

A PROMISING PATH OR DEAD END? A DIRECTOR'S DUTY OF CARE IN CHINA

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After over two decades of development, Chinese statutory directorial duties have evolved into two segments: the duty of care and the duty of loyalty. However, the duty of care is still difficult to apply. While an abstract and vague drafting style is a common characteristic of Chinese legislation, a survey of existing Chinese laws and administrative rules should assist in clarifying the duty of care requirements expected of directors. Considering the increasing significance of judicial precedents and the exemplary function of administrative sanctions, analysing recent duty of care cases is conducive to supplementing further information and deciphering myths surrounding the application of the duty of care mechanism in China. However, this analysis demonstrates that there are inconsistencies in the standards of care applied by courts and by the China Securities Regulatory Commission. The article finds that a clearer statutory standard of care should be introduced into the People's Republic of China Company Law.

I INTRODUCTION

The company is the most common form of organisation in modern business. Shareholders, as owners, contribute resources to a company and hire a management team to operate it. Management consists of directors who make strategic decisions and operational management who run the day-to-day business. The delegated management feature enables many companies to expand into transnational behemoths, acquiring capital from millions of investors.¹ However, as management operates assets for others, managerial opportunism can become a problem that

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1 John Armour et al, 'What Is Corporate Law?' in Reinier H Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 3rd ed, 2017) 1, 12–13 <<https://doi.org/10.1093/acprof:oso/9780198739630.001.0001>>.

reduces companies' value.² Managerial opportunism usually manifests in two significant aspects: managerial shirking (responsibility avoidance) and self-dealing.³ Directors' duties are the most critical legal strategy available to curb managerial opportunism.⁴ Corporate law addresses the first issue with directors' duty of care, focusing on the quality of managerial decisions, and the latter issue with directors' duty of loyalty, which emphasises the avoidance of conflict between the interests of management and the firm.⁵ Of the two, the duty of care is more difficult to enforce due to opaque standards and hindsight bias that ex post reviewers often experience.⁶ Indeed, the duty of care has never been exhaustively and undisputedly apparent for enforcement purposes.⁷

Nevertheless, over the past century, many non-common law jurisdictions have introduced the duty of care to safeguard the quality of managerial decisions.⁸ It has been argued that it could be futile to transplant the duty of care without the established practice of a law of equity.⁹ Further, considering the difficulties in assimilating case law development into civil law systems, transplanting jurisdictions need to intermittently refer to common law jurisdictions to obtain insight for improvements, which creates a significant delay in the domestic development of directors' duties.

The connections between the Australian and Chinese economies are extensive and substantial. This is increasingly being experienced in the corporate arena which makes this research of significant value. There are more than 20 Chinese companies listed on the Australian Securities Exchange.¹⁰ Further, Australian investors, through various financial instruments, hold a substantial proportion of shares in Chinese companies. Doing business with a Chinese company requires an understanding of how they are managed and governed. Perhaps most critical for Australian investors is an appreciation of the Chinese director's duty of care

2 Ibid 2.

3 See, eg, Michael C Jensen and William H Meckling, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3(4) *Journal of Financial Economics* 305 <[https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/10.1016/0304-405X(76)90026-X)>.

4 John Armour, Henry Hansmann and Reinier H Kraakman, 'Agency Problems and Legal Strategies' in Reinier H Kraakman et al (eds), *The Anatomy of Corporate Law: A Comparative and Functional Approach* (Oxford University Press, 3rd ed, 2017) 29, 44 <<https://doi.org/10.1093/acprof:oso/9780198739630.001.0001>>.

5 Paul Redmond, *Corporations and Financial Markets Law* (Thomson Reuters, 7th ed, 2017) 385 [7.10].

6 Ian Ramsay and Robert Austin, *Company Directors: Principles of Law and Corporate Governance* (LexisNexis Butterworths, 1st ed, 2005) 250 ('Company Directors').

7 Ibid.

8 For a survey of case law concerning fiduciary duties from Poland, Russia and Germany, see Katharina Pistor and Chenggang Xu, 'Fiduciary Duty in Transitional Civil Law Jurisdictions: Lessons from the Incomplete Law Theory' in Curtis J Milhaupt (ed), *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (Columbia University Press, 2003) 77 <<https://doi.org/10.7312/milh12712-005>>.

9 See, eg, Jiangyu Wang, 'Enforcing Fiduciary Duties as Tort Liability in Chinese Courts' in Robin Hui Huang and Nicolas Calcina Howson (eds), *Enforcement of Corporate and Securities Law: China and the World* (Cambridge University Press, 2017) 185, 186.

10 Richard Henderson, 'Delisting Leaves Just 20 Chinese Companies on ASX', *Australian Financial Review* (online, 9 April 2021) <<https://www.afr.com/markets/equity-markets/delisting-leaves-just-20-chinese-companies-on-asx-20210409-p57hv0>>.

with respect to the quality of managerial decision-making and an awareness of remedies in the case of a breach of the duty. These are necessary considerations which must be factored in when making valuation decisions. Further, with the growth of business collaboration between Australia and China, Australians are increasingly taking on directorships in Chinese companies. For these individuals, knowledge of their legal liabilities, as a member of the managerial team, is crucial. This research therefore has important consequences for Australians and Australian companies doing business with Chinese companies.

China first adopted directors' duties in its corporate law in 1993.¹¹ The development of the duty of care in China, similar to the legal transplantation campaigns of many other jurisdictions, has created many misunderstandings over its common law origin and invited a growing number of criticisms over the past two decades.¹² Nevertheless, the current duty of care remains generic and confusing at best.¹³ The Chinese judiciary and market supervisory agencies, mainly the Chinese Securities Regulatory Commission ('CSRC'), have progressively developed a set of rules for the enforcement of a director's duty of care in practice which have become increasingly influential on ensuing cases. This article analyses the development of the Chinese duty of care from both law in books (theory) and law in action (practical) perspectives. The logic behind the development of a Chinese director's duty of care, being unsupported by equitable considerations, is examined. Further, the principles in practice are teased out to observe whether the concept of a director's duty of care has improved to a functional level. It then explores what could be done so as to construct an effective and practical duty of care mechanism owed by Chinese directors.

The structure is as follows: Part II introduces the legislative history and the current status of the directors' duty of care in China from a theoretical perspective. The analysis is further informed by a comparison between the duty of care in China and in Australia. Part III analyses recent duty of care cases to examine the development of the duty of care in Chinese judicial practice. Based on findings from the perspective of private enforcement, Part IV examines how the public enforcement agency, the CSRC, has explained the duty of care in its civil penalty decisions during the last three years. From the findings of Parts III and IV, Part V assesses the functionality of the director's duty of care in China and the relative strengths and weaknesses of existing practices. The final Part offers a conclusion on the findings and provides suggestions for legislative reform.

11 Nicholas Calcina Howson, 'Twenty-Five Years On: The Establishment and Application of Corporate Fiduciary Duties in PRC Law' (Law and Economics Research Paper Series No 17-024, Michigan Law, University of Michigan, October 2017) 6.

12 See, eg, Guangdong Xu et al, 'Directors' Duties in China' (2013) 14(1) *European Business Organization Law Review* 57 <<https://doi.org/10.1017/S1566752912001048>>.

13 *Ibid.*

II HISTORY AND CURRENT STATUS

The history and current status of the Chinese statutory duty of care are indispensable components of this research. The historical development provides context for understanding this duty from a non-static perspective. The multistage approach to the enactment of the statutory provisions reveals the evolutionary path of development taken with each stage carrying idiosyncratic information relevant to the logic that came to define the Chinese duty of care. Further, the current status provides a reference point for case studies examined later in this research. Given that China is a civil law jurisdiction and therefore statutes are the only authoritative source of law,¹⁴ discussion without analysis of the current duty of care statutory provisions is groundless. Before considering the relationship between statutes and cases in the lawmaking process, the legislative history prior to 1993 when the first version of Chinese company law was promulgated, provides context.

The period can be divided into two stages: the planned economy stage (1949–79) and the corporatisation burgeoning stage (1979–93). Planned economy was the dominant production mode in the three decades following the establishment of the People's Republic of China,¹⁵ which minimised the demands for independent legal personality and investor limited liability protection. As almost all production units were state-owned and operated, management and the bureaucratic system merged.¹⁶ The open door policy in 1978 and the promulgation of the regulations on foreign-invested business organisations generated burgeoning corporatisation.¹⁷ However, the focus of legislation was on ownership and property rights rather than management liability.¹⁸ The protracted planned economy and corporatisation burgeoning periods left almost no institutionalised heritage for director's duties.¹⁹ Nevertheless, the long-held bureaucratic customs that held management accountable are slowly abating with an increasing emphasis on private economy and its demand for director's accountability. The waxing and waning of old customs and new accountabilities explain the slow progress of Chinese directors' duties.

A The Increasing Significance of Precedents

China's legislature has a significantly extended history of using statutes as the only source of law.²⁰ After the establishment of the People's Republic of

14 梁慧星 [Liang Huixing], «民法总论» [General Analysis on Civil Law] (Law Press, 4th ed, 2011) 23.

15 See Jian Fu, 'The Enterprise Concept in Chinese Law and Its Application in PRC Company Law' (1998) 8(3) *Australian Journal of Corporate Law* 266, 266–7.

16 See generally Fang Liufang, 'China's Corporatization Experiment' (1995) 5(2) *Duke Journal of Comparative and International Law* 149.

17 See generally Roman Tomasic, 'Company Law Implementation in the PRC: The Rule of Law in the Shadow of the State' (2015) 15(2) *Journal of Corporate Law Studies* 285 <<https://doi.org/10.1080/1473970.2015.1044769>>.

18 朱慈蕴 [Zhu Ciyun], «中国公司法在本土化与国际化的融合中演进：改革开放四十年的历史沿革、最新发展与未来走向» [The Internationalisation and Adaptation of Chinese Company Law: History, Development and Future since Open-Up] [2020] 2 *东方法学 Eastern Law Review* 91, 94–5.

19 Ibid.

20 Ibid.

China in 1949, China's legislatures have actively promulgated laws to regulate business-related issues,²¹ replacing the previous practice of emulating other civil law jurisdictions.²²

In terms of adjudication, the applicable law is ascertained with regard to the significant difference between statute and case law.²³ Case law usually uses precedents with similar material facts to tease out principles to decide the case in dispute. In contrast, statute focuses on constructing a logical structure in light of the existing law and applies this to the case.²⁴ The guiding case system, established by the Supreme People's Court of China ('SPC'), nevertheless changes the dynamic of statute application.²⁵ Here individual Chinese court judgments are selected and published as guiding cases to exemplify the adjudication of similar subsequent cases and ensure uniformity in the application of the law.²⁶ Although the guiding case system does not substantially touch on the duties, it is recognised as the inception of introducing the China Judgments Network, which encourages judges to refer to similar cases before making a judicial decision.²⁷ Given reference to similar cases is a requirement of the SPC, following case precedents is encouraged and past cases are de facto binding.²⁸ Most corporate law cases in the China Judgments Network database serve an explanatory function to corporate law adjudication.²⁹ After years of improving the case precedent system, judges are becoming more inclined to apply precedents to explain vague statutes.³⁰ Similarly, local high courts have commenced publishing typical cases so as to clarify certain points to the lower courts (and the legal community).³¹ Analysing recent cases on the application of the duty of care in China is therefore of significant relevance.³²

21 See, eg, 赵旭东 [Zhao Xudong], «改革开放与中国商法的发展» [Open-Up Policy and Chinese Commercial Law Development] [2018] 8 法学 *Legal Science* 32.

22 Ibid.

23 梁慧星 [Liang Huixing] (n 14) 14–15.

24 Ibid 27–8.

25 See, eg, Yang Li, 'Practice and Theory of the Guiding Case System in China' (2016) 46(1) *Hong Kong Law Journal* 307, 308.

26 Ibid.

27 For the corporate law reverent cases in the guiding case system of the Supreme People's Court of China ('SPC'), see «最高法指导案例分类汇编之六-公司篇(更新至2019年12月31日)» [SPC Guiding Cases Classification Compilation No 6: Companies (Updated to 31 December 2019)], *Sohu* (Web Page, 13 March 2020) <https://www.sohu.com/a/379922337_693598>. For information on the China Judgments Network, see Guodong Du and Meng Yu, 'You Can View Almost All the Chinese Court Judgments Online for Free', *China Justice Observer* (Blog Post, 8 June 2018) <<https://www.chinajusticeobserver.com/a/you-can-view-almost-all-the-chinese-court-judgments-online-for-free>>.

28 Charlie Xiao-Chuan Weng, 'Assessing the Applicability of the Business Judgment Rule and the "Defensive" Business Judgment Rule in the Chinese Judiciary: A Perspective on Takeover Dispute Adjudication' (2010) 34(1) *Fordham International Law Journal* 124, 133–8 ('Business Judgment Rule').

29 Li (n 25) 309.

30 Susan Finder, 'The "Soft Law" of the Supreme People's Court', *Supreme People's Court Monitor* (Blog Post, 16 November 2020) <<https://supremepeoplescourtmonitor.com/2020/11/16/the-soft-law-of-the-supreme-peoples-court/>>.

31 Ibid.

32 See, eg, Susan Finder, 'China's Evolving Case Law System in Practice' (2017) 9(2) *Tsinghua China Law Journal* 245. See also Colin Hawes, 'How Chinese Judges Deal with Ambiguity in Corporate Law:

Indeed, the coupling of statute and case precedent mirrors the experience of many common law jurisdictions.

B The Evolution of the Chinese Duty of Care Provision

In 1992, China turned to marketisation³³ and the first version of Chinese corporate law was promulgated in 1993 (*Company Law 1993*)³⁴ which introduced many basic corporate features, such as independent legal personality.³⁵ For the first time, Chinese law recognised that the management of a firm needed to be personally liable for the violation of directors' duties.³⁶ Article 59 stipulates:

Directors, supervisors and manager[s] of a company shall abide by the articles of association, perform their duties faithfully, and safeguard the interests of the company. They are not allowed to exploit their positions and powers in the company for personal gains. Directors, supervisors or manager[s] of a company are not allowed to exploit their position to accept bribes or other illegal income or wrongfully take over the company property.

This was only a very general and abstract definition of directors' duties. It is possible to include the duty of care and the duty of loyalty in a slightly expanding analytical method. The expression 'perform their duties faithfully, and safeguard the interests of the company' implies directors should manage the matters of the corporation responsibly. Further information, such as reference benchmarks, for establishing the standard of care directors should follow was not provided. This position remained in the 1999 version and 2004 versions of Chinese corporate law.³⁷ An insufficient understanding of the nature of this duty could be the reason for the reluctance to modify article 59.

Nonetheless, even if the law provided a more specific description of the duties, the Chinese judiciary and market supervisors, such as the CSRC, require more explicit practical guidance on the application of the law. In order to meet the demand for greater clarification for law enforcement purposes, the CSRC released two crucial documents for listed companies: *Guidelines for the Constitutions of Listed Company* (1997) (*Guidance 1997*)³⁸ and *Code of Corporate Governance*

Suggestions for Improving the Chinese Case Precedent System' (2018) 19(1) *Australian Journal of Asian Law* 1.

- 33 袁剑 [Yuan Jian], «中国证券市场批判» [Criticism on China's Capital Market] (China Social Science Press, 2004) § 1. This was following the 1992 speech by Deng Xiaoping: 'Deng Xiaoping's Southern Tour Speech', *The World and Japan* (Web Page) <<https://worldjpn.grips.ac.jp/documents/texts/docs/19920118.S1E.html>>.
- 34 «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 16, 29 December 1993 (*Company Law 1993*).
- 35 The *Company Law 1993* stated '[a] limited liability company and a joint-stock company limited are enterprise legal persons': *ibid* art 3.
- 36 *Ibid* art 59.
- 37 «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 29, 25 December 1999, art 59; «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 20, 28 August 2004, art 59.
- 38 «上市公司章程指引» [Guidelines for Constitutions of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, Zheng Jian No 16, 16 December 1997 (*Guidance 1997*).

of *Listed Companies* (2002) ('*Governance Code 2002*')³⁹ wherein a further duty of diligence was articulated (qinmian yiwu 勤勉义务). Article 81 of the *Guidance 1997* required that '[d]irectors shall cautiously, seriously and diligently use their power granted by their firm', which strongly indicated directors might have owed a duty similar to the duty of care (zhuyi yiwu 注意义务).⁴⁰ Later, article 33 of the *Governance Code 2002* stated that 'directors shall faithfully, honestly and diligently perform their duties for the best interests of the company and all the shareholders', further extending the duty to include a combination of the duty of loyalty and some segments of the duty of care.⁴¹

With the facilitation of the CSRC's ministerial rulemaking, the *Company Law 1993* introduced a general directors' duty that included certain elements similar to the duty of care under common law. The most notable element was 'diligence',⁴² owing to the fact that either the state or individuals tightly controlled most listed firms.⁴³ Compared with its western counterparts, Chinese corporate law traditionally provides shareholders with more significant business decision power.⁴⁴ Therefore, directors play a less significant role in Chinese listed firms when making strategic decisions. It is, therefore, not a coincidence that diligence became the primary requirement for Chinese directors of listed firms. However, it is widely acknowledged that the legislature did intend to use the duty of diligence as a complement to the duty of care under common law.⁴⁵ While having the same regulatory objective, a combination of an inadequate understanding of the contents of the duty and the application of conservative legislative principles lead to disparate wording under Chinese corporate law.⁴⁶

In 2005, Chinese company law made a landmark modification to directors' duties by setting aside an entire chapter, chapter VI, to clarify the obligations of directors ('*Company Law 2005*').⁴⁷ Following the 16th National Congress of the Communist Party of China in 2002, significant economic reform focused on diversifying the ownership of state-owned enterprises and improving corporate

39 «上市公司治理准则» [Code of Corporate Governance of Listed Companies] (People's Republic of China) China Securities Regulatory Commission and the State Economic and Trade Commission, Order No 1, 7 January 2002 ('*Governance Code 2002*').

40 See «上市公司章程指引» [Guidelines for Constitutions of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, Order No 16, 16 December 1997, art 81.

41 *Governance Code 2002* (n 39) art 33.

42 «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the People's Republic of China, Order No 15, 26 October 2018 ('*Company Law 2018*').

43 Charlie Xiao-Chuan Weng, 'Inside or outside the Corporate Law Box? Shareholder Primacy and Corporate Social Responsibility in China' (2017) 18(1) *European Business Organization Law Review* 155 <<https://doi.org/10.1007/s40804-017-0063-5>> ('Inside or outside the Corporate Law Box?').

44 *Ibid* 174–5.

45 叶金强 [Ye Jinqiang], «董事违反勤勉义务判断标准的具体化» [The Breach of Directors' Obligation of Diligence Standard Research] [2018] 6 比较法研究 *Journal of Comparative Law* 79.

46 朱慈蕴 [Zhu Ciyun] (n 18) 94–5.

47 «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 42, 27 October 2005, ch VI ('*Company Law 2005*').

governance mechanisms.⁴⁸ With many companies transitioning to a dispersed-ownership structure, managerial opportunism became the main challenge facing the legislature. Corporate law enabled managerial opportunism, associated with widely-held firms, to be curbed.⁴⁹ Articulating the directors' duties in a provision was therefore a natural consequence of a changing economic landscape. Article 147 stipulates:

The directors, supervisors and senior managers shall comply with the laws, administrative regulations, and bylaws. They shall bear the obligations of fidelity and diligence to the company. No director, supervisor or senior manager may accept any bribe or other illegal gains by taking advantage of his powers, or encroach on the property of the company.⁵⁰

Compared to article 59 in the *Company Law 1993*, article 148 of the *Company Law 2005* enunciated that directors are legally obliged to demonstrate fidelity and diligence.⁵¹ Although ministerial rules, such as those of the CSRC,⁵² had required the duties, the law did not formally recognise them until 2005. As the power of law made by the National People's Congress is only second to the constitution, above all administrative regulations and rules, this change further entrenched the directors' duties.⁵³ An almost identical version was incorporated into the enterprise bankruptcy law a year later.⁵⁴ Both the 2013 (*'Company Law 2013'*) and 2018 (*'Company Law 2018'*) versions of corporate law included this obligation.⁵⁵ Despite the improvement to its antecedent versions, a few issues remain unsettled.

As noted above, the coupling of statute and case precedent mirrors the experience of many common law jurisdictions. It may therefore be informative to compare the Australian duty of care with that of China to highlight both similarities and differences, using managerial shirking as an example.

Under Australian law, there are two types of rules addressing these problems.⁵⁶ First, the general law (common law and equity) requires directors and officers to exercise reasonable care in the performance of their office, as developed through the law of negligence and the duties for trustees.⁵⁷ Second, there is a statutory duty

48 See, eg, 彭冰 [Peng Bing], «中国证券法学» [Chinese Securities Law] (Higher Education Press, 2007). See also Yuan Jian, *Criticism on China's Capital Market* (China Social Science Press, 2004).

49 Armour, Hansmann and Kraakman (n 4).

50 *Company Law 2018* (n 42) art 147.

51 *Company Law 2005* (n 47) art 148.

52 *Guidance 1997* (n 38); *Governance Code 2002* (n 39).

53 See, eg, «中华人民共和国立法法» [Legislation Law of the People's Republic of China] (People's Republic of China) National People's Congress, Order No 20, 15 March 2015 (*'Legislation Law 2015'*).

54 Article 125 states, '[w]here a director, supervisor or senior manager violates his obligations of being honest and diligent and thus leads to enterprise bankruptcy, he shall be subject to the relevant civil liabilities according to law': «中华人民共和国企业破产法» [Enterprise Bankruptcy Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 54, 27 August 2006, art 125 (*'Bankruptcy Law 2006'*).

55 «中华人民共和国公司法» [Company Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 8, 28 December 2013; *Company Law 2018* (n 42).

56 See, eg, Redmond (n 5) 426–8, quoting *Australian Securities and Investments Commission v Adler* (2002) 168 FLR 253, 346–9 (Santow J).

57 Redmond (n 5) 410.

of care and diligence, contained in section 180 of the *Corporations Act 2001* (Cth) ('*Corporations Act*'), complementing the general law duty. While both options are available to private plaintiffs, the Australian Securities and Investments Commission ('ASIC'), as a public plaintiff, is restricted to statutory recourse. China, as a civil law jurisdiction, only has a statutory duty of care. Of course, ASIC's enforcement has its unique practical meaning for setting up an industry standard of care in Australia.⁵⁸ The public enforcement counterpart in China will be discussed later in this the article because this is a practical issue that cannot be categorised as an institutional comparison.

The Australian common law duty of care is considered identical to the statutory duty under section 180(1) of the *Corporations Act*.⁵⁹ It can be further separated into reasonable care, skill and diligence.⁶⁰ The reasonable care part establishes that directors and officers owe to their company a duty to take reasonable care in the performance of their office.⁶¹ The standard of care is typically that of the ordinary prudent person.⁶² Further, the duty to exercise skill factors in the skill expectation of the office and the boundaries of such expectations into the assessment of a director's performance.⁶³ The diligence duty introduces a performance expectation of continuous and routine managerial activities.⁶⁴ Compared with article 147 of *Company Law 2005*, the Australian duty of care is more definitive and richer in content; the Chinese duty of care lacks certainty and ease of application. It conveys neither the standard of care nor consideration of the expectations of the office as those articulated under Australian law. Although administrative rules are being made to further explain the Chinese statutory duty of care, they have a limited binding effect on the duty of care cases and often apply only to certain types of corporations. The gaps in the Chinese duty of care are canvassed in greater detail in Part II(C) below.

Apart from the differences in the expectations and standard of care, Chinese company law does not offer any defence for directors and officers. Australian law, on the other hand, enlists a comprehensive defence that protects managerial entrepreneurship.⁶⁵ The statutory business judgment rule, contained in section 180(2) of the *Corporations Act*, contains a set of conditions to be met by the defendants to prevent courts from assessing the quality of the managerial decisions. Further, sections 189 and 190 offer reliance and delegation defences by allowing directors and officers to rely on other qualified individuals, and delegate some of

58 See, eg, Ian M Ramsay and Benjamin B Saunders, 'An Analysis of the Enforcement of the Statutory Duty of Care by ASIC' (2019) 36(6) *Company and Securities Law Journal* 497.

59 Stephen Bottomley et al, *Contemporary Australian Corporate Law* (Cambridge University Press, 2nd ed, 2020) 304 <<https://doi.org/10.1017/9781108859929>>.

60 Robert P Austin and Ian M Ramsay, *Ford, Austin and Ramsay's Principles of Corporations Law* (LexisNexis Butterworths, 17th ed, 2018) 532 ('*Principles of Corporations Law*').

61 See generally *Daniels v Anderson* (1995) 37 NSWLR 438 ('*Daniels*').

62 *Re City Equitable Fire Insurance Co Ltd* [1925] Ch 407 ('*Re City Equitable Fire Insurance*').

63 *Re Brazilian Rubber Plantations and Estates Ltd* [1911] 1 Ch 425.

64 *Daniels* (n 61) 501, 503–4 (Sheller JJA).

65 Ramsay and Saunders (n 58) 497–500.

their duties to others, when necessary.⁶⁶ Although Chinese company law is silent on any duty of care defence, the Chinese judiciary and law enforcement agencies may have some *modus operandi* in addressing the issue. Nonetheless, the *modus operandi* is neither law nor legally binding precedent in China. The discussion on the practical supplementation of defences for the duty of care is further developed in Part III.

C Unsettled Issues with the Existing Statutory Duty of Care

Reading article 147 in the 2018 version⁶⁷ (the same as article 148 in the 2005 version)⁶⁸ of the existing corporate law, one can easily determine that there is a requirement similar to the duty of loyalty. However, to suggest that the provision also contains a segment of duty of care can be less confidently asserted.⁶⁹ This is because the law explicitly uses the term ‘diligence’ rather than ‘care’.⁷⁰ It would also appear that the provision is too coarse for the judiciary to apply, requiring further explanatory legislation.⁷¹ Based on the previous comparison with the Australian duty of care, one may conclude that the wording of article 147 is simply not informative enough to even imply the standard of care (zhuyi biao zhun 注意标准).

1 *What Does the Obligation of Diligence Mean in Article 147?*

As article 147 only mentions diligence, it could be concluded that Chinese law only requires the duty of diligence to be discharged instead of the duty of care. This, however, cannot be justified either in theory or practice. Since the first version in 1993, Chinese corporate law has been curtailing the business decision powers exercisable by a board of directors.⁷² The Chinese board of directors has less business decision power relative to their counterparts in common law jurisdictions. Articles 37 and 46 show the division of powers between a board of directors and the shareholders’ assembly, with the board carrying more executive functions rather than strategic business decision-making functions.⁷³ However, the critical question is whether Chinese management is an executive extension of the shareholder meeting for operative purposes, or an agent of a firm.

66 Bottomley et al (n 59) 319–21.

67 *Company Law 2018* (n 42) art 147.

68 *Company Law 2005* (n 47) art 148.

69 *Company Law 2018* (n 42) art 147:

The directors, supervisors and senior managers shall comply with the laws, administrative regulations, and bylaw. They shall bear the obligations of fidelity and diligence to the company. No director, supervisor or senior manager may accept any bribe or other illegal gains by taking advantage of his powers, or encroach on the property of the company.

70 *Ibid.*

71 Weng, ‘Business Judgment Rule’ (n 28) 144.

72 For the Chinese board of directors’ power, see *Company Law 2018* (n 42) arts 37, 46.

73 *Ibid.* In common law jurisdictions, company law usually only articulates what powers shareholder meetings have: Jason Harris, *Company Law: Theories, Principles and Applications* (LexisNexis Butterworths, 2nd ed, 2011) 300–1.

As noted in the introduction, the primary justification for installing the directors' duties mechanism is to mitigate the agency problem,⁷⁴ caused by the existence of asymmetric information.⁷⁵ Agents can enrich themselves by utilising information attained through the exercise of business decision-making power.⁷⁶ If the role of directors involves merely operational management, rather than strategic decision-making, then the agency problem should not be a concern of corporate law. Having relatively reduced strategic decision-making functions while retaining more business operation-related decision powers, articles 37 and 46 indicate that directors still retain substantial discretionary power to affect the value of a firm. Therefore, considering the necessity to reduce agency costs, it would not be beneficial to require directors to only work diligently rather than exercise powers with due care. It is, however, widely believed that the Chinese 'obligation of diligence' (qinmian yiwu 勤勉义务) has a broader meaning and is almost equivalent to the duty of care in common law jurisdictions.⁷⁷ That the Chinese statutory obligation of diligence is, in effect, synonymous and interchangeable with the common law concept of duty of care will be demonstrated, through evidence, in Parts III and IV.

Another issue relevant to the definition of the Chinese obligation of diligence is whether it is an independent duty. Article 147 bundles the prudential and fidelity requirements together and consequently could be interpreted in two ways:⁷⁸ either as a single duty of care and of loyalty, or as two separate duties, being the duty of care and the duty of loyalty. The legal implications are significant. If the duty of care and of loyalty are viewed as a singular duty, should the standard of deciding contraventions for breaches of the duty of care and breaches of the duty of loyalty be the same? Cases in the United States ('US'), such as *Cede & Co v Technicolor, Inc* ('*Cede II*') in Delaware,⁷⁹ provide examples of where the two standards could be mistakenly combined.⁸⁰ However, if article 147 intended two separate duties, this justifies having two independent sets of review standards.

2 What Is the Chinese Law-in-Books (Theoretical) Duty of Care?

Article 147 is silent on the requisite standard of care required to discharge the duty. The provision was designed for the sole purpose of establishing the statutory duty. Given that it has been 15 years, are there any statutes and rules that can shed light on the standard of care required? The primary sources of law, promulgated by

74 Armour, Hansmann and Kraakman (n 4).

75 Ibid.

76 Jensen and Meckling (n 3).

77 Luo Peixin, Li Jian and Zhao Yingjie, 'Empirical Study on Senior Executive Obligation of Diligence Adjudication in China' (2010) 2 *Securities Law Review* 372, 407; 叶金强 [Ye Jinqiang] (n 45).

78 Ibid.

79 *Cede & Co v Technicolor, Inc*, 634 A 2d 345 (Del, 1993). See also William T Allen, Jack B Jacobs and Leo E Strine Jr, 'Realigning the Standard of Review of Director Due Care with Delaware Public Policy: A Critique of *Van Gorkom* and Its Progeny as a Standard of Review Problem' (2002) 96(2) *Northwestern University Law Review* 449.

80 Allen, Jacobs and Strine (n 79) 460.

the National People's Congress, are the *Company Law 2018*,⁸¹ *Securities Law 2019*⁸² and *Bankruptcy Law 2006*.⁸³ Rules provided by the CSRC, as market supervisor, can be found in the *Corporate Governance Guidance for Listed Companies 2018* ('*Governance Guidance*')⁸⁴ and the *Guidance for Constitutions of Listed Companies 2019* ('*Constitution Guidance*').⁸⁵ Listing rules have been established by the self-regulatory associations, the Shanghai Stock Exchange ('SSE') Listing Rules ('*SSE Listing Rules*')⁸⁶ and the Shenzhen Stock Exchange ('SZE') Listing Rules ('*SZE Listing Rules*')⁸⁷ as well as rules covering director selection and conduct.⁸⁸ The CSRC's rules are only binding on listed firms, whereas the self-regulatory associations' rules cannot affect firms that are not trading on the exchanges.⁸⁹

Chinese commercial laws are usually generic and abstract⁹⁰ and therefore not very helpful for determining the standard of care required to discharge the duty. Chinese local economy development levels are very asymmetric.⁹¹ Moreover, legal talent tends toward more economically developed areas. Therefore, a one-size-fits-all approach and enactment of highly detailed commercial law tends to only be efficacious in some areas and largely non-functional in others.⁹² Article 147 of the *Company Law 2018* does not offer any further assistance for establishing the standard of care but does indicate that there are two distinct duties: diligence and loyalty. By contrast, article 148 of the *Company Law 2005* only referred to the duty of loyalty. This suggests that article 148 seeks only to clarify the duty of good faith, not the duty of diligence. The *Bankruptcy Law 2006* barely mentions that compensation liability arises should directors breach their duties and cause their firm to become insolvent. Nonetheless, the wording of the provision seems to

81 *Company Law 2018* (n 42).

82 «中华人民共和国证券法» [Securities Law of the People's Republic of China] (People's Republic of China) Standing Committee of the National People's Congress, Order No 37, 28 December 2019 ('*Securities Law 2019*').

83 *Bankruptcy Law 2006* (n 54).

84 «上市公司治理准则» [Corporate Governance Guidance for Listed Companies] (People's Republic of China) China Securities Regulatory Commission, Announcement No 29, 30 September 2018 ('*Governance Guidance*').

85 «上市公司章程指引» [Guidance for Constitutions of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, Announcement No 10, 17 April 2019 ('*Constitution Guidance*').

86 «上海证券交易所股票上市规则» [Rules Governing the Listing of Stocks on Shanghai Stock Exchange] (People's Republic of China) Shanghai Stock Exchange, [2019] 52, 30 April 2019 ('*SSE Listing Rules*').

87 «深圳证券交易所股票上市规则» [Rules Governing the Listing of Stocks on Shenzhen Stock Exchange] (People's Republic of China) Shenzhen Stock Exchange, [2018] 556, 16 November 2018.

88 «上海证券交易所上市公司董事选任与行为指引» [Guidance on the Selection and Conduct of Directors of Listed Companies in Shanghai Stock Exchange] (People's Republic of China) Shanghai Stock Exchange, 13 June 2013 ('*Director Selection and Conduct Rules 2013*').

89 See, eg, *Legislation Law 2015* (n 53).

90 Charlie Xiao-Chuan Weng, 'Do Auctions Matter? Assessing the Chinese Auction Promotion Institution of Takeover Law' (2017) 10(1) *Tsinghua China Law Review* 49, 51 ('Do Auctions Matter?').

91 See, eg, 沈续雷, 王桂新, 孔超 [Xulei Shen, Guixin Wang and Chao Kong], «中国人口分布和经济发展空间不均衡性对比研究» [A Comparative Research on Distribution and Economic Development Space Asymmetry in China] (2009) 15(6) *人口与发展 Population and Development* 69.

92 顾培东 [Peidong Gu], «能动司法若干问题研究» [Issues on Active Adjudications] [2010] 4 *中国法学 China Legal Science* 5, 17–18.

recognise that diligence and loyalty should be viewed as two separate duties.⁹³ The *Securities Law 2019* does not appear to assist in clarifying the required standards either, only confirming that directors who fail to act with due diligence may be replaced.⁹⁴

The CSRC's and self-regulatory associations' rules are comparatively more specific than the laws in offering explanations on what is required to fulfil the duty of care because they regulate a particular target audience – listed firms. The *Governance Guidance* requires directors to allocate adequate time and effort to board activities,⁹⁵ although a delegate can be appointed in certain circumstances.⁹⁶ While this diligence requirement may enrich the standard of care, it raises questions such as what constitutes a permissible absence that justifies the participation of a delegate. The *Constitution Guidance*, mandatory for listed firms, differs from traditional common law statutory constitutional templates, such as table A of the *Companies Act 1985* (UK) in the United Kingdom ('UK') or the replaceable rules of the *Corporations Act* in Australia.⁹⁷ Article 136 of the *Constitution Guidance 2019* states that

[s]upervisors shall comply with laws, administrative regulations and these Guidelines and bear fiduciary obligations and diligence obligations towards the

93 *Bankruptcy Law 2006* (n 54) art 125:

Where a director, supervisor or senior manager violates his obligation of being honest and obligation of being diligent and thus leads to enterprise bankruptcy, he shall be subject to the relevant civil liabilities according to law. No person under any circumstance as prescribed in the preceding paragraph may, within 3 years as of the day when the procedures for bankruptcy are concluded, assume the post of director, supervisor or senior manager of any enterprise ...

94 *Securities Law 2019* (n 82) art 142:

Where any director, supervisor or senior executive of a securities company fails to act with due diligence, resulting in the securities company's major violation of law or regulation or major risks, the securities regulatory authority of the State Council may order the securities company to replace him or her.

Article 143 states

Where a securities company [undertakes] illegal operation[s] or major risks, which seriously disrupts the order of the securities market and damages the interests of investors, the securities regulatory authority of the State Council may take such regulatory measures as ordering it to cease business operation for rectification, designating any other institution to manage or take over its business, and administratively dissolving ... the securities company ...

95 *Governance Guidance* (n 84) art 22. The CSRC's 2018 announcement of its revised Guidance read:

For the purposes of further regulating the operation of listed companies, improving the corporate governance level of listed companies, protecting investors' lawful rights and interests, and promoting the steady and sound development of China's capital market, the [CSRC] has revised the Code of Corporate Governance of Listed Companies, which is hereby issued and shall come into force on the date of issuance ...

« [第29号公告] 上市公司治理准则 » [29th Announcement: Code of Corporate Governance of Listed Companies], 中国证券监督管理委员会 *Chinese Securities Regulatory Commission* (Web Page, 30 September 2018) <<http://www.csrc.gov.cn/csrc/c101864/c1024585/content.shtml>>.

96 *Governance Guidance* (n 84) art 22:

