

The Importance of Voting Trust for Securing Shareholders Protection in Chinese Corporations

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Abstract

The focal point of this paper is concentrated on identifying the problems faced by shareholders in the Chinese corporations due to the issues of shareholder activism; tunneling and other grave problems which are linked to the unwarranted incidents faced by corporations due to uncertain events. In doing so, this paper will shed light on the important corporate body such as, voting trust system the adoption of which, has already proven its worth in the corporate sectors of other developed countries. Hence, it is discussed in the paper as to how the inclusion of same mechanism could work as a solution for shareholder protection in the Chinese Corporate sector which could potentially assist China in becoming the top corporate player of today's modern corporate world.

Keywords: voting trust, shareholders abuse, minority shareholder protection, shareholders activism, company law

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1. Introduction

Since China has initiated to open up, it has experienced massive economic growth however, simultaneously it has brought many concerns for the country, in shape of abuse from both, the managers and majority shareholders conjointly, which has caused numerous problems for the country.¹ Since, the shareholders always have a role to play in China likewise, the shareholders evolution took more than 150 years in Chinese history starting from “Qing Dynasty” which initially empowered the private sector and then, comes the second phase under which the government was headed towards the nationalization which then leads towards the era where China was finally turned into (PRC) Peoples Republic of China. However, despite, going through several changes from time to time, one thing which remains constant in China was the shareholders always had a role to play in the corporate system of the country.²

Simultaneously, in the case of China the shareholders which holds major shares; or were institutional investors, were seen putting major influence on the company in several ways for instance, the institutional shareholders have the authority to exercise their vote of veto if they feel that any decision is contrary to their interest. Secondly, the major investor can also impact the decision making in different ways such as by proposing a name of director of the company. Besides, there is another way through which the institutional investors can use their influence over the corporation by contacting and directing the superior officers to act according to their will. Hence, these are few of those numerous methods through which the mighty institutional investors use influence over the whole corporation.³ In China the category of shareholders could only be ascertained by looking at the kind of shares which they hold, in the corporation. The Chinese corporate system mainly provides for three categories of shares: which lists as: (1) The state-owned shares: These are such shares which are owned by the state itself. On the contrary, the other type of shares is called (2) The Trading shares which are issued by the corporations, and they are open for sale to all individuals. And then comes the third type which is called corporate shares which are owned by the corporations; or in some instances by the state - owned institutions.⁴ However, the former type could only be bought by those entities which are either part of the state; or are either those entities which are authorized by the state to act on its behalf. In China, the shareholders are the main body in Chinese corporate system, just like in other corporate sectors specifically, when if he/she is a controlling shareholder. As the controlling shareholders controls the whole corporation in their hands by holding around fifty percent of shares in the limited liability company. They therefore, are in a position to influence the entire mechanism of corporation due to their lions share.⁵ On the other side, it has been argued in the past that, the shareholders are often found over exercising their authority in China. The article published in 2015 described

¹ See Shaowei Lin, Non-legal Protection for Minority Shareholders in China, Journal of Cambridge Studies, Volume 7, No. 3, 2012 available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447094.

² See Min Yan, “Evolution of the Corporation and Shareholders Role in China”1, 12-13 (2015) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948022.

³ *Ibid.*

⁴ See Board of Supervisors and stakeholders available at <https://www2.deloitte.com/cn/en/pages/risk/solutions/cg-supervisory-committee-and-shareholders.html>.

⁵ *Ibid.*

the details regarding shareholders over influence on the corporations under which the author gave references of around 300 court judgements to justify his claim. The findings of which reflected that huge number of shareholders have been sued by the corporation under article 20 of the company law of China and the findings were quite grave as they showed around 75 percent of shareholders were charged with debt claims by the corporations.¹

1.1. Detailed reflection of shareholders role in China from past

As the first Chinese company law was promulgated in 1904 during the period of “Qing dynasty” the only purpose behind the promulgation of this law was to provide a friendly environment to shareholders through which the private investment could be attracted in China.² However, where the promulgation of this new law worked as beneficial for shareholders. Similarly, it was not as fruitful for other entities because in this law the rule of limited liability was introduced for the first time which was never available to the shareholders earlier. This increased the sense of protection amongst shareholders and they started to feel more secure than earlier, because in the case of any loss they were aware that, they might only bear a minimal loss which appears far from what they could have inflicted before the promulgation of the new law.³ Hence, where this law had opened the doors of hope for shareholders on one side; on the other side it had created some hurdles for the government because the government was in no position to interfere with the legal matters on its own. Thus, the same turned the shareholders as whole and sole authority and the traditional role of the government was substituted from the corporate sector.⁴ However, after 1927, the state once again initiated to take the command into its hands after the charge was taken up by the Nanjing government which is often mentioned as the rise of bureaucracy and decline of bourgeoisie in the history books and then, after comes the era of nationalization of companies in China.⁵ After the inception of Sino-Japanese war in 1937, the country was in dire need of nationalization the statistics showed in one year alone from 1942-1943 the state had controlled 70 percent of the total capital of China at that time.⁶ However, when that era ended a new era of Chinese history was about to start from (1949-1983) during this period the (C.P.C) Chinese communist party took the charge of entire China and the people’s republic of China came in to existence thereby in (1949).⁷ This paves the way towards the establishment of first constitution of China under which the structure of the country was based on the ideology of communism/socialism and the ownership was divided into two categories (1) The ownership belonged to state, i.e. Ownership by the entire people (2) Collective ownership by general working class⁸ within the state. However, the private ownership was entirely abolished during the transitional period and in three decades duration the ownership was entirely hold by the state and the state-owned enterprise (SOE). In short the complete control of management and operation was entirely shifted into the hands of the state in that phase.⁹ Under the planned economy system every segment including resource allocation, investment; consumption distribution; production and every other important element was planned by the state. However, after the end of this era a new period was started in China from 1982-1992 under this period in October 1984 the 12th national congress determined the economic structural reforms. Where the role of market was recognized for the first time in the history of country and likewise, the responsibilities for tackling (SOPE’S) was given back to the companies and the government was barred from interfering with management of the SOEs. The economic structural reforms introduced another important reform in shape of management contract under which the profits and fees was required to be paid to the government and in case if the profits exceeds the target then the same was supposed to be divided amongst the government and the SOES management team. The logic behind this sort of contract was to keep the management separate from the ownership and it was this way the state becomes the owner of shares and the managers were able to have an independent operational powers through which they could run the enterprise independently.¹⁰ Since then, the stock markets were initiated to operate in the country and by 1990. The shanghai stock exchange and Shenzhen stock exchange were thereon established and in the same year the China security regulatory commission (CSRC)

