oriented and competition-encouraging, the party-state is taking back control over the national economy and allowing SOEs to dominate strategic sectors so that

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http://www.gov.cn/zhengce/2019-03/17/content_5374532.htm (China); Zhongguo Gongchandang Jilv Chufen Tiaoli (中国共产党纪律处分条例) [Regulations of The Communist Party of China on Disciplinary Measures] (promulgated by CPC Central Comm., effective Oct. 1, 2018), http://www.12371.cn/2018/08/27/ARTI1535321642505383.shtml (China).

35. Qian, *Corporate Governance*, *supra* note 15, at 9.

36. Guanyu Guoyou QIye Gongneng Jieding Yu Fenlei De Zhidao Yijian (关于国有企业功能界定与分类的指导意见) [Guiding Opinions on Function Definition and Classification of State-Owned Enterprises], passed on Dec. 7, 2015, by SASAC, Ministry of Finance, Development and Reform Commission.

37. In 2003, SASAC was established as a government agency that acts as both supervisory authority and the legal shareholder of all SOE business groups. The SASAC consolidated government control over SOEs, which had previously been shared by various central and local government agencies. According to the Law on the State-Owned Assets of Enterprises, the state is the investor of all state-owned enterprises, and SASAC would fulfil the legitimate rights and responsibilities of an investor/shareholder and supervise state-owned assets on behalf of the state. Guowuyuan Guoziwei Yi Guan Ziben Weizhu Tuijin Zhineng Zhuanbian Fangan De Tongzhi (国务院国资委以管资本为主推进职能转变方案的通知) [Promote Transformation of the Function of SASAC to Managing the Capital of SOEs] (promulgated by General Office St. Council, Apr. 27, 2017), http://www.gov.cn/zhengce/content/2017-05/10/content_5192390.htm (China).

38. Guanyu Guoyou Qiye Fazhan Hunhe Suoyouzhi Jingji De Yijian (关于国有企业发展混合所有制经济的意见) [Opinions of the State Council on the Development of Mixed Ownership of SOEs] (promulgated by St. Council, Sept. 23, 2015), http://www.gov.cn/zhengce/content/2015-09/24/content_10177.htm (China).

39. 2015 Guiding Opinions, *supra* note 6.

China can compete with Western counterparts as a global leader in all aspects.[40]

On August 24, 2015, the General Office of the CCP published the Guiding Opinion on Deepening SOE Reform[41] (2015 Guiding Opinion), which the Chinese government officially designated as the key document guiding and promoting SOE reform in the new era.[42] The 2015 Guiding Opinion demonstrates the CCP's determination to consolidate its control over SOEs and emphasizes that upholding the party's leadership over SOEs is the political direction and principle that must be followed.[43] Reinforcing party leadership in SOEs is apparently a move to ensure continuing party control in light of the forthcoming mixed-ownership reform. Party-building reform and mixed-ownership reform are a bundled set of policies. The CCP deems strengthening party-building to be a necessary condition for SOEs to introduce private equity. For example, the State Council requires all SOEs that engage in mixed-ownership reform to clarify the role and function of party organizations in relation to other internal governance institutions and to strengthen party-building-related work to ensure that party organizations play the core political role in mixed-ownership SOEs.[44] Even in the new round of restructuring and reorganization among central SOEs since 2016, the State Council stressed the importance of maintaining party leadership and enhancing party-building work in the restructuring process.[45]

The 2015 Guiding Opinion declared that the "rule by law" (*yifazhiguo*) was a key guiding principle in the new round of SOE reform.[46] Party-building work must comply with the modern corporate-law framework. Giving party organizations legal status in corporate governance is the only way to ensure

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40. Hong Yu, *Reform of State-owned Enterprises in China: The Chinese Communist Party Strikes Back*, 43 ASIAN STUD. REV. 332, 340 (2019).

41. 2015 Guiding Opinions, *supra* note 6.

42. *Id.*

43. *Id.*

44. Opinions of the State Council on the Development of Mixed Ownership of SOEs, *supra* note 38, at r.17, r.27.

45. Guowuyuan Bangongting Guanyu Tuijin Zhongyang Qiye Jiegou Tiaozheng Yu Chongzu De Zhidao Yijian (国务院办公厅关于推动中央企业结构调整与重组的指导意见) [Guiding Opinions of the General Office of the State Council on Promoting the Restructuring and Reorganization of Central SOEs] (promulgated by General Office St. Council, July 17, 2016), http://www.gov.cn/zhengce/content/2016-07/26/content_5095050.htm (China).

46. 2015 Guiding Opinions, *supra* note 6. Rule by law is different from rule of law. Commentators have observed that the Xi administration has paid unprecedented attention to law but the legal changes that Xi administration endorsed are those "politically non-threatening, technical and generally party-state capacity-enhancing" changes. Jacques Delisle, *Law in the China Model 2.0: Legality, Developmentalism and Leninism under Xi Jinping*, 26 J. CONTEMP. CHINA 68, 70 (2017).

legitimate party control under modern corporate norms.[47] Therefore, for the first time, the 2015 Guiding Opinion expressly prescribed that all SOEs must incorporate party organizations into their official governance system by writing relevant provisions into their corporate charters.[48] However, the party-building reform did not get traction until President Xi's speech in the Party-Building Working Conference of SOEs in October 2016. He portrayed CCP leadership as the foundation and soul of SOEs and that writing the requirements for party-building into companies' articles of association and clarifying the legal status of party organizations was necessary.[49] Specifically, SOEs must clarify the power, responsibilities, and working procedures of party organizations in decision-making and supervision and define the boundaries between the party organization and other corporate governance bodies, including boards of directors, shareholders, and senior management.[50]

To implement the party-building reform, the Central Organization Department of the CCP and the Party Committee of the SASAC jointly issued a notice on October 31, 2016 to delineate the specific arrangements and schedules for party-building work in SOEs.[51] This notice required SOEs, according to their situations, to write into their articles of association the legal status, responsibilities, meeting procedures, and funding sources of the party organization.[52] It also established the schedule that SOEs should strive to achieve within one year.[53] On January 3, 2017, the Party Committee of the SASAC issued a set of model party-building provisions to serve as a reference for future SOE charter amendments for the first time.[54] Later, in

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47. Guanyu Zai Shenhua Guoyou Qiye Gaige Zhong Jianchi Dang De Lingdao Jiaqiang Dang De Jinashe De Ruogan Yijian (关于在深化国有企业改革中坚持党的领导加强党的建设的若干意见) [Several Opinions on Adhering to Party leadership and Enhancing Party Building in Deepening SOE Reform] (promulgated by General Office CCP Central Comm., Sept. 20, 2015), XINHUA NEWS AGENCY, http://www.gov.cn/xinwen/2015-09/20/content_2935593.htm (China).

48. 2015 Guiding Opinions, *supra* note 6.

49. *Xi Stresses CCP Leadership of State-Owned Enterprises*, *supra* note 5.

50. *Id.*

51. Guanche Luoshi Quanguo Qiye Dang De Jianshe Gongzuo Huiyi Jingshen Zhongdian Renwu (贯彻落实全国国有企业党的建设工作会议精神重点任务) [Implementing Key Tasks and Spirit of the Party-Building Working Conference of SOEs] (promulgated by Org. Dep't CCP & Party Comm. SASAC, Oct. 31, 2016), http://wenda.12371.cn/liebiao.php?mod=viewthread&tid=576719 (China).

52. *Id.*

53. *Id.*

54. Guanyu Jiakuai Tuijin Zhongyang Qiye Dangjian Gongzuo Zongti Yoaqiu Naru Gongsi Zhangcheng Youguan Shixiang De Guiding (关于加快推进中央企业党建工作总体要求纳入公司章程有关事项的通知) [The Notice on Accelerating Advancement of Incorporating the Work Requirements of Central SOEs Party-Building into the Articles of Association] (promulgated by Party Comm. SASAC, January 3, 2017) [hereinafter Model Party-Building Articles] (unpublished document); Ke-jun Guo & Dong-yang Hu, *State-Owned Enterprise Party-Building into Articles of Association: Analysis of Path and*

May 2017, the Ministry of Finance published similar model articles for financial firms.[55] Further, in March 2017, the CCP and the State Council jointly published a notice stipulating that the charter amendment must be carried out in accordance with the ownership structure of SOEs.[56] SOEs that are entirely state owned and majority-controlled enterprises would be the first batch of SOEs to write party-building into their articles. Local governments and the SASAC at lower levels could issue guidance for the revision of articles of association that the wholly SOEs and majority state-controlled enterprises must obey. However, mixed-ownership enterprises with minority state capital were allowed more leeway in designing the appropriate party-building provisions.[57]

On May 3, 2017, the State Council published another guiding opinion to direct SOE corporate governance reform.[58] The opinion specifically required all SOEs to grant party organizations legal status in their corporate charters by 2020.[59] In particular, the opinion characterized party organizations as integral parts of SOEs' governance systems and portrayed party organizations as not only the political lead but also the overall leading voice of SOEs. It became clear that the CCP proposed to integrate party leadership with corporate leadership through the party-building reform initiated in 2015.[60] The opinion even required the full-time deputy party secretary in

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Mechanism, ZHONG LUN (Aug. 1, 2017), http://www.zhonglun.com/Content/2017/08-01/1843041618.html.

55. Cai Zheng Bu Yin Fa <Zhong Yang Jin Rong Qi Ye Jiang Dang Jian Gong Zuo Yao Qiu Xie Ru Gong Si Zhang Cheng Xiu Gai Zhi Yin >De Tong Zhi (财政部印发<中央金融企业将党建工作要求写入公司章程修改指引>的通知) [Notice on Guidelines for Central Financial Enterprise to Write Party-Building into the Articles of Association] (promulgated by Ministry of Finance, May 27, 2017) (unpublished document); Guo & Hu, *State-Owned Enterprise Party-Building into Articles of Association*, *supra* note 54.

56. Guanyu Zhashi Tuidong Guoyou Qiye Dangjian Gongzuo Yaoqiu Xieru Gongsi Zhangcheng De Tongzhi (关于扎实推动国有企业党建工作要求写入公司章程的通知) [Notice Regarding the Promotion of the Requirements of Incorporation of Party Building Work into the Articles of Associations of State-Owned Enterprises] (promulgated by Org. Dep't CCP & Party Comm. SASAC, March 15, 2017) (unpublished document); Guo & Hu, *State-Owned Enterprise Party-Building into Articles of Association*, *supra* note 54.

57. Notice Regarding the Promotion of the Requirements of Incorporation of Party Building Work, *supra* note 56; Guo & Hu, *State-Owned Enterprise Party-Building into Articles of Association*, *supra* note 54.

58. Guowuyuan Bangongting Guanyu Jinyibu Wanshan Guoyou Qiye Faren Zhili Jiegou de Zhidao Yijian (国务院办公厅关于进一步完善国有企业法人治理结构的指导意见) [Guiding Opinions of the General Office of the State Council on Further Improving the Corporate Governance Structure of State-owned Enterprises] (promulgated by Gen. Off. St. Council, Apr. 24, 2017, effective Apr. 24, 2017), http://www.gov.cn/zhengce/content/2017-05/03/content_5190599.htm (China).

59. *Id.*

60. To integrate party leadership with corporate leadership, CCP needed a group of top executives who were loyal to the party. In September 2018, CCP and State Council issued "Regulations on Senior Officials in Central SOEs" to meet such needs. The regulation requires SOEs to adhere to the

central SOEs to become a director and the head of the corporate party discipline committee to attend board meetings and board sub-committee meetings.[61] The opinion emphasized the role of party organizations, the workers' congress, and the corporate party discipline committee in SOE governance side-by-side with the three modern governance organs—the board of directors, the board of supervisors, and shareholders meeting.

By October 2017, all group-level central SOEs had completed the revisions of their articles of association.[62] As for the second- and third-level affiliated companies of central SOEs, more than 3,900 of them had completed revisions of their articles of association, more than 2,800 had single individuals fulfilling the jobs of party committee secretary and chairman of the board, more than 2,600 had appointed full-time deputy party secretaries, and more than 12,000 had added the prescribed procedural requirements into their articles.[63] The party-building reform also applies to listed companies. On October 15, 2018, the Corporate Governance Code for listed companies was amended to include a provision on party-building requiring majority state-controlled listed companies to incorporate party organizations or committees into their articles.[64] The Corporate Governance Code also urged all listed companies to establish party organizations and provide the necessary support for party activities.

C. Major Party-Building Provisions

As mentioned above, the SASAC and the Ministry of Finance published their model provisions for party-building as a reference for all SOEs in January and May 2017, respectively. The contents are almost identical. The model articles set out that the main responsibility of corporate party

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principle of Party's authority over cadres by introducing a unique personnel management system which fit the characteristic of central SOEs. The goal is to train a group of senior central SOE officials who are loyal to the Party. Zhongyang Bangongting Guowuyuan Bangongting Zhongyang Qiye Lingdao Renyuan Guanli Guiding (中央办公厅、国务院办公厅中央企业领导人员管理规定) [Regulations on Senior Officials in Central SOEs] (promulgated by Gen. Off. CCP Central Comm. & Gen. Off. St. Council, Sept. 30, 2018) (document not published online); Li Mingxing, *Interpretation of the Regulations on Senior Officials in Central SOEs,* CPC NEWS (Oct. 17, 2018), http://dangjian.people.com.cn/n1/2018/1017/c117092-30346610.html.

61. 2017 Guiding Opinion, *supra* note 58.

62. *Strong Roots, Casting Souls, Graspoing Party Building, Stepping Stones, Leaving Seals and Seeing Actual Results—the State-Owned Assets Supervision and Administration Commission of the State Council Promotes the Party Building Work of Central Enterprises*, 2017 ST. OWNED ASSETS REP. (Oct. 10, 2017).

63. *Id*.

64. Shangshi Gongsi Zhili Zhunze (上市公司治理准则) [Code of Corporate Governance for Listed Companies in China] (promulgated by CSRC, Sept. 30, 2018, effective Sept. 30, 2018), http://www.csrc.gov.cn/pub/tianji-n/tjfzyd/tjjflfg/tjbmgz/201810/t20181015_345303.htm (China).

committees was to determine future directions (*bafangxiang*), monitor important matters (*guandaju*), and ensure the enforcement of CCP policies (*baoluoshi*). Table 1 shows the major content of the model party-building provisions, one of the most important of which is the requirement that the board (and/or management) consult with the party organization or committee prior to making decisions on "important matters." The CCP defines "important matters" as "three important, one large" (*sanzhongyida*) matters (i.e., decisions on "important issues," the appointment of "important cadres," investment in "important projects," and the use of "large" sums).[65] Most SOEs have stipulated internal rules on the scope of "three important, one large" decisions as well as the responsibility and meeting procedures of party committees.[66]

Even though the wording in the model provision is "to hear the party committee's opinion beforehand," implying that, in form, the board of directors is still the highest decision-making organ in the firm and that such an arrangement still literally conforms to the modern company law requirement, the prior-consultation procedure itself significantly undermines the independence of the board and raises concerns about the accountability of the party committee members. The CCP tries to reconcile the conflicting roles of the party committee and the board and to blend party leadership into the modern corporate form by stipulating several interlocking personnel provisions.[67] One provision, called "double entry, cross appointment" (*shuangxiangjinru jiaocharenzhi*), requires the cross appointment of members in the party committee and the board of directors.[68] The more overlap there is between members in these two organs, the less likely the two organs will make conflicting decisions and the more justified the party

65. Guanyu Jinyibu Tuijin Guoyu Qiye Guanchi Luoshi "Sanzhongyida" (关于进一步推进国有企业贯彻落实"三重一大"决策制度的意见)[Opinions on Further Promoting State-owned Enterprises to Implement the Decision-Making System of "Three Important and One Large"], Zhong Ban Fa [2010] No. 17 (July 15, 2010).

66. *See, e.g.*, Sumeida Gufen Youxian Gongsi "Sanzhongyida" Jueci Zhidu Shishi Banfa (苏美达股份有限公司 "三重一大"决策制度实施办法) [Sumec Corp. Ltd. "Three Important, One Large" Decision-Making System Implementation Method], CNINFO.COM (Apr. 19, 2019), http://www.cninfo.com.cn/new/disclosure/detail?orgId=gssh0600710&announcementId=1206061643&announcementTime=2019-04-20; Jiangsu Lianyugong Gangkou Gufen Youxian Gongsi "Sanzhongyida" (苏连云港港口股份有限公司 "三重一大"决策制度实施办法) [Measures of Jiangsu Lianyungang Port Co., Ltd. on Implementing "Three Important, One Large" Decision-Making System], CNINFO.COM. (Oct. 28, 2020), http://www.cninfo.com.cn/new/disclosure/detail?orgId=9900002722&announcementId=1208623958&announcementTime=2020-10-28.

67. *See* Sun & Xu, *Conflict and Coordination*, *supra* note 21, at 128 (describing the conflicting responsibilities of the party committee and corporate management, leading to the CCP issuing guidance on how the board can coordinate with parties to strengthen SOEs and profitability).

68. Model Party-Building Articles, *supra* note 54.

committee's involvement is in business decisions under modern corporate law. The other provision is the "one shoulder" provision (*yijiantiao*), requiring the leadership of these two organs to be shouldered by the same person—that is, that the party secretary of the party committee and the chairman of the board be the same person.[69] The one-shoulder provision enhances consistency in party leadership and business leadership. In reality, it is unlikely that the board would make a decision contrary to the party committee's opinion even if there were no interchange of members between the two organs, but the interlocking personnel design does provide stronger justification for the party's involvement in the business decision-making process under modern corporate practices and ensures effective "policy-channeling" in SOEs.[70]

The model articles also suggest that SOEs establish an internal party disciplinary committee to supervise party members and enforce party discipline in the firm.[71] The inclusion of an internal disciplinary committee serves as a check-and-balance on the party committee and internalizes the enforcement cost of party rules. Furthermore, the principle of Party's authority over cadres ensures the party's control over personnel matters.[72] The principle is the bedrock of the CCP's ruling over not only SOEs but also other government institutions. In a way, the principle allows the CCP to supersede the board in appointing managers, even when the CCP does not control most of the board. Party committees may recommend manager candidates and make appointment decisions jointly with the board of directors. In this respect, the management power of the board is seriously eroded by the party committee. Figure 1 illustrates the structure of the major party-building provisions.

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69. *Id.*; *Implement "One Shoulder" to be a Good "Master"*, PEOPLE'S DAILY ONLINE (June 27, 2017), http://dangjian.people.com.cn/n1/2017/0627/c117092-29364554.html.

70. *See* Curtis J. Milhaupt & Mariana Pargendler, *Related Party Transactions in State-Owned Enterprisess: Tunneling, Propping, and Policy Channeling*, *in* THE LAW AND FINANCE OF RELATED PARTY TRANSACTIONS 245, 245 (Luca Enriques & Tobias H. Tröger eds., 2019) (noting the state's motives for using firm ownerhsip in pursuing public policy goals and profits). However, the personnel diffusion strategy under the "double entry, cross appointment" policy cannot resolve the long-standing conflict between party organization and boards of the directors in terms of value-maximization and division of power. *See* Sun & Xu, *Conflict and Coordination*, *supra* note 21, at 126 (discussing the integration of CCP leadership into the corporate governance structure and its resulting effectiveness for SOEs).

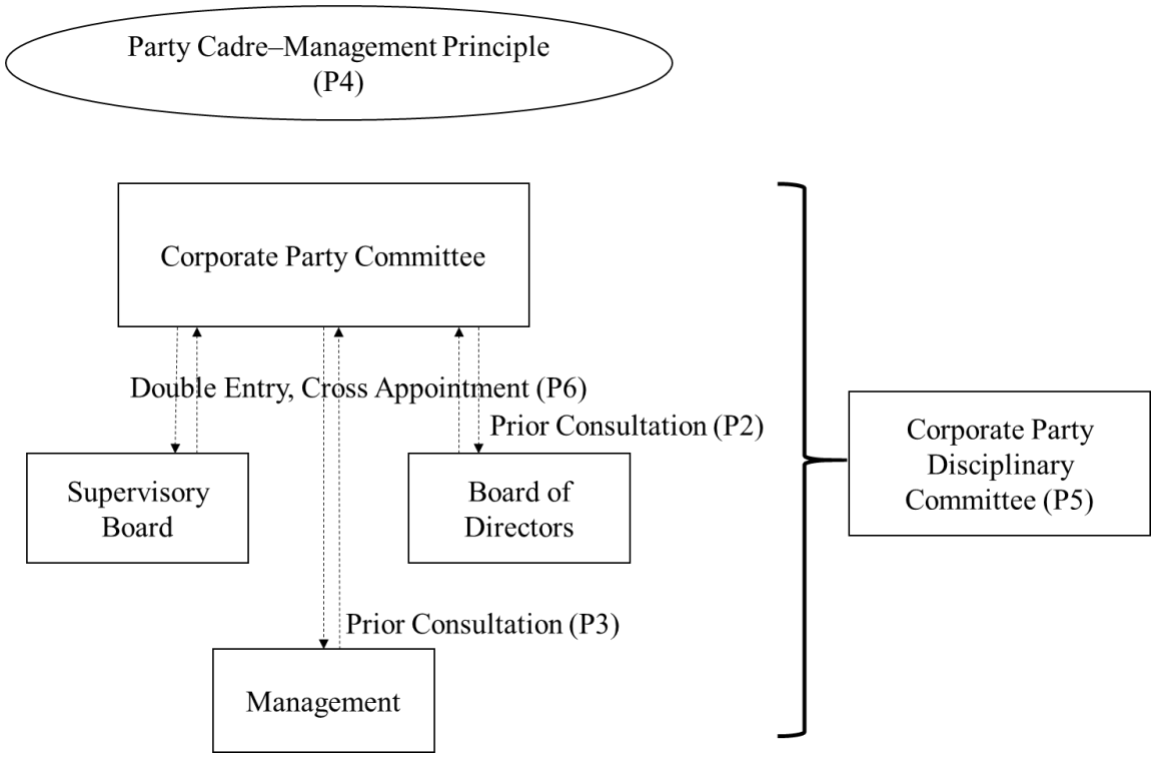
71. Model Party-Building Articles, *supra* note 54.

72. *Id.*

Table 1: Major Model Party-Building Provisions

Party-Building Provisions
P1: Provide Support for Party Activities
P2: Prior-Consultation Procedure of the Board
P3: Prior-Consultation Procedure of Management
P4: Principle of Party's Authority over Cadres
P5: Establish Corporate Party Disciplinary Committee
P6: Double Entry, Cross Appointment (Cross Appointment of Members in Party Committee and Board of Directors)
P7: One-Shoulder Principle for Chairman and Party Secretary
P8: Full-Time Deputy Party Secretary

Figure 1: Illustration of Major Party-Building Provisions



II. CHARTER AMENDMENT OF LISTED SOES

As a charter amendment requires the board of directors to first submit an amendment proposal and then obtain supermajority approval from the shareholders, the amendment process provides an opportunity to glimpse into the political economy of shareholder voting in China. Listed SOEs are mixed-ownership firms where a substantial portion of the shares are owned by outside, non-state shareholders. Outside shareholders might oppose an amendment proposal, anticipating that firms will be forced to make decisions that please the political party and sacrifice firm profitability. In particular, foreign institutional shareholders who place great emphasis on corporate governance and profit maximization might oppose such proposals. SOE managers might also oppose them because they limit managerial discretion. This Part presents data that illustrates the concerns of different stakeholders—the CCP, outside shareholders, and SOE managers—over the

party-building amendment, and it reveals the dynamic political negotiation during the process.

A. Current State of Amendments

To understand the enforcement status of this reform, I used a web crawler to search for relevant charter amendments on CNINFO,[73] the disclosure website officially designated by the China Securities Regulatory Commission (CSRC). I searched the corporate charters and announcements of the board meetings and shareholder meetings of all A-share listed companies on both the Shanghai and the Shenzhen Stock Exchanges between January 1, 2015 and December 31, 2018. Then, I manually checked the minutes of the board meetings and shareholder meetings to confirm the content of the actual amendments. I manually coded data on the approval rates of all shareholders, including minority and foreign shareholders, that were disclosed in the shareholder meeting minutes.

Of the 3,537 A-share firms searched, a total of 1,108 amended their corporate charters to formally establish corporate party committees during the four-year period. As Chinese law requires all listed firms to disclose their actual controllers (*Shiji Kongzhiren*), I further categorized adopting and non-adopting firms by their self-disclosed actual controllers. Table 2 reports the results. In total, 31.33% of A-share listed firms adopted party-building provisions. Of the 1,108 adopting firms, 314 are central SOEs and 621 are local SOEs. Unsurprisingly, most adopting firms were controlled by the state, but surprisingly, 126 POEs, 34 dispersed ownership firms, and two foreign-owned enterprises had adopted party-building provisions.[74]

73. *See* Ju Chao Zixun Wang (巨潮咨询网) [Juchao Information Network], SHENZHEN SEC. INFO. CO. LTD., http://www.cninfo.com.cn (last visited May 10, 2021).

74. *See* Lin & Milhaupt, *Party Building, supra* note 8, at 17–18 (noting a study exploring the characteristics of adopting POEs and finds that politically-connected POEs are more likely to adopt party-building provisions).

Table 2: Current State of Adoption (as of December 31, 2018)[75]

	Types of Firms							
	Central SOEs	Local SOEs	Dispersed-Ownership Firms	Collectively-Owned Enterprises	POEs	FOEs	Others	Total
Adopting firms	314	621	34	1	126	2	10	1,108
(%)	87.22	92.83	20.99	5.26	5.82	1.64	25	31.33
Non-adopting firms	46	48	128	18	2,039	120	30	2,429
(%)	12.78	7.17	79.01	94.74	94.18	98.36	75	68.67
Total	360	669	162	19	2,165	122	40	3,537

It appears that this seemingly "SOE-only" reform has also spread among non-SOEs. Even two foreign-owned enterprises responded to this political call. In response to the widespread campaign in recent years to enhance party leadership, there are growing numbers of private- and foreign-invested enterprises setting up internal party organizations.[76] As of the end of 2016, 106,000 foreign-backed companies had set up internal party organizations, a figure that has doubled since 2011.[77] Similarly, around 68% of 2.73 million private enterprises in China have established internal party organizations as of the end of 2016, reflecting a rise of 30% since 2011.[78] Party organizations are said to "aid foreign companies' business and development by helping them better understand government policies and by guiding them in obeying the country's laws and regulations."[79] Following the requirement in Article 30 of the Constitution of the Chinese Communist Party, Article 19 of Company Law requires all companies to establish party organizations if the

75. "Central SOEs" are defined as firms whose actual controller is the Chinese central government; "local SOEs" are firms whose actual controllers are local/provincial level governments; "dispersed ownership firms" are those who report no actual controller; "collectively-owned enterprises" are enterprises collectively owned by townships or villages and are incorporated under special regulations; "POEs" are firms whose actual controllers are private individuals or private entities; and "FOEs" denotes foreign-owned enterprises and are firms whose actual controllers are foreign individuals or foreign entities. The data for firm types were collected from the Wind Financial Database (WIND) maintained by Wind Information.

76. Nectar Gan & Frank Tang, *China's Communist Party Makes Big Inroads into Foreign-Funded Firms*, S. CHINA MORNING POST (Oct. 19, 2017), https://www.scmp.com/news/china/policies-politics/article/2116107/chinas-communist-party-boosts-presence-foreign-funded.

77. Chen Qingqing, *Foreign Firms Concerned over Party Building*, GLOB. TIMES (Nov. 29, 2017), http://www.globaltimes.cn/content/1077866.shtml.

78. Gan & Tang, *supra* note 76.

79. *Id.*

company has more than three party members.[80] A similar article was written into Chinese Company Law since its inception in 1993.[81] Even though the establishment of party organizations has roots in the Chinese Company Law, the law does not stipulate the roles of party organizations in the formal corporate governance structure. The functions of corporate party organizations were usually limited to organizing meetings or social events for party members after office hours.[82] Therefore, private- and foreign-invested enterprises were less concerned about setting up internal party organizations in the past than after the 2015 reform.

The concern over corporate party committees peaked when the CCP, in October 2016, required all SOEs to write such committees into their corporate charters.[83] The pressure on charter amendments also spread to foreign-invested companies.[84] Many foreign-invested companies involved in joint ventures with Chinese SOEs were asked to give corporate party organizations formal roles in corporate decision-making. This was especially true for joint ventures in which foreign investors accounted for only a minority of shares. Such a movement raises huge concerns among foreign investors about the political intrusion of the CCP into business decision-making in general.[85] The European Union Chamber of Commerce in China, for instance, fears that the move might be a salami-slicing tactic in which the

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80. CONST. OF THE COMM'T PARTY OF CHINA, art. 29 (2002) ("Primary Party organizations are formed in enterprises, rural areas, government organs, schools, research institutes, communities, social organizations, companies of the People's Liberation Army and other basic units, where there are at least three full Party members."); CHINESE CO. LAW, art. 19 (2018) ("The Chinese Communist Party may, according to the Constitution of the Chinese Communist Party, establish its branches in companies to carry out activities of the Chinese Communist Party. The company shall provide necessary conditions to facilitate the activities of the Party.").

81. Zhonghua Renmin Gongheguo Gongsi Fa （中华人民共和国公司法）[Corporate Law of the Republic of China], art. 17 (1993), http://www.lawinfochina.com/Display.aspx?lib=law&ID=641 (last visited Mar. 1, 2021) ("The grass roots organizations of the Communist Party of China in a company shall carry out their activities according to the Constitution of the Communist Party of China.").

82. Financial Times even described these party organizations as "moribund bodies." Tom Mitchell, *China's Communist Party Seeks Company Control Before Reform*, FIN. TIMES (Aug. 14, 2017), https://www.ft.com/content/31407684-8101-11e7-a4ce-15b2513cb3ff; *see also* Simon Denyer, *Command and Control: China's Communist Party Extends Reach into Foreign Companies*, THE WASH. POST (Jan. 28, 2018), https://www.washingtonpost.com/world/asia_pacific/command-and-control-chinas-communist-party-extends-reach-into-foreign-companies/2018/01/28/cd49ffa6-fc57-11e7-9b5d-bbf0da31214d_story.html?utm_term=.9137266a20b5 (noting that the function of corporate party leaders has changed).

83. *Xi Stresses CCP Leadership of State-Owned Enterprises*, s*upra* note 5.

84. Denyer, *Command and Control, supra* note 82.

85. *Chamber Stance on the Governance of Joint Ventures and the Role of Party Organisations*, THE EUR. UNION CHAMBER OF COM. IN CHINA (Nov. 3, 2017), https://www.europeanchamber.com.cn/en/press-releases/2583/chamber_stance_on_the_governance_of_joint_ventures_and_the_role_of_party_organisations.

CCP targets not just minority joint ventures, but eventually wholly foreign-owned entities.[86] The Association of German Chambers of Industry and Commerce in China even threatened to withdraw from the Chinese market if the CCP continued to strengthen its influence in foreign-owned enterprises.[87] It remains to be seen whether the party-building exercise will have a chilling effect on foreign investment and Sino-foreign joint ventures in China.

B. Do Minority Shareholders Speak Out?

To coat the party organization with a legal form, the charter amendment proposal needs shareholder approval in the general meeting. In China, the Company Law requires a supermajority vote—at least two-thirds of the attending shareholders' votes—for charter amendment.[88] Hence, state shareholding and support from outside shareholders are crucial to the success of the party-building reform. The existing literature has observed that the state shareholding level affects the responsiveness of SOEs to the party-building reform.[89] SOEs where the state owns more shares are more likely to adopt party-building provisions in their charters.[90] While many amendment proposals were passed, no prior study has explored the extent to which outside shareholders support the party-building proposal.

On January 6, 2017, Tianjin Realty Development (Group) (a local SOE in Tianjin City) submitted a charter amendment proposal for shareholder approval to formally establish a corporate party organization.[91] The proposal received only 62.5% of the votes, failing to meet the two-thirds threshold for a charter amendment.[92] As this was the first case in which the party-building amendment proposal was outvoted by outside shareholders, the SASAC paid great attention to the case. Subsequently, the SASAC suspended amendments in SOEs in which the state owned less than two-thirds of the shares to avoid

86. Denyer, *Command and Control, supra* note 82.

87. The statement reads, "[S]hould these attempts to influence foreign-invested companies continue, it cannot be ruled out that German companies might retreat from the Chinese market or reconsider investment strategies." He Huifeng, *German Trade Body Warns Firms May Pull out of China Vver Communist Party Pressure*, S. CHINA MORNING POST (Nov. 29, 2017), https://www.scmp.com/news/china/economy/article/2122104/german-trade-body-warns-firms-may-pull-out-china-over-communist.

88. Gongsi Fa (公司法) [Company Law] art. 43.

89. John Zhuang Liu & Angela Huyue Zhang, *Ownership and Political Control: Evidence from Charter Amendments*, 60 INT'L REV. L. & ECON. 105853, 60 (2019).

90. Lin & Milhaupt, *Party Building*, *supra* note 8.

91. *Tianjin Real Estate Development (Group) Co., Ltd. Announcement on the Resolutions of the Second Extraordinary General Meeting of Shareholders in 2017*, TIANJIN REALTY DEV. (Jan. 6, 2017), http://www.cninfo.com.cn/new/disclosure/detail?stockCode=600322&announcementId=1202998577&orgId=gssh0600322&announcementTime=2017-01-07.

92. *Id.*

further failed cases.[93] After about five months, Tianjin Realty put up the amendment proposal again on May 5, 2017, and it passed with 99.87% approval, a nearly unanimous vote.[94]

Tianjin Realty is, in fact, an outlier in the party-building reform. While many firms passed the resolution afterward, we must wonder whether minority and foreign shareholders speak out in the amendment process. As anecdotal evidence suggests that foreign institutional investors in Hong Kong were actively lobbied prior to shareholders' meetings, are they completely silent because the CCP has persuaded them party-building reform is good for the company?[95] Or did they vote against the proposal but the amendment still passed owing to the CCP's stronger voting power in the firm? To answer these questions, I hand-collected the approval rates of minority and foreign shareholders—H-share and B-share, respectively—for party-building charter-amendment resolutions disclosed in shareholders' meeting minutes on CNINFO. Chinese listed companies are required to calculate and separately disclose the voting statistics of minority (or middle-and-small) shareholders, H-share shareholders, and B-share shareholders.[96] This information sheds light on outside shareholders' reactions to the corporate party-building reform.

Table 3 summarizes the statistics on shareholder voting data. Panel A shows the results for all sample firms. The average approval rate of all shareholders is 98.99%, almost unanimous. But the approval rates of minority and foreign shareholders are much lower, at 77.16% and 52.95%, respectively. These results evince the objection and concern of minority and, in particular, foreign shareholders. The voting results for SOEs are similar (see Panel B). Note that the minimum approval rate of minority and foreign shareholders for both "all samples" and "SOEs" are zero. Here, zero does not mean missing data but actually means that no presenting shareholders voted

93. ASIAN CORP. GOVERNANCE ASS'N, AWAKENING GOVERNANCE: THE EVOLUTION OF CORPORATE GOVERNANCE IN CHINA 47 (2018).

94. Tianjin Realty Development, 'Notice of Tianjin Realty Development (Group) Co., Ltd on Poll Results at the Second Extraordinary General Meeting of 2017 (May 5, 2017), http://www.cninfo.com.cn/new/disclosure/detail?stockCode=600322&announcementId=1203482992&orgId=gssh0600322&announcementTime=2017-05-06 (last visited May 20, 2021).

95. ASIAN CORP. GOVERNANCE ASS'N, AWAKENING GOVERNANCE, *supra* note 93.

96. Middle-and-small shareholders refer to shareholders who are not directors, supervisors, managers, and those who hold more than five percent of the shares. H-shares are shares traded on Hong Kong Stock Exchange. B-shares are shares traded in foreign currencies on Chinese stock exchanges and held by non-mainland Chinese residents. *See* Guowuyuan Bangongting Guanyu Jinyibu Jiaqiang Ziben Shichang Zhongxiao Touzizhe Hefa Quanyi Baohu Gongzuo De Yijian (国务院办公厅关于进一步加强资本市场中小投资者合法权益保护工作的意见) [Gen. Off. of the St. Council, Opinions Regarding Enhancing the Protection of Middle-and-Small Shareholders of Capital Markets], Guo-Ban-Fa, no. 110, 2013; Guidelines for Articles of Association of Listed Companies (上市公司章程指引) (promulgated by the China Sec. Regul. Comm'n), art. 78, 2019.

for the party-building related amendments. A total of 20.52% of sample firms (143 of 697) with most of their attending minority shareholders voted against the party-building amendments (or abstained).[97] The objection from foreign investors was even stronger. Of the sample firms, 52.34% (56 of 107) saw most of their attending foreign shareholders object to the amendment.[98]

Table 3: Summary Statistics of Shareholder Voting[99]

Approval Rate (%)	N	Mean	Std. Dev.	Min.	Median	Max.
Panel A: All Samples						
All Shareholders*	1097	98.99	2.77	68.63	99.88	100
Minority Shareholders**	697	77.16	33.57	0	96.54	100
Foreign Shareholders***	107	52.95	28.7	0	48.69	100
Panel B: SOEs						
All Shareholders	928	98.93	2.88	68.63	99.86	100
Minority Shareholders	583	75.26	34.2	0	95.65	100
Foreign Shareholders	97	52.11	29.23	0	46.41	100
Panel C: POEs						
All Shareholders	169	99.37	2.02	82.39	99.97	100
Minority Shareholders	114	86.87	28.31	0	99.41	100
Foreign Shareholders	10	61.12	22.45	29.64	56.09	100
Panel D: H-Share Firms						
All Shareholders	71	93.71	5.9	68.63	95.3	99.97
Minority Shareholders	30	75.04	34.01	2.47	92.1	99.99
Foreign Shareholders	61	57.01	26.29	7.6	51.29	100

For Panel A, "All Shareholders*" denotes the total number of shares of the shareholders who voted for the amendment proposal divided by the total number of all outstanding shares presented.

"Minority Shareholders**" denotes the total number of minority shares of the shareholders who voted for the amendment proposal divided by the

97. Lauren Yu-Hsin Lin, Excel Data Sheet [hereinafter Lin, Dataset] (summarizing Author's hand-collected data).

98. *Id.*

99. *Id.*

total number of outstanding minority shares presented; "minority shares" refers to shares not held by directors, supervisors, managers, or substantial shareholders who hold more than 5% of shares.

And, "Foreign Shareholders***" denotes the total number of foreign shares of the shareholders who voted for the amendment proposal divided by the total number of outstanding foreign shares presented; "foreign shares" refers to B-shares and H-shares. B-shares are shares traded in foreign currencies on Chinese stock exchanges and held by non-mainland Chinese residents, and H-shares are shares traded in Hong Kong dollars on the Hong Kong Stock Exchange.

Interestingly, minority and foreign shareholders in POEs do not object as much as their counterparts in SOEs (Panel C). On the contrary, the average approval rates of minority and foreign shareholders in POEs are 11.61% and 9.01% higher, respectively, than those in SOEs. This result may seem odd at first glance, given that POEs are not obligated to establish corporate party organizations and political interference does not benefit POE shareholders. At least two plausible explanations exist. First, since these POEs initiated the amendment proposals voluntarily, the incumbent boards—if they foresaw objections from outside shareholders—likely explained the benefits of passing the amendments and negotiated with them beforehand to win their votes. Otherwise, the board would not have proposed the amendments in the first place. Second, an empirical study on the contents of the amendments showed that the provisions adopted by POEs are mostly symbolic, such as stating that the firm will follow the constitution of the CCP, establish corporate party organizations, and provide financial support for party activities.[100] In most cases, the party-state had no real power over the decision-making and management of POEs after the amendments. While Chinese POEs may benefit economically from staying close to the party-state in the distinct institutional environment in mainland China, it would be rational for outside shareholders to support symbolic party-building amendments.[101]

Panel D shows the voting results of sample firms that list their shares on Hong Kong Stock Exchanges (H-share firms). Firms that list in Hong Kong have more foreign shareholders than other A-share listed firms. It is generally agreed that foreign shareholders, particularly foreign institutional shareholders, are more professional, more sophisticated, and place more value on corporate governance. Therefore, we should expect a lower approval rate in H-share firms. Indeed, the overall approval rate for H-share

100. Lin & Milhaupt, *Party Building*, *supra* note 8.

101. *See* Milhaupt & Zheng, *supra* note 7, at 688–700 (discussing the economic benefts of firms allied with political leaders).

firms is 93.71%, which is much lower than the 99% approval rate of firms in other categories. The minority approval rate is also lower than that of all samples but is consistent with that of SOEs, as most H-share firms are SOEs.[102] In contrast, the foreign shareholder approval rate in H-share firms (57.01%) is actually higher than that of all sample firms (52.95%) and of SOEs (52.11%). This is probably because the provisions adopted by H-share firms are more symbolic and less intrusive than those adopted by SOEs.[103]

In summary, the party-building amendments gained almost full support from shareholders. Given the much lower approval rates from minority and foreign shareholders, the data suggest that the high supporting rate is mainly driven by controlling shareholders (i.e., the state, in the case of SOEs). In fact, such extremely high supporting rates are not unusual in China. A study by Institutional Shareholder Services shows that the average approval rate for resolutions in shareholders meetings of mainland-listed companies from 2010 to 2013 was 99.3%, the highest among all other comparable jurisdictions.[104] The high approval rate suggests that corporate ownership in Chinese firms is concentrated (particularly in SOEs); foreign shareholders account for only a small minority of the shareholder base; and outside shareholders generally do not attend shareholder meetings to exercise their voting power.[105] In addition, even though charter-amendment proposals require two-thirds approval from attending shareholders, there is no quorum required for resolutions passed by shareholders under Chinese Company Law.[106] In fact, the average percentage of shares actually voting in shareholder meetings of mainland-listed companies from 2010 to 2013 was only 55.3%.[107] The voter turnout rate of mainland-listed companies is the lowest among listed companies in Hong Kong, France, the United Kingdom,

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102. In our sample, 69.31% of sample H-share firms are SOEs. *See* Lin, Dataset, *supra* note 97.

103. Lin & Milhaupt, *Party Building*, *supra* note 8, at 19 (showing regression results that show a significant negative correlation between cross-listing SOEs and the personnel index (personnel provisions are more politically intrusive provisions), suggesting that H-share firms (which are mostly SOEs) adopted less intrusive and more symbolic provisions to shield themselves from political influence).

104. Mainland China companies have the highest approval rate among companies listed in Hong Kong, France, United Kingdom, and United States. France has the lowest average approval rate of 93.7% from 2010 to 2013. INSTITUTIONAL S'HOLDER SERVICES, CHINA: INVESTOR STEWARDSHIP AN EXAMINATION OF VOTING AND ENGAGEMENT ACTIVITIES IN CHINA 10 (2014).

105. The QFII quota in China only accounts for less than two percent of the A share market. *Id.* at 11.

106. Zhonghua Renmin Gongheguo Gongsi Fa (中华人民共和国公司法) [Company Law of the People's Republic of China] (promulgated by Standing Comm. of the Nat'l's People's Cong., effective Oct. 26, 2018), art. 103; *see* also SHI TIANTAO (施天涛), Gongsi Falun (公司法论) [Corporation Law], 336 (4th ed. 2018).

107. INSTITUTIONAL SHAREHOLDER SERVICES, *supra* note 104, at 6.

and the United States.[108] Therefore, it is relatively easy for incumbent managers and controlling shareholders in China to control the results of charter amendments. Since minority shareholders rarely turn out to vote in China, the voting patterns of foreign institutional shareholders are worth exploring in the next Subpart.

C. Support from Foreign Institutional Shareholders?

Equity investments from foreign institutional investors are usually deemed a sign of good corporate governance and performance. With the growing institutional ownership in listed companies worldwide, institutional investors nowadays have greater power in directing the governance matters of listed corporations.[109] For Chinese firms, such influence is more prevalent in dual-listed companies in which foreign investors comprise larger portions of shareholders than in pure A-share listed companies. Even A-share listed firms heavily lobbied foreign investors before they proposed amendments for shareholder voting.[110] Some lobbying activities appeared to have been organized systematically by group-level SOEs and all levels of the

108. United States companies have the highest voter turnout rate of 86.5% in 2013, suggesting a much higher level of investor participation in the United States. *Id.* at 8.

109. Lucian A Bebchuk & Scott Hirst, *The Specter of the Giant Three*, 99 B.U. L. REV. 1, 13–15 (2019). Even though in the first quarter of 2019, foreign investors only accounted for 2.76% of the A-share market, Chinese stock market has speed up its pace in opening the market to foreign investors in recent years with Hong Kong-Shanghai connect, Hong Kong-Shenzhen connect projects, and inclusion of A-share companies in MSCI and Russell Index in 2018 and 2019. *Waizi Jiasu Liuru Qudong Agu cong "Sanhu Shi "Zhuanxiang "Jigou Shi* (外资加速流入 驱动 A 股从"散户市"转向"机构市) [*Accelerated Flow of Foreign Capital Drives A-shares to Shift from Individual-based to Institutional-based*], XINHUA NEWS AGENCY (June 27, 2019), http://www.xinhuanet.com/fortune/2019-06/27/c_1210171463.htm.

110. For example, Bank of Shanghai communicated with foreign shareholders before a party-building charter amendment and received almost unanimous consent in the vote for amendment. *Shanghai Yinhang: Jiang Dang De Hexin Zuoyong Yu Gongsi Zhili Youxiao Ronghe* (*上海银行: 将党的核心作用与公司治理有效融合*) [*Bank of Shanghai: Effectively Integrate the Core Role of the Party with Corporate Governance*], ECON. DAILY (Apr. 20, 2018), http://finance.ce.cn/sub/ybnzt/gszl/jj03/201804/20/t20180420_28899383.shtml.

SASAC.[111] Some were instigated by firms themselves to obtain higher approval rates in order to outcompete their peers in this "political task."[112]

With strong lobbying efforts from the CCP, it would be interesting to see how foreign institutional investors responded. In theory, the effect of party-building amendments can be two-fold: (1) heightened monitoring from the party may restrain the misbehavior of SOE managers and thus reduce the agency costs of SOEs, and (2) enhanced political influence from the party may encourage enterprises to detour from maximizing shareholder interests to fulfill policy goals and thus jeopardize outside shareholders' welfare.[113] Foreign investors' decisions may also depend on the discrepancy between previous practices and the new proposals of specific firms. Presumably, foreign investors considered previous practices when they made their investments. All SOEs had party organizations in the past, but the level of party control in each SOE is different. It would be reasonable for foreign investors to agree on amendments that only reflect reality and nothing more.[114] After all, putting existing practices into writing enhances overall transparency.[115] However, if the amendment gives the party much more power on business decision-making than before—which can directly affect business strategies and efficiency—foreign investors are likely to vote against the proposal.

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111. For example, Lucion Venture Capital Group, a listed SOE, reported that they actively communicated with small-and-minority shareholders before the shareholders meeting under the instruction of Lucion Group and Shandong SASAC. AVIC Trust, an unlisted subsidiary of Aviation Industry Corporation of China (central SOE), also reported that they were instructed by the party committee of AVIC Group to actively lobby their largest strategic investor, OCBC Bank from Singapore, about a party-building amendment. *Lucion Venture Capital's Completed Party-Building Charter Amendment*, LUCION NEWS (Aug. 2, 2017), http://www.600783.cn/index.php?m=content&c=index&a=show&catid=37&id=355; *AVIC Trust: Blending Party into Governance to Ensure Correct Development Path*, FIN. NEWS (Aug. 7, 2017, 9:52 PM), http://www.financialnews.com.cn/trust/hyzx/201708/t20170807_122293.html.

112. Jennifer Hughes, *BlackRock and Fidelity Put China's Communists into Company Laws*, FIN. TIMES (Sept. 7, 2017), https://www.ft.com/content/e91270a8-9364-11e7-bdfa-eda243196c2c. For example, Bank of Shanghai talked to each institutional investor who holds more than 2 million shares before the shareholder meeting and finally obtained 99.97% approval in the official vote. Bank of Shanghai specifically mentioned in the news that they ranked highly in terms of approval rate among firms in the financial industry in Shanghai. *Shanghai Bank: Blending Party Leadership with Corporate Governance*, ECON. DAILY (Apr. 20, 2018), http://finance.ce.cn/sub/ybnzt/gszl/jj03/201804/20/t20180420_28899383.shtml.

113. *See* Lin et al., *Political Influence and Corporate Governance*, *supra* note 8 (discussing the impact of political intervention on SOEs through the lens of political and agency costs).

114. BlackRock treats the unique governance structure in China a country-level risk, which has already been taken into account when making Chinese investments. Hughes, *BlackRock and Fidelity, supra* note 112.

115. For example, Fidelity and the Asian Corporate Governance Association are of the opinion that the proposed amendments improve the transparency of a company's decision-making process. *Id.*

Proxy advisors generally oppose party-building amendments. Institutional investors usually refer to voting guidelines published by proxy advisors, such as Institutional Shareholder Services (ISS) and Glass Lewis, before making their voting decisions.[116] In general, these proxy advisory firms highlight two main issues about the amendments: transparency and accountability. In its voting guidelines for Chinese and Hong Kong companies, ISS generally recommends that institutional investors vote against amendments regarding corporate party organizations if the proposed governance structure lacks transparency and accountability.[117] ISS holds the view that most amendment proposals do not delineate the actual responsibility of the party committees compared to those of the board: giving rise to concerns over transparency and shadowing the supposedly highest decision-making authority of the firm—the board of directors.[118] ISS also points to the accountability issue of the party secretary and other committee members, who are not necessarily elected by the shareholders and not directly accountable to shareholders under corporate law and securities regulations.[119] In contrast, Glass Lewis recommends that investors make decisions on a case-by-case basis, and cautions against such amendments only if the board is to defer its decision-making power on material matters to the party committee.[120]

However, not all institutional investors follow proxy advisors' recommendations. The three largest institutional investors—BlackRock, State Street, and Vanguard—usually make their own voting decisions because they have the resources to do research into specific firms.[121] Index

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116. *See* Lucian A Bebchuk & Scott Hirst, *Index Funds and the Future of Corporate Governance: Theory, Evidence, and Policy*, 119 COLUM. L. REV. 2029, 2078 (2019) [hereinafter Bebchuk & Hirst, *Index Funds*] (showing that even though some of the largest institutional investors, such as BlackRock, State Street, and Vanguard, make their own decisions on voting, these large funds still subscribe to proxy advisors' services).

117. "Generally vote against proposals for article and/or bylaw amendments regarding Party Committees where the proposed amendments lack transparency or are not considered to adequately provide for accountability and transparency to shareholders." INSTITUTIONAL S'HOLDER SERVS., HONG KONG PROXY VOTING GUIDELINES 13 (Nov. 19, 2020), https://www.issgovernance.com/file/policy/active/asiapacific/Hong-Kong-Voting-Guidelines.pdf.

118. *Id.* at 13–14.

119. *Id.*

120. *See* GLASS LEWIS, GUIDELINES AN OVERVIEW OF THE GLASS LEWIS APPROACH TO PROXY ADVICE: HONG KONG 16 (2020), https://www.glasslewis.com/wp-content/uploads/2016/12/Guidelines_HONG-KONG.pdf ("We may consider recommending a vote against the article and/or bylaw amendments in cases where there is clear evidence of the board letting Party Committee make material decisions, as party committee's members are not elected by shareholders and thus are not accountable to shareholders.").

121. Bebchuk & Hirst, *Index Funds*, *supra* note 116, at 2078; Ryan Bubb & Emiliano Catan, *The Party Structure of Mutual Funds* 3–4 (Eur. Corp. Governance Inst., Working Paper No. 560, 2020).

funds generally defer to management proposals when voting.[122] Regarding party-building amendments, BlackRock, Fidelity, and Schroders chose to back management and vote for the amendments.[123] This appears to be the result of enhanced mutual communication—active lobbying from SOEs as well as shareholder-engagement efforts from large institutional investors.[124] These large institutional investors believe that such amendments promote the best interests of their clients and potentially enhance transparency, given that such practices have existed for a long time.[125]

III. ANALYSES AND IMPLICATIONS

A. A Political Renegotiation Process

A key issue that party-building and other SOE reforms attempted to address is the insider-control problem. As illustrated in Part I, managerial control is a common, long-standing issue in the privatization and corporatization of SOEs. One reason for managerial control in SOEs is that the state, as a controlling shareholder, is an empty entity that relies on chains of agents, that is, government officials, to carry out its function.[126] Chinese SOEs suffer from a serious principal problem in which the state, as a controlling shareholder and principal, cannot effectively monitor SOEs.[127] The misalignment of interests between the state (as the principal) and government officials (as agents) is the key to the problem.[128] In the past, Chinese SOEs were supervised by ministries supervising relevant business operations. To consolidate state control and avoid conflicting views from different ministries, a single ownership entity for all SOEs, the SASAC, was

122. *See* Bebchuk & Hirst, *Index Funds*, *supra* note 116, at 2138 (acknowledging the extreme deference to corporate managers).

123. Hughes, *BlackRock and Fidelity, supra* note 112.

124. *Id.*

125. *Id.*

126. Donald Clarke, *The Role of Non-Legal Institutions in Chinese Corporate Governance*, *in* TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 168, 179–80 (Hideki Kanda et al. eds., 2008); Nan Jia et al., *Public Governance, Corporate Governance, and Firm Innovation: An Examination of State-Owned Enterprises*, 62 ACAD. MGMT. J. 220 (2019).

127. Nicholas Calcina Howson, *Quack Corporate Governance as Traditional Chinese Medicine-the Securities Regulation Cannibalization of China's Corporate Law and a State Regulator's Battle against Party State Political Economic Power*, 37 SEATTLE U. L. REV. 667, 692 (2014); Yingyi Qian, *Enterprise Reform in China: Agency Problems and Political Control*, 4 ECON. TRANSITION & INSTITUTIONAL CHANGE 427, 429 (1996).

128. Donald Clarke, *Corporate Governance in China: An Overview*, 14 CHINA ECON. REV. 494, 499 (2003).

established in 2003.[129] While the SASAC has been the legal owner of Chinese SOEs for almost two decades, its power is still limited. For example, even though it has the formal power to appoint SOE executives, the appointment decisions are in fact made together with various party organs and ministries that supervise relevant business operations.[130]

Aside from sharing power with other government/party organs, the SASAC also has limited influence over central SOE managers because of the deep linkage between the government/party and business in China. Senior corporate leaders commonly rotate among business groups as well as between government/party and business.[131] There is even a routine exchange of personnel between the SASAC and central SOEs.[132] While SASAC officials and central SOE managers are under the same training and rotation scheme as elite leaders, it is hard to imagine that monitoring from the SASAC would be as effective as the monitoring from controlling shareholders over managers of private corporations. Furthermore, the CCP follows the *nomenklatura* system to appoint SOE managers. Central SOE managers can obtain ministerial or vice-ministerial ranks, which might be equivalent or even higher than the rank of an SASAC official.[133] One study showed that the Chinese government has frequently failed to implement major policy decisions in central SOEs.[134] As a result, insider control still exists in Chinese SOEs, especially in high-level national ones. Even though the insider-control problem is well recognized in the literature, we know little about how the problem applies at the firm level and the dynamics of managerial resistance to state control. The unprecedented party-building amendment exercise provides a unique opportunity to empirically examine the scope of insider control and the complex interaction between SOE managers and the state.

I postulate that the party-building reform is actually a political-renegotiation and resource-redistribution process whereby the CCP rebuilds its power over SOEs by institutionalizing party organizations. In fact, party organizations were not actively involved in corporate management in the past. An empirical study showed that the "double entry, cross appointment" policy has never been effectively enforced: among the 344 listed SOEs from 2008 to 2010, only 18.8% of members of the board of directors, 13.7% of the

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129. Dishi Jie Quanguo Renmin Daibiao Dahui Diyi Ci Huiyi Guanyu Guowu Yuan Jiegou Gaige Fangan de Jueding (第十届全国人民代表大会第一次会议关于国务院机构改革方案的决定) [Decision of the First Session of the Tenth National People's Congress on the Plan for Restructuring the State Council] (effective Mar. 10, 2003), art. 1.

130. Lin & Milhaupt, *We are the (National) Champions*, *supra* note 33, at 737–38.

131. *Id.* at 740–41.

132. *Id.* at 726–27.

133. *Id.* at 738.

134. Milhaupt & Zheng, *supra* note 7, at 681–82.

board of supervisors, and 15.4% of the management overlapped with those of party organizations.[135] For the SOEs that the CCP was already firmly controlling, the CCP reaffirmed its dominant position by formally writing itself into corporate charters. For others in which the CCP's power was shaky, the charter amendments were renegotiation processes between SOE managers, key outside shareholders, and the CCP. The autonomy enjoyed by SOE managers may well become the obstacle facing the CCP when implementing the party-building policy. Hence, the writing-in process manifests a power struggle and a resource-reallocation process.

Data seems to support this conjecture. Of 1,108 adopting firms, 157 (14.16%) amended their party-building provisions more than once (Table 4). A charter amendment carries a high cost for a listed company and is not a trivial decision. Every charter amendment must be approved by a majority of the board and a supermajority (two-thirds) of the attending shareholders. Listed SOEs must disclose all meeting minutes and voting results to their shareholders and on the disclosure website. As a result, listed firms do not propose charter amendments lightly. These SOEs must have felt pressure from the SASAC or the CCP for them to consider submitting amendment proposals twice or even three times. Table 4 shows the changes in adopted provisions for firms that underwent multiple amendments. A total of 157 firms amended their charters twice, and another seven firms amended them three times. On average, the first amendment contained 3.65 of the eight provisions, while the second amendment contained 5.45 provisions, showing an increase of 1.8 provisions in the second amendment (Panel A). Most additions focused on personnel-related provisions, including double-entry cross appointment of the party cadre and top executives (32%), the principle of Party's authority over cadres (30%), the one-shoulder principle for chairmen and party secretaries (27%), internal party disciplinary committees (25%), and full-time deputy party secretaries (22%). A similar pattern exists in firms that amended their charters three times (Panel B). The second amendment added 2.14 provisions on average, and the third added 0.86. The second and third amendments also focused on personnel-related provisions. The numbers in brackets in Table 4 represent the changes in provisions from the previous amendment. All numbers are positive, suggesting that firms add more provisions rather than trimming them back in the second or third amendments.

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135. *See* Lianfu Ma et al., *Research on Governance Effects of China's State-Owned Companies' Party Organization—A Perspective Based on "Insiders Control"*, 8 CHINA INDUS. ECON. 82, 88–90 (2012) (discussing the impact of "cross appointment[s]" of party committee secretaries and deputy party secretaries on corporate governance).

These results have two implications. One is that even SOEs that are supposedly firmly controlled by the CCP by equity rights are reluctant to allow it to step into management and personnel decisions. After modernizing SOEs, giving autonomy to professional managers has been recognized as a best practice. In practice, the influence of the party committee over management has faded over time. That is why even the SASAC has published model provisions that contain a panoply of provisions; the SOEs adopted only a minimal number in their initial amendments. It is plausible that the initial amendments reflected the reality of the party committee's role in these firms. When the SASAC presses for more intrusive provisions, SOE managers and outside shareholders renegotiate their respective power in the firm throughout the writing process. Those in strategic industries where the CCP needs a tighter grip have little room for negotiation. Conversely, firms with substantial outside shareholders have a better chance of resisting CCP intrusion. After all, the party's political call is still subject to shareholder votes and bound by the norms of corporate law and governance.

Table 4: Changes in Adopted Provisions for Firms with Multiple Amendments[136]

Panel A: Firms amended twice										
	N	Index8	P1	P2	P3	P4	P5	P6	P7	P8
1st Amendment	157	3.65	0.82	0.7	0.27	0.48	0.61	0.39	0.22	0.17
2nd Amendment	157	5.45	0.97	0.85	0.39	0.78	0.86	0.71	0.49	0.39
(2nd–1st)			-0.15	-0.16	-0.12	-0.3	-0.25	-0.32	-0.27	-0.22
Panel B: Firms amended three times										
	N	Index8	P1	P2	P3	P4	P5	P6	P7	P8
1st Amendment	7	3.57	0.86	0.71	0.57	0.29	0.57	0.29	0.14	0.14
2nd Amendment	7	5.71	0.86	0.71	0.57	0.71	0.71	0.86	0.57	0.43
(2nd–1st)			0	0	0	-0.43	-0.14	-0.57	-0.43	-0.29
3rd Amendment	7	6.57	1	0.86	0.57	1	0.71	1	0.86	0.57
(3nd–2nd)			-0.14	-0.15	0	-0.29	0	-0.14	-0.29	-0.14

Note: The definition of each provision is as follows: P1: Provide Support for Party Activities; P2: Prior-Consultation Procedure of the Board; P3: Prior-Consultation Procedure of Management; P4: Principle of Party's Authority over Cadres; P5: Establish Corporate Party Disciplinary Committee; P6: Double Entry, Cross Appointment (Cross Appointment of

136. *See* Lin, Dataset, *supra* note 97.

Members in Party Committee and Board of Directors); P7: One-Shoulder Principle for Chairman and Party Secretary; and P8: Full-Time Deputy Party Secretary.

B. Characteristics of Resisting SOEs

Besides initial evidence of managerial resistance to enhanced party control, it is also crucial to know the profiles of the firms that underwent multiple amendments. The characteristics of resisting firms help map the contours of power distribution among the party, state, and business. To that end, I estimate the following logit regression specifications:

$$MultiAmend_{SOE} = \alpha + \beta_1 Index + \beta_2 Central\ SOE + \beta_3 Cross\ List + \beta_4 State\ Share + \beta_5 External\ Share + \beta_6 ROA + X_{it} + \varepsilon_i$$

The dependent variable is a dummy that takes the value of one if an SOE underwent more than one amendment relating to party-building provisions; otherwise, the dependent variable takes the value of zero. The major explanatory variables for the logit regression include the total index of party-building provisions (*Index*), whether the firm is a central SOE (*Central SOE*), whether the firm cross-lists on foreign stock exchanges (*Cross List*), direct state shareholding (*State Share*), ownership of external shareholders measured by shareholding of top 2–10 shareholders (*External Share*), and profitability measured by return on assets (*ROA*). X_{it} indicates common controls on firm age, firm size, and leverage ratio. I also include industry fixed effects where appropriate.

Table 5 presents the regression results. First, to know what types of provisions firms resisted the most, Models (1) and (2) use the total index as the explanatory variable, which adds up eight party-building provisions; Models (3) and (4) examine two sub-indices—the decision-making power index (P2+P3) and the interlocking party-personnel index (P4+P5+P6+P7+P8)—and Models (2) and (4) include industry fixed effects. The results show that even after multiple revisions, multiple-amendment SOEs still adopted much fewer provisions than other adopting SOEs. Models (1) and (2) show that *Index* is negatively correlated with multiple-amendment SOEs and significant at the 1% level. In particular, multiple-amendment SOEs resisted adopting interlocking party-personnel provisions the most. The Interlocking Party Personnel Index is negative and significant at the 1% level in Models (3) and (4), which is consistent with the preliminary summary statistics from the previous section, which showed that provisions added in latter amendments mostly concerned personnel control.

Second, resistance seems to come from central SOEs rather than local SOEs. *Central SOE* is positively correlated with the multiple-amendment dummy and significant at the 1% level across all models. Our previous analysis shows that the SASAC and central SOEs have routine personnel exchange, and the elite leaders in both organizations share similar ranks in the administrative or party hierarchy. With dominant market power mostly in strategic industries, central SOEs are the crown jewels of the Chinese economy and at the center of political power.[137] With the political assets of the insiders of central SOEs, central SOEs have more resources and political power to resist political intrusion from the CCP than local SOEs.

Finally, resisting SOEs tend to be firms that do not cross-list on foreign stock exchanges and are less profitable. *Cross List* is negatively and significantly correlated with the multiple-amendment dummy at the 1% level in all the models, while *ROA* is only significant at the 10% level. In China, cross-listing is not a firm decision but a state decision: the Chinese government chooses which SOEs can list their shares on foreign exchanges.[138] Profitability is, of course, only one criterion. As the insider-control problem indicates higher risks in managerial tunneling and thus lower firm profit, the fact that resisting SOEs have lower ROA ratios implies that resisting SOEs are less efficient in business operations and potentially suffer from managerial tunneling.

In sum, this Article finds that resisting SOEs tend to be large, nationally important central SOEs where managers have the political status and rank to resist orders from the SASAC or the party. However, the fact that these resisting SOEs are not the more profitable, internationally presentable ones shows signs of managerial tunneling possibly resulting from insider control. However, the evidence presented here is only preliminary.Further research is

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137. In 1995, the Chinese central government implemented a new SOE reform named "grasping the large, letting go of the small" (*zhuadafangxiao*). *Correctly Handling Several Important Relationships in Socialist Modernization—-Speech of Present Zemin Jiang at the Closing of the Fifth Plenum of the 14th CPC Central Committee (Part Two)*, COMMUNIST PARTY OF CHINA (Sept. 28, 1995), http://cpc.people.com.cn/BIG5/64162/64168/64567/65397/4441712.html#. Large SOEs in key industries, those with high profitability and that serve the public interest, were retained and reorganized, while a significant number of small ones went bankrupt or private. Ross Garnaut et al., *Impact and Significance of State-Owned Enterprise Restructuring in China*, 55 CHINA J., 35, 37–38 (2006). After a series of restructuring, public offering of shares, and employee stock plans, SOEs' efficiency and competitiveness were significantly enhanced. *Id.* at 41–42, 60. For discussion on "*Zhuadafangxiao*," also known as "*Gaizhi*," see, e.g., Song, *State-Owned Enterprise Reform in China, supra* note 14, at 356; Ross Garnaut et al., *Impact and Significance of State-Owned Enterprise Restructuring in China*, 55 CHINA J. 35, 41–42, 60 (2006).

138. *See* CARL E. WALTER & FRASER J.T. HOWIE, PRIVATIZING CHINA: INSIDE CHINA'S STOCK MARKETS 109 (2nd ed. 2011) (describing the state role in identifying and approving the selection of companies).

warranted to draw a better picture of the dynamics of corporate ownership and control in Chinese SOEs.

Table 5: Logit Regression on Characteristics of Multiple-Amendment

	(1)	(2)	(3)	(4)
	Dependent Variable:			
	Dummy for multiple amendments			
Index	-0.148***	-0.152***		
	(0.049)	(0.050)		
Decision-Making Power Index			-0.046	-0.053
			(0.133)	(0.135)
Interlocking Party Personnel Index			-0.173***	-0.175***
			(0.057)	(0.058)
Central SOE	0.922***	0.951***	0.948***	0.978***
	(0.193)	(0.202)	(0.197)	(0.206)
Cross List	-3.118***	-3.204***	-3.140***	-3.224***
	(1.057)	(1.063)	(1.058)	(1.065)
State Share	0.006	0.005	0.006	0.005
	(0.005)	(0.005)	(0.005)	(0.005)
External Share	0.002	0.003	0.003	0.004
	(0.008)	(0.009)	(0.009)	(0.009)
ROA	-3.467*	-3.421*	-3.384*	-3.332*
	(1.904)	(1.970)	(1.895)	(1.958)
Firm Age	-0.005	0.002	-0.004	0.002
	(0.019)	(0.020)	(0.019)	(0.020)
Firm Size	0.162*	0.164*	0.159*	0.160*
	(0.084)	(0.088)	(0.084)	(0.088)
Leverage	-0.812	-0.638	-0.782	-0.609
	(0.584)	(0.616)	(0.583)	(0.615)
Constant	-4.438**	-4.420**	-4.599**	-4.584**
	(1.833)	(1.979)	(1.838)	(1.985)
Industry FE	No	Yes	No	Yes
Observations	874	867	874	867
Pseudo R^2	0.069	0.075	0.069	0.075

Standard errors in parentheses

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

C. Other Corporate Governance Concerns

Inserting party-organization provisions into corporate charters and institutionalizing party leadership in modern corporations is unprecedented. Given the history of the single-party state and the CCP's long-standing influence and control over Chinese SOEs, it is important to clarify the party organization's power and accountability, as opposed to that of the board of directors, in modern Chinese SOEs. The current approach raises at least four major concerns in SOE corporate governance. First, the prior-consultation provision can be treated as a different kind of control-enhancing mechanism, like dual-class shares and the pyramidal ownership structure.[139] As mentioned, party-building reform was carried out against the backdrop of the mixed-ownership reform. Party-building can ensure the CCP's continued control over SOEs, even after introducing substantial private investment.

The effect of the prior-consultation procedure is similar to that of *golden shares*, whose holders usually have veto rights over certain matters. Golden shares were originally used by the British government to control state business in the process of SOE privatization and were later adopted in various European countries.[140] Both the Chinese prior-consultation procedure and British golden shares detach a special shareholder's economic rights from their control rights and grant said shareholder disproportionate or excessive control rights compared to their economic rights. The discrepancy between economic rights and control rights could lead to opportunistic behavior on the part of such special shareholders. Since both golden shares and the prior-consultation procedure apply only to state shareholders, the focus must be on these rights and powers being used only in the public interest and being commensurate with their corresponding economic rights.

These two concerns are reflected in the design of the party-building reform. As already mentioned, party building is a reform bundled with mixed ownership reform. The Guiding Opinions categorized SOEs into two types

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139. *See* Yu-Hsin Lin, *Controlling Controlling-Minority Shareholders: Corporate Governance and Leveraged Corporate Control*, 2017 COLUM. BUS. L. REV. 453, 456 (2017) (highlighting how the control-enhancing mechanisms can provide shareholders with disproportionate control).

140. Alice Pezard, *The Golden Share of Privatized Companies*, 21 BROOKLYN J. INT'L L. 85, 85 (1995); Guido Ferrarini, *One Share - One Vote: A European Rule*, 3 EUR. CO. AND FIN. L. REV. 147, 168 (2006); Larry Cata Backer, *The Private Law of Public Law: Public Authorities as Shareholders, Golden Shares, Sovereign Wealth Funds, and the Public Law Element in Private Choice of Law*, 82 TUL. L. REV. 1801, 1814 (2008); Bernardo Bortolotti & Mara Faccio, *Government Control of Privatized Firms*, 22 REV. FIN. STUD. 2907, 2907 (2009); Gianluca Scarchillo, *Privatizations, Control Devices and Golden Share the Harmonizing Intervention of the European Court of Justice*, 3 COMP. L. REV. 1, 1 (2012); *see* Ginka Borisovaa et al., *Government Ownership and Corporate Governance: Evidence from the EU*, 36 J. BANKING & FIN. 2917, 2917 (2012) (providing a study of almost 400 companies from 14 European Union countries to test the impact of government ownership on corporate governance).

in planning the mixed-ownership reform: (1) public-interest SOEs (*gongyilei*) and (2) commercial SOEs (*shangyelei*).[141] The state maintains a controlling stake in the former while relaxing its stake in the latter.[142] Accordingly, party organizations/committees should have more say in public-interest SOEs than in commercial ones.[143] However, the CCP or central government does not have a clear ruling on which industries qualify as public-interest or commercial—they leave it to each local government to decide.[144] This creates confusion about what combinations of party-building provisions are required for each type. Two sets of model articles, one for public-interest SOEs and one for commercial SOEs, would clarify this. A sunset clause for commercial SOEs would also phase out party organizations when the state's shareholding drops below a certain level or if the nature of a firm changes from an SOE to a POE.

Second, the current charter-amendment approach lacks sufficient legal grounds to grant party organizations a formal role under the existing company-law framework. Even though the institution of party organizations was mentioned in the Company Law and the Corporate Governance Code for Listed Companies, the provisions therein only provide legal grounds for companies to establish party organizations but do not stipulate their respective power and responsibility compared to other governance institutions, such as boards of directors and supervisory boards. Detailed rulings with respect to the power of party organizations are party rulings rather than statutory laws.[145] Under the existing Company Law, the board of directors is still the highest decision-making authority, and the supervisory board is the monitoring organ. Leaving individual firms to write into their charters an institution with a power superior to that of the board of directors (i.e., the provision of the prior-consultation procedure) casts doubt on the legality of the amendment as well as the limits of corporate autonomy. This issue is especially acute for listed SOEs in which minority shareholders' interests are at stake.[146] The fact that state shareholders all voted on the amendment proposal deserves legal discussions about whether state

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141. Jiangyu Wang & Cheng Han Tan, *Mixed Ownership Reform and Corporate Governance in China's State-Owned Enterprises*, 53 VAND. J. TRANSNAT'L L. 1055, 1066–67 (2020).

142. 2015 Guiding Opinions, *supra* note 6.

143. *See* Sun & Xu, *Conflict and Coordination, supra* note 21, at 131–32 (noting that the party's roles in these enterprises differ, so the direction of reform should also be different); Liu Dahong & Xu Danlin, *The Approaches and Implementation Mechanism of the Party's Participation in Administering the State-Owned Enterprises Under the Circumstances of Classification Reform*, 23 J. CENT. S. UNIV. (SOC. SCL.) 31, 34 (2017).

144. *See* 2015 Guiding Opinions, *supra* note 6, at pt. 2, sec. 4.

145. *See* Part I.B (detailing the round of party rulings from 2013 to the present).

146. Mariana Pargendler et al., *In Strange Company: The Puzzle of Private Investment in State-Controlled Firms*, 46 CORNELL INT'L L.J. 569, 569, 588–89, 594 (2013).

shareholders should abstain from voting due to conflicts of interest and whether such alterations of articles oppress minority shareholders.

Third, the lack of clear legal guidance jeopardizes the role of an SOE's board as the highest decision-making authority. The 2015 Organisation for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of State-Owned Enterprises defined the role of the state as a shareholder and separated the state from the board to ensure full autonomy in SOE management.[147] An SOE's board should be composed to allow the exercise of objective, independent judgment and to limit political interference in board processes.[148] However, the Chinese Company Law does not provide guidance regarding the power and responsibility of party organizations,[149] nor do the party-building model articles published by the CCP. The provision of the prior-consultation procedure requires SOE boards to consult party organizations on "three important and one large" decisions but does not clarify the legal effect of the party organization's decision, nor does the party organization have to disclose its decisions or meeting minutes. The whole consultation procedure is a black box to outside investors. No accountability provision for the members of party organizations seems to exist, either. More problematically, each firm can stipulate their own charter provision, making it more difficult for outside investors to understand the division of power between party organizations and boards of directors. In theory, shareholders can bring shareholder litigation to court in the event of disputes about the power of party organizations. In reality, however, the chance that shareholders can clarify such doubts through shareholder litigation is slim given the weak institutional setting in corporate-law enforcement and judicial independence in China.

Finally, the current "voluntary" adoption approach misleads non-SOEs into sending political signals to the CCP by writing politically compliant provisions into corporate charters and thereby converting the corporate charter from a legal document into a political one. Stipulating party organizations in general statutes (i.e., Company Law and the Corporate Governance Code for Listed Companies) for all types of companies might not be ideal because such a regulatory approach confuses non-SOEs about the necessity and justification for establishing corporate party

147. According to the OECD Guidelines, the government should allow SOEs full autonomy and refrain from intervening in SOE management. OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES 18 (2015).

148. *Id.* at 26.

149. *See* Sun & Xu, *Conflict and Coordination, supra* note 21, at 132 (noting that Company Law directs party organizations to be conducted in accordance with the party constitution).

organizations.[150] Theoretically, only wholly state-owned or majority state-controlled firms must establish corporate party organizations and enhance their power under the party-building reform. In reality, as shown in Part II, 173 non-SOEs also adopted party-building provisions in their charters. A contextual analysis of the provisions adopted by these non-SOEs shows that most adopted provisions were simply symbolic and granted the party organization no real power over firm management.[151] Even though such symbolic adoption may help these firms capture political resources to their advantage, the adoption creates a confusing governance structure by writing party organizations into their charters without clearly defining their power or responsibility.

CONCLUSION

The party-building reform is an effort by the CCP to institutionalize its control over SOEs. The evidence and analyses presented in this Article reveal a great deal about the complexity and dynamics of corporate ownership and control in Chinese SOEs. This Article finds that foreign shareholders play limited roles in the corporate governance of Chinese SOEs, even in cross-listed firms. Although around half of foreign shareholders voted against party-building amendments, they could not block them because they held only minority shares. This could change in the near future, as China has been gradually opening up its capital market to foreign shareholders in recent years. Future research may explore the impact of foreign shareholders on Chinese SOE governance.

While the purpose of party-building reform is to address the long-standing insider-control problem in SOEs, this Article finds preliminary evidence that resistance from SOEs still suffers from insider control. Furthermore, resisting SOEs still adopted much fewer party-building provisions in their charters than other SOEs, even after multiple amendments. The political renegotiation between the CCP and elite SOE managers over crucial economic resources shows that even though resisting SOEs amended their charters to comply with party orders, the amendments themselves did not guarantee power shifting. The road ahead is still rough. Future empirical research is warranted to investigate the changes in decision-making and personnel appointment in firms that strengthened the power of the CCP in the party-building exercise and—most importantly—to investigate the

150. Chinese scholars have advocated for a separate statute for SOEs to better regulate party organizations. *Id.* at 131.

151. Lin & Milhaupt, *Party Building*, *supra* note 8, at 19.

changes in managerial autonomy and its effects on SOE operational efficiency and performance.