¹ See Colin Hawes, Alex K.L. Lau & Angus Young Lifting the Corporate Veil in China: Statutory Vagueness, Shareholders Ignorance and Case Precedent In a Civil Law System Journal of Corporate Law studies V.15 (2015) available at <https://www.tandfonline.com/doi/full/10.1080/14735970.2015.1057965>.

² See Min Yan, *supra*.n.2.

³ See *id.* at 3.

⁴ See William Goetzmann and Elisabeth Köll The History of Corporate Governance around the World: State Patronage, Company Legislation, and the Issue of Control (2005) available at <https://www.nber.org/chapters/c10269.pdf>.

⁵ See Marie-Claire Bergère, The Golden Age of the Chinese Bourgeoisie, 1911–1937 p.272 (Cambridge: Cambridge University Press, 1989) available at <https://www.cambridge.org/core/journals/modern-asian-studies/article/golden-age-of-the-chinese-bourgeoisie-19111937-by-marie-claire-bergere-trans-janet-lloyd-cambridge-university-press-cambridge-1989-pp-x-356/22D2317A847AD3153ED18D1DD3B2FD43>.

⁶ See Jian Sun, Economic History of China 1840–1949 (Beijing: China People’s University Press) pp.1237–1240, (2000) available at <https://www.abebooks.com/Chinese-Economic-History-Modern-Section-1840/9423944696/bd>.

⁷ See Min Yan, *supra*. n.2 at 5.

⁸ *Ibid.*

⁹ *Ibid.*

¹⁰ See *id.* at 7

was also constructed in China.¹ Then comes the era between the end of 20th and the start of 21st century starting from (1993-2005), In 1993, the Chinese national congress promulgated its first company law under which the SOEs were granted the independent status and the private ownership was initiated to consider as an important tool for the whole economy.² This leads towards the amendment in constitution in 1999 under which the non-state sectors such as private business owners and other individuals constitutes an important segment of the socialist market economy.³ However, afterwards the law was again amended in 2005, and certain new amendments were introduced in the law such as the area of independent directors was made a legal requirement through the amendment. Similarly, the shareholders were given more forums and grounds to appeal.⁴ Moreover, another prominent change was made under this new amendment through which the new system of Chinese stock market was introduced in the law which was called split share system in which the state owned shares which were earlier nontrade were later changed into tradeable shares.⁵ Nevertheless, the same was stopped in the early 21st century after the experiment in Beijing and Tsinghua Tong fang along with three other listed companies and with a second group of 42 companies which requested to join the split share system. However, after wards the reforms were extended to the rest of domestically listed companies by the end of 2005.⁶ It obvious that the split share system was very beneficial for the capital market. Therefore, it is understood from the recent history that the constant reforms in past decades has not only improved the economic situation of the country in general. But, On the contrary, it has also assisted the entire corporate system to work efficiently and as well as it has given the opportunity of protection to the shareholders against the infringements of their rights.⁷

2. Main provisions of Law regarding shareholders in China

According to the recent amendment in the company law of China October 26th, 2018 there are several provisions which provides for shareholders in the company law. However, there are numerous articles which specifically talks about shareholders. Among those articles, Article 4 of this law states that the shareholders shall take all due benefits and shall also take their due share and shall make all the important decisions such as electing managers.⁸ On the contrary, the Article 42 and 43 of the company law of China specifically talks about the concept of voting of shareholders where by everything is explained in detail under these two articles however, Article 42 provides that the shareholders shall exercise their voting rights in the meeting according to their respective percentage of the capital contributions accordingly until and unless it is provided otherwise. Meanwhile, under article 43 the actual procedure of voting is provided under which it is explained that if there is any change made into the company during the shareholders meeting though a resolution in relation to the share capital or either for the revision of : bylaws, split, merger, dissolution or any kind of other change in the company then under such scenario such change shall only be adopted by the shareholders who are representing more than 2/3rd or more votes. These two sections are amongst two most important sections of the company law of China which causally relates to the concept of voting by shareholders in the company law of China.⁹

2.1. Importance of shareholders for smooth corporate progression

There is no denying that the Shareholders are very important for the smooth corporate progression it is due to the fact that they are basically the owners of the whole corporation as they guide the company towards implementing important decisions such as framing proper strategy matters related to finance; and as well as electing directors and other important board members.¹⁰ The importance of shareholders impact on business can be understood thoroughly when we look towards the divorce case of an American business tycoon Harold Hamm when he divorces his wife the stock of his company plunged right away after the divorce was finalized it was due to the fact that the investors were concerned about the future of the corporation which leads to the cause of huge plunge in his stock value.¹¹ It has been said that, the shareholders are like the center of corporate universe so the managers and board should revolve around them like an orbit this philosophy does make sense when we look towards several circumstances such as the money factor we know that, shareholders invest money into the corporation and in number of cases the corporations entirely rely on shareholders for their survival such as small

¹ See Min Yan, "Obstacles in China's Corporate Governance" 34 Company Lawyer 311, 318 (2011) available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2948044.

² See Min Yan, *supra* n.2 at 7.

³ See *id.* at 8.

⁴ See Company Law of China 2005 arts 54, 103, 152 available at <http://en.pkulaw.cn/display.aspx?cgid=e54c465cca59c137bdfb&lib=law>.

⁵ See Min Yan, *supra* n. 2 at 9.

⁶ *Ibid.*

⁷ *Ibid.*

⁸ See Company Law of The Peoples Republic of China (2018 Revision) available at <http://www.ghiplegal.com/laws/company.html>.

⁹ *Ibid.*

¹⁰ See Kathy Zheng "How shareholders Affect A Business" available at <https://yourbusiness.azcentral.com/shareholders-affect-business-8879.html>.

¹¹ See Effects of Business Decisions on Shareholders (2014) <https://study.com/academy/lesson/effects-of-business-decisions-on-stakeholders.html>.

or new companies.¹ Thus a slightest change or incident can sometime put a harsh impact on the whole corporation as the same happened in the case when Apples Co-owner and major shareholder Steve Job passes away in October 2011 and right after his demise the shares of apple company were dropped for about 0.2 percent just because of a single incident. This is an example which illustrates that, how much impact a single incidents could put on the whole business of corporation.² Besides that, a strong relationship between the investor and a corporation is also necessary for the swift business of company as the investors plays a vital role in the progress of company. It is therefore, very much important for the company that it should maintain a strong and transparent relation with its investors so that the company could also achieve its targeted goals such as : shareholder confidence, desirable financial targets and credibility for the future.³

2.2. Shareholder activism issue in China

In the case of China a very famous case arises due to the reasons of shareholder activism in China between *Vanke v Baoneng* in this case *Vanke* who is the biggest real estate tycoon in China was sued by the *Baoneng* which was a private owned property insurance company which was holding a minor share in the insurance company. However, he claimed that the CEO of *Vanke* is not paying reasonable annual profit which was still amounting to 7.5 million USD for that reason *Baoneng* increased his holding in the corporation by 25% meaning he becomes the major shareholder and started to threatened the management including the CEO to come to his terms as he is the major holder. however, the case was later-on settled through the government's intervention.⁴ Due to that reason the same cause has disrupted the natural balance of power in today's modern corporate world.⁵ The shareholder activism has been often termed as controversial and on number of occasions it has caused a lot of troubles due to the reason of extra ambitiousness which is the root cause of the collapse of the whole system.⁶ Similarly, the majority holders use numerosu tactics which could lead towards activism which is driven on the basis of personal gains such as the exit activism, it is a kind of activism strategy under which the majority shareholders threats to sell his shares so that the company's direction could be molded according to their will by using the threat of exit strategy this tactic is commonly termed as "wall street walk" in the language of corporate world.⁷ By doing so, the major shareholders are able to influence the entire managing body due to their overall impact their influence on the over all managing body including all the important entities. Hence when the major shareholders thinks any action is going against their choice or there is something which they don't agree to then under such circumstance they always comes up with the tactic of trimming their stake from the company.⁸ Nevertheless there is no wrong in becoming an active shareholder but becoming aggressively active could some time change its entire course in its entirety. Specifically, in this course when on several occasions the shareholder activism could entirely change the entire direction. Therefore, it has been viewed that such kind of activism devised on a plan which is solely driven under the diguise of ulterir motives the whole agenda of which is based on exploiting the rights of other shareholders.⁹ In the modern corporate universe the activism is exercised with the assistance of hedge funds under which the shareholders points out the weaker points in the company and they devise huge stakes in the company by influincing the management by dictating orders. It is therefore understandable that, how important it is for a corporate system to include a body like voting trust in the corporate sector¹⁰thereby the problems like activism could be restricted which eventually becomes fruitful for the entire corporate sector.¹¹

2.3. Tunneling Define

The tunneling is basically a phenomenon through which the owner of major number of shares transfers the assets of the company to the privately owned entities/firms in more simplified language we can say that the act of

¹ See Justin Fox & J.W Lorsch "What Good Are Shareholders" HARVARD BUSINESS REVIEW (2012) available at <https://hbr.org/2012/07/what-good-are-shareholders>.

² See Dan Burrows, Apple's Stock Dips After Death of Steve Jobs October (2011) available at <https://www.cbsnews.com/news/apples-stock-dips-after-death-of-steve-jobs/>.

³ See "Role of Investor Relations" available at <https://corporatefinanceinstitute.com/resources/careers/jobs/role-of-investor-relations-ir/>.

⁴ See An Ran, "The Battle of Ownership In Chinese Enterprise: Vanke" (2017) available at <https://cbk.bschoo1.cuhk.edu.hk/the-battle-of-ownership-in-chinese-enterprises-the-case-of-vanke/>.

⁵ See *ibid* (citing Davis & Thompson, 1994; Kahan & Rock, 2010).

⁶ See Marco Becht, Julian Franks, Colin Mayer, Stefano Rossi Returns to Shareholder Activism Evidence from a Clinical Study of the Hermes U.K. Focus Fund (2007) available at <https://www.academia.edu/people/search?utf8=%E2%9C%93&q=shareholder+activism+disadvantage>.

⁷ See Janet H. Marler, Christophe Faugère Shareholder Activism and Middle Management Equity Incentives Corporate Governance: An International Review, 2010, 18(4): 313–328 available at <https://onlinelibrary.wiley.com/doi/abs/10.1111/j.1467-8683.2010.00794> (citing Ryan & Schneider, 2002; Parrino et al., 2003).

⁸ *Ibid*.

⁹ See Donald Nordberg, Some Are More Equal The politics of Shareholder Activism (2009) available at <http://ssrn.com/abstract=1150130>.

¹⁰ See Maurice Finkelstein, *Voting Trust Agreements*, 24 MICH. L. REV. 344 (1926) available at https://heinonline.org/HOL/Page?collection=journals&handle=hein.journals/mlr24&id=373&men_tab=srchresults#.

¹¹ See Donald Nordberg, *supra* n.35.

enjoying benefits at the risk of minority shareholders is known as tunneling.¹ Tunneling is a type of problem which arises due to the conflict of major and minority shareholders in a corporation it is mainly driven on the basis of majority shareholders interest over the expense of minority shareholders.²

2.4. Tunneling issue in China

The tunneling issue lists among one of the most prominent issues faced by the current corporate sector of China it has been observed that the issue of tunneling raises mainly due to two reasons in China. First, when a large number of shares are held by few shareholders and secondly, when the minority shareholders have lesser protection. In such circumstances tunneling causes many problems.³ It was observed in the study which was conducted after collecting the data of ten years from Chinese corporations from 1996 to 2006 which revealed that the controlling shareholders were found having transferred massive amount of funds from the Chinese corporations which was directly linked to the tunneling.⁴ Moreover, studies in the past regarding listed companies reflects tunneling activities by controlling shareholders in the shape of corporate loans which were directly driven out from the public listed companies in China.⁵ It is a fact that, tunneling puts its impact collaterally on corporation and as well as on minority shareholders for instance it was turned out that the nonpayment issue by the original company to the listed company for the repaying of debt is the utmost reason why several listed companies were turning down their businesses.⁶ The data collected from the Hong Kong's listed companies and their controlling shareholders between the period of two years from 1998 to 2000 revealed major losses faced by both the minority shareholders and as well as by the firms due to similar cause.⁷ According to the past research in China it was viewed that the controlling shareholders hold almost 38.3 percent of absolute rights over shares on the listed firms which includes voting rights as well.⁸ Generally, the controlling shareholders enjoy absolute authority in the Chinese corporations and in most cases they even suggested the name of potential board members.⁹ However, when these members are nominated by controlling shareholders then naturally their sincerity lies with the majority holders which causes them to support the agenda of controlling shareholders in corporations. The past researches also suggested that the directors of the companies holds almost 40 percent of total board seats which is a clear reflection that how controlling shareholders can use their influence in making some very important decisions.¹⁰ Moreover, the controlling shareholders exercise their controlling rights in various forms of tunneling such as by utilizing opportunities, shifting of assets, and by enforcing loan guarantees.¹¹ It is indeed a fact that, board of directors often have very limited role to play in such kind of setups it is due to the fact that the actual control of firm is in the hands of controlling shareholders. Not only this, the controlling shareholders often name the directors and independent directors.¹² However, despite having these issues and the influence of large number of shareholders in corporation the major problems does not arise due to the confrontation between management and shareholder but it emerges due to the undue influence of major shareholders over minority shareholders.¹³ In the border aspect it is discovered that not only this effects the minor holders interest but on the contrary, it also impacts the growth of stock market.¹⁴ For further illustration, the reference of study which was carried out in 2008 is important for ascertaining the impact of these activities under which total eight economies of Asia were opted for study for this purpose and it was seen that the value of corporation is directly connected with the cash flow rights which is an explanation in itself as it showed that the large shareholder ownership has a viable effect and simultaneously this explains the adverse

¹ See Tunneling, February 2016, available at <https://economictimes.indiatimes.com/t/tunneling/articleshow/51194494.cms?from=mdr>.

² See Tunneling and expropriation, available at <http://finworld.wikidot.com/tunneling-and-expropriation>.

³ See Helen Wei Hu, Pei Sun "What Determines the Severity of Tunneling in China" Asia Pacific Journal of Management Volume 36, pp 161–184 March (2019).

⁴ See Guohua Jiang, Charles. M. C. Lee, Heng Yue Tunneling In China: The Remarkable Case of Inter Corporate Loans may (2008) available at https://haas.berkeley.edu/wp-content/uploads/2018/11/JLY_080530.pdf.

⁵ See Jun Chen, Wang Dong, Jamie Tong, Feida Zhang Corporate philanthropy and Tunneling: Evidence From China Journal Of Business Ethics Vol. 150 ISS.1, (2018) available at <https://search.proquest.com/docview/2050326156?pq-origsite=summon&accountid=15198> (citing Jiang et al. 2010).

⁶ See *ibid* (citing Aharony et al. (2010).

⁷ See *ibid* (citing Cheung et al. 2006).

⁸ See *ibid* (citing Claessens et al. 2000).

⁹ See *ibid* (citing Cullinan et al., 2012).

¹⁰ See *ibid* (citing Conyon & He, 2011; Firth et al., 2006a).

¹¹ See Min Zhang, Shenghao Ghao, Xinjiao Guan, Fuxiu Jiang Controlling Shareholder-Manager Collusion and Tunneling: Evidence From China Corporate Governance an international review 22(6) (2014) available at https://www.researchgate.net/publication/264427889_Controlling_Shareholder-Manager_Collusion_and_Tunneling_Evidence_from_China (citing Claessens, Djankov, Fan, & Lang, 2002; Fan & Wong, 2002; Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000).

¹² See *ibid* (citing Cullinan et al., 2012; Fan, Wong, & Zhang, 2007).

¹³ See Lei Gao, Gerhard Kling Corporate Governance and Tunneling: Empirical Evidence From China Pacific- Basin Finance Journal Vol.16 Iss:5 P 591-605 (2008) available at <https://www.sciencedirect.com/science/article/pii/S0927538X07000741> (citing Shleifer and Vishny (1986).

¹⁴ See *ibid* (citing Johnson et al., 2000b; Wurgler, 2000; Bertrand et al., 2002).

relationship between the rights of controlling shareholders and the market value.¹ When the controlling right of controlling shareholders surpasses the ownership in such a case the controlling shareholders have significant control over the listed company which paves a way for the majority shareholders to loot the company.² It was also pointed out that certain rights such as purchasing and selling of assets, and other transactional and managing rights of controlling shareholders over the listed company could likely be effected by the interest of standard and minor shareholders.³ Significant evidence suggests that the majority shareholders often found taking advantage due to the complex nature of structure of corporation which often results in the shape of personal benefits for majority shareholders over the interest of corporation through the tunneling process.⁴ It was further examined that when a number of majority shareholders are connected to each other than such connection often cause disadvantage to the company it is due to the fact that when number of majority shareholders are connected then under such circumstances the value of the company decreases naturally it is due to the fact that, when certain amount of shares are owned by some specific family then it is natural that the important positions in the firm will be held by the members of the same family which causes disadvantage to the corporation.⁵ Another important study conducted regarding the majority shareholders under which it was revealed that the major shareholders took huge amount of money through the inter corporate loans from several public companies in China during the period starting from 1996 till 2006. During that time big number of loans were either taken by the majority shareholders themselves or either through their representatives which proves that the corporate loan process of majority shareholders has become a strong platform for the majority shareholders to perform tunneling in China.⁶

2.5. Unwarranted Incidents and their impact on shareholders in corporate world

In today's modern world the companies face several issues from outside and as well as from inside of the company on daily basis including some ethical⁷ and non-ethical issues at the same time the ethical issues includes accounting frauds, harassment and discrimination at work, health and safety issue, and the issues related with technology and privacy.⁸ Besides that, there are some other problems which companies face from inside of the company in the shape of asset misappropriation by the employees and fake financial reporting by the top management these both fraudulent activities could easily leads a company towards total devastation.⁹ The ultimate result of such commissions could lead the company towards complete financial loss due to the constant leakage of money. Similarly, when the fraud is disclosed in such a scenario the company is faced with another problem which is the lack of public trust, since no body will be willing to invest in such an organization which is not safe for their investments. Moreover, whenever there is a commission of fraud in a company it also puts an impact on employees since it's an embarrassing moment for the employees who have been working there as it brings the stigma of fraud with itself which sticks to them even after when they resigned from a job.¹⁰ Recently, China saw a back huge fraud scandal from an insiders employee which resulted in drastic bearish trend in the stock price of several stocks and the same appears to have an impact on foreign investors reluctance from investing in the Chinese market.¹¹ It is a true that, number of organizations face fraud problems these days the global economic crime and fraud survey of 2018 states that 49 percent of organizations have reported that they have become prey to that issue which is very alarming but the actual figure could be even more higher.¹² Likewise, the recent report published in 2020 reflected around 47% of companies face fraud in past two years which makes it the second highest in two decades.¹³

¹ See Xiao Bao Song Monitoring or Tunneling by large shareholders Evidence From China Private Listed Companies China finance review International, vol.5 p.187-211 available at <https://doi.org/10.1108/CFRI-09-2014-007> (citing Claassen's et al (2002).

² *Ibid.*

³ See *Ibid* (citing Cheung et al. (2006).

⁴ See *Ibid* (citing Liu et al. (2008).

⁵ See *Ibid* (citing Wei et al. 2013).

⁶ See Wenting Chen, Shenmin Li, Crystal Xiaobei Chen How much control causes tunneling? Evidence from China China Journal of Accounting Research vol.10 (2017) 231-245 available at <https://www.sciencedirect.com/science/article/pii/S1755309116300429>

⁷ See The 5 Biggest Ethical Issues Facing Businesses available at <https://www.floridatechonline.com/blog/business/the-5-biggest-ethical-issues-facing-businesses/>.

⁸ *Ibid.*

⁹ See John Freedman, How Fraud Hurts You and Your Organization available at <https://smallbusiness.chron.com/fraud-hurts-organization-58563.html>.

¹⁰ *Ibid.*

¹¹ See [Sofia Horta E Costa](https://www.bloomberg.com/news/articles/2020-04-08/two-accounting-scandals-in-one-week-burn-investors-in-china-inc), Two Accounting Scandals In China In One Week Burn Investors Bloomberg April 7th (2020) available at <https://www.bloomberg.com/news/articles/2020-04-08/two-accounting-scandals-in-one-week-burn-investors-in-china-inc>.

¹² See Michael Volkov, The Growing Problem of Corporation Fraud (2018) available at <https://www.corporatecomplianceinsights.com/the-growing-problem-of-corporate-fraud/>

¹³ See Global Economic Crime Rates Remain High as Customer Fraud Continues To Rise PWC Global 2020 available at <https://www.pwc.com/gx/en/news-room/press-releases/2020/global-economic-crime-survey-2020.html>.

3. Voting trust and its advantages for Shareholders protection

The voting trust is a device under which a person known as trustor transfers his voting right in favor of trustee who thereon, becomes eligible to attend shareholders meeting and thereby becomes fully authorized to vote on behalf of trustor/shareholder or number of trustors/shareholders under the execution of such voting trust agreement.¹

The voting trust is an important device due to numerous reasons, as it not only secures the interest of beneficial owner/ trustor but simultaneously, it secures his actual lawful status as an owner as the beneficial owner still remains the holders of shares. The other advantage which the voting trust provides is when a trust is established the shareholders cannot just withdraw from the trust instead, they have to wait for the trust to expire at the date agreed upon. In the meantime, as the trustee is a properly designated trust organization/entity which is much stronger than just a mere agent therefore, the same cannot be just rescinded on the demand of an individual.²

The most beneficial thing about voting is that, as it is not controlled by the will of an individual alone since, it is comprised of a trustee who has been coupled with the authority by a pack of shareholders which makes it a much stronger instrument and the same cannot be manipulated by a single individual and in the meantime the trustee takes all decision which are in the better interest of the whole pack rather than a single shareholder.³ Hence, therefore, the voting trust provides a platform for the fragile and vulnerable minority shareholders a stronger protection against any misadventure on part of other entities such as major shareholders in corporation.⁴

3.1. Impact of merger on shareholders and voting trusts benefits in such juncture

Whenever, there is a merger of corporation it has been observed that it always has severe impact on the company's shareholders.⁵ Nevertheless, it is a debate-able point that which type of shareholders are impacted the most either the one which exercise merger or the one who are being acquired but one thing is very clear that in both situations one has to gain something and the other might have to suffer the consequences due to merger. The first and foremost thing merger does is it puts an impact on the value of shares on the both sides of market. However, with that being the case in number of instances it has been viewed that, most of the time under such scenario the value of the stock of targeted company's shareholders normally increases. On the other side, the value of the stock of acquirer decreases initially.⁶ Many studies have suggested in the past that the acquiring company's shareholders bear losses specifically, before the announcement of merger news.⁷ Similarly, in the case of freeze-out merger it is viewed that the majority shareholders buys the shares of minority shareholders and then it delists the whole corporation which naturally leads towards the ultimate outcome of freeze-out merger which relies on constraining the minority shareholders from keeping the shares in the targeted company so that the majority shareholder could keep up with the control of acquired company.⁸ However, to curb similar kind of situation the voting trust comes into action as a protective device for vulnerable shareholders.⁹ In merger cases it is often observed that the ultimate wrath of merger usually falls upon the shoulders of minority shareholders because in most situations the decision is taken by the top management and it is approved by the majority shareholders which normally let the minority behind as they lack higher stacks in the company. Simultaneously, when the company does not do well after the merger under such a juncture it is the minority holders who struggles the most naturally.¹⁰ It has been viewed that, the major shareholders often play their merger card on minority shareholder through freeze-out rule and whenever the majority shareholder senses any

¹ See J. Gordon Gose, "Legal Characteristics and Consequences of Voting Trusts", 20:3 WASH. L. REV. 129, 129 (1945) available at <https://digitalcommons.law.uw.edu/wlr/vol20/iss3/1/>.

² See Chen Yun-ying, Discuss on Voting Trust And Exertion Of Minority Shareholder Voting Rights Guizhou Radio and TV University, Guiyang 550004, China (2007) available at http://en.cnki.com.cn/Article_en/CJFDTOTAL-GGYS200701042.htm.

³ *Ibid.*

⁴ See Gary D. Burger, "The Voting Trust: California Effects A Barrier To A Rationale Law of A Corporate Control", STANFORD L. REV. 18(6) 1210, 1210-1220 (1966) available at https://www.jstor.org/stable/1227129?Search=yes&resultItemClick=true&searchText=voting&searchText=trust&searchText=impact&searchText=on&searchText=minority&searchText=shareholder&searchUri=%2Faction%2FdoBasicSearch%3FQuery%3Dvoting%2Btrust%2Bimpact%2Bminority%2Bshareholder%26amp%3Bfilter%3D&ab_segments=0%2F12b_100k_with_tbsub%2Fcontrol&seq=1#metadata_info_tab_contents.

⁵ See Aaron Marquis "What Happens to Stockholders When Business is Merged?" available at <https://smallbusiness.chron.com/happens-stockholders-business-merged-20901.html>.

⁶ *Ibid.*

⁷ See Neelam Rani, Surendra S. Yadav, P.K Jain "Impact of Merger and Acquisition on The Shareholders Wealth In The Short Run: An Event Study Approach" VKILPA Vol.40 Is:3 (2015) available at <https://journals.sagepub.com/doi/pdf/10.1177/0256090915600842> (citing Beitel et al., 2004; Corhay & Rad, 2000; Datta & Puia, 1995; DeLong, 2001; Doukas et al., 2002; Goergen & Renneboog, 2004; Houston, James, & Ryngaert, 2001; Mitchell & Stafford, 2000; Morck, Schleifer, & Vishny, 1990; Mulherin & Boone, 2000; Sirower, 1997; Walker, 2000).

⁸ See Elif Dalkir, Mehmet S Dalkir & Daron Levit Freeze-Out Mergers (2018) available at <https://corp.gov.law.harvard.edu/2018/09/25/freeze-out-mergers/>.

⁹ See Will Kenton, "Voting Trust" (2019) available at <https://www.investopedia.com/terms/v/votingtrust.asp>.

¹⁰ See M&A Critique, Impact of mergers on Small Investors Nov (2017) available at <https://mnacritique.mergersindia.com/mergers-impact-small-investors/>.

chance of resistance from minority shareholder then the majority shareholder uses the option of freeze-out clause through which the majority shareholders compels the minority shareholders to sell their shares. In the meantime, the majority shareholder uses chain of tactics to push minority shareholders to sell out their shares and such scheme includes the provision of dividend stoppage to the minor shareholders.¹ It is a fact, that the freeze-out issue has caused number of problems for the minority shareholders but in the meantime the same cause has enabled them to challenge the same in the court of justice. For instance, in the case between *Brayan v. Block Blevins, Inc.*, (5th Cir. 1974) the majority shareholder tried to exercise freeze-out but the minority shareholder who was functioning as corporate director in the corporation at that time surrendered its resignation as a protest against such move and challenged the same decision in the court of law on the ground of commission of fraud over the rights of the minority shareholders. The 5th circuit court of Georgia later on in its findings deliberated that there is no obvious business purpose for the majority shareholder and gave its verdict in favor of the minority shareholder stating that, there was no justification on the part of major shareholders which could justify such action as legitimate hence, the decision was given in favor of minority shareholder.² The merger also cost minority shareholders in several other ways like for instance when the company opts for merger then it normally goes for the swap of shares option under which it surrenders its own shares to the shareholders of company which it is about to acquire under the execution of merger.³ On the contrary, In such condition when the majority shareholders sell the targeted company at lower price then such act normally effects the interest of minority shareholders.⁴ Nevertheless, whenever any decision has been made on merger the only option which is left with the minority shareholders is to vote and follow such motion which compels them to be unwillingly dragged with the decision of the majority whether they like it or dislike the same.⁵ On the contrary, In some cases it has been seen that the majority shareholders pays specific amount set by the majority shareholders for buying the shares of the small shareholders occasionally the minor shareholders are found dissatisfied with the amount of money which they have been offered or paid by the major shareholders. Nevertheless, such decision could be challenged in the court but on the same time it can cause more pain and suffering for the minority shareholders.⁶ Meanwhile, in the case of China studies in the past regarding mergers and acquisitions reflected that the same does not really bring much benefits to the shareholders of acquired company; nor does the same necessarily impacts the company's performance in a positive way.⁷ Hence, in these circumstances the actual strength of voting trust could be used to protect the interest of both the corporation and as well as of minority shareholders from any take over maneuver's simultaneously.⁸

3.2. Monitoring bodies for shareholders in China and voting trusts significance for their execution

The Chinese security regulatory commission (CSRC) operates as a supervisory body for all the securities. Besides, it also monitors market behavior for securing the interest of shareholders of listed companies⁹ for achieving the same target in 2017 the Chinese security regularity commission (CSRC) launches the service establishment center for the purpose of safeguarding the interest of minority shareholders.¹⁰ The pilot scheme for minority shareholders is comprised of highly qualified professionals who are authorized to keep 100 A type shares in the respective pilot territories and are also authorized to operate as normal shareholder on behalf of the minority shareholders.¹¹ Likewise, when we look at the voting trust system it becomes more viable that it would be an ideal system for China because by its inclusion in the system we would not need to be dependent on any other bodies like service establishment center since, the voting trust system provides the same capacity to secure the interest of minority shareholders and as well as the range of protection which it provides extends to the entire

¹ See James Chen, Freeze Out (2019) available at <https://www.investopedia.com/terms/f/freeze-out.asp>.

² See The Big Chill: "Freezing Out" Minority Shareholders In Georgia Corporations (2003). available at <https://www.sgrlaw.com/ttl-articles/912/>.

³ See C.A Raksha Tripathi "What is The Impact of Mergers on Small Investors (2017) available at <https://www.quora.com/What-is-the-impact-of-mergers-on-small-investors>.

⁴ *Ibid.*

⁵ See Yogita Khatri "How Corporate Mergers and Acquisitions Impact Small Investors" (2017) Available at <https://economictimes.indiatimes.com/wealth/invest/are-mergers-and-takeovers-wealth-creation-opportunities-for-investors/articleshow/59606562.cms?from=mdr> (citing Sanjeev Krishan).

⁶ See Gardner, Steven. D A Step Forward: Exclusivity of The Statutory Appraisal Remedy for Minority Shareholders Dissenting from Going Private Merger Transactions 53 Ohio st. L.J Pg 239-241 (1992) available at https://heinonline.org/HOL/Page?collection=journals&handle=hein.journals/ohslj53&id=251&men_tab=srchresults.

⁷ See Ping Xiang, Lu Qu, The Influential Factors For The Performance of Chinese Enterprises' International Takeovers Cogent Economics & Finance Journal V.6 – Iss.1 2018 available at <https://www.tandfonline.com/doi/citedby/10.1080/23322039.2018.1442631?scroll=top&needAccess=true>.

⁸ See Maurice Finkelstein, *supra*.n.36.

⁹ See China's Security Regulatory Commission available at http://www.csrc.gov.cn/pub/csrc_en/about/.

¹⁰ See Xinhua China Moves to Protect Minority Shareholders (2018) available at <http://www.chinadaily.com.cn/a/201803/15/WS5aa94cb7a3106e7dcc141ad7.html>.

¹¹ See Raymond Shi China: Corporate Governance 2019 available at <https://iclg.com/practice-areas/corporate-governance-laws-and-regulations/china>.

corporate sector at large.¹

3.3. Proxy concept In China and world and voting trust as an alternative

The Code of Corporate Governance for listed companies provides for the concept of proxy the article 9 of the law provides that the shareholders could either vote by themselves by taking part in the shareholders meeting in person or either by appointing a proxy who could vote on their behalf in their absence.² The recent amendment in the securities law of China provides details regarding the rights of shareholders to appoint proxy who could attend the shareholders meeting and likewise, vote on behalf of shareholders under chapter 4 article 32 and article 59.³ Numerous changes has been seen under the new amendment which were missing under the previous law.⁴ However, despite recent amendments in the law there are still some lacunas which the proxy system could not address due to its fragile nature as they deem to expire on a certain date as mentioned under article 61 sub section 4.⁵ On the contrary, the case is entirely different with voting trust as they are more permanent in nature and operation.⁶ It often confuses people as to what the actual difference is between a proxy and a trust as they both include transfer of voting rights into an another person who could vote on their behalf. However, there is a clear difference in both as in the case of proxy the right to vote is transferred for a very limited time duration while in the case of trust the right to vote is transferred for a much longer period. In the meantime, the proxy is usually created for some particular voting while the trust is created for a longer period.⁷ Likewise, the shareholder are seen opting for the proxy option under those conditions when they are not available for voting under those circumstances the shareholders appoint an agent who could vote on their behalf. Meanwhile, in the voting trust when several shareholders delegates their voting right through a trust agreement into another person for the purpose of voting on their behalf then such an act of establishment of voting right is known as voting trust. The basic concept behind a voting trusts establishment is to make a block of fragile and vulnerable shareholders through which they could block any move which could harm their interest such as hostile takeover and other similar maneuvers.⁸ Whereas, the proxy is just used for the purpose of transferring of voting rights.⁹

3.4. Cases from the past justifying voting trusts validation

There are so many instances when people has challenged the validity of voting trust on the ground that it is against the public policy as the alleged that the trustee has acted in his own interest rather than the interest of owners or directors.¹⁰ However, this claim is observed to be untrue as the Massachusetts court later on gave its verdict involving the same matter and deliberated that whenever there is no element of foul play over the rights of minority “shareholders or creditors” under such scenario the same could not be considered as illegal even if the same accord has been in function for years and years.¹¹ There was a very famous case on the similar kind of issue which was contested between the *Carnegie Trust Co. and Security Life Ins. Co.*, in this cases it was decided that the trust agreement was established on the basis of consideration and the court decides that such consideration is enough for the validity of trust the significance of this case was the time duration of that trust as it extends to more than twenty five years. However, it did not considered it as against the public interest.¹² The same allegation has been denounced by Justice Holmes in the *Brightman vs. Bates* under which the honorable judge writes as we have no idea regarding the policy of our law which suggests to restrain the majority shareholders from transferring their shares in favor of trustee with unlimited power to vote upon the same.¹³ Similarly, in another case between *Bowditch vs. Jackson Co.*, 76 N.H.351, the court gave its opinion by stating that by conducting strict deliberation in terms of the knowledge to the shareholders regarding the rights of their co shareholders the accord which has been entered by the three fourth of the total number of shareholders is

¹ See Maurice Finkelstein, *supra*.n.82.

² See Code of Corporate Governance for Listed Companies available at http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/DepartmentRules/201804/P020180427400732459560.pdf.

³ See Securities Law of The Peoples Republic of China (2019) available at http://www.csrc.gov.cn/pub/csrc_en/laws/rfdm/DepartmentRules/201904/P020190430549564730317.pdf.

⁴ See Securities Law of The Peoples Republic of China (2014) available at <http://en.pkulaw.cn/display.aspx?cgid=233280&lib=law>.

⁵ See Henry. W. Ballantine Voting Trusts, Their Abuses and Regulation 21 Tax L. Rev. 139,153 (1942) available at <https://heinonline.org/HOL/Page?handle=hein.journals/tlr21&page=139&collection=journals>.

⁶ See Proxy V/S Trust available at <https://wikidiff.com/trust/proxy>.

⁷ See Erika Johansen Voting Trust VS. Voting Proxy available at <https://finance.zacks.com/voting-trust-vs-voting-proxy-7370.html>.

⁸ *Ibid*.

⁹ See Maurice Finkelstein, *supra*.n.86.

¹⁰ See Leslie J. Tompkins. Summary of the Law of Private Corporations Pg 220-236 chp XI (1904). Consolidation, reorganization, Pooling Agreements; Voting Trust; Trust Combinations. Pg 220-236

¹¹ *Ibid*.

¹² See Max W Heck Voting Trusts Marquette Law Review V.3 Iss 4 (1919) available at <https://scholarship.law.marquette.edu/cgi/viewcontent.cgi?referer=https://cn.bing.com/&httpsredir=1&article=4801&context=mulr>.

¹³ See Heck, Mark W Voting Trusts Law Review V.3, Iss 4, pp 158-168 available at <https://heinonline.org/HOL/Page?handle=hein.journals/marqlr3&id=162&collection=journals&index=>.

purely a genuine agreement which could be carried out for the same purpose.¹ The court of New Jersey In the case between *Chapman vs Bates*, 61 N.J Eq. 658 and as well as in the case between *Warren vs Pimm* 66 N. J. Eq. 353; gave its verdict and stated that it is clear that, the combination of several stock could not be deemed as unlawful when it is apparent that the same pooling of stock is in the best interest of all the stakeholders.² In another case between *Boyer vs Nesbit* the court was of the view that if the agreement had elements of active trust then it does not mean that the same agreement is contrary to the public interest.³ Hence, these all cases justifies the validity of voting trust.⁴

Conclusion

The shareholder's protection is the utmost necessity of every corporate system likewise, the same philosophy fixed in the Chinese context. Since China is aiming to become the world's top economy in near future. Therefore, for achieving the same target it is necessary that the issues such as lack of protection for shareholders should be addressed in the Chinese corporate system with the introduction of protective bodies like voting trust. As viable evidence suggests in the past that, the same is still lacking in the country. In the meantime, with the inclusion of bodies like voting trust the stockholders confidence could also be increased in the market due to the improved shareholders protection. Therefore, the introduction of voting trust in the corporate system could provide numerous benefits altogether as the same appears an important device for corporate sector. Through which the country could achieve its true corporate potential which would not only assists the economy of China alone but simultaneously, the same shall have a long lasting impact on other related economies of the world due to China's emerging role in the worlds future economy.

¹ *Ibid.*

² See Elvis Picardo "How Mergers and acquisition can effect a company" available at <https://www.investopedia.com/articles/investing/102914/how-mergers-and-acquisitions-can-affect-company.asp>.

³ *Ibid.*

⁴ *Ibid.*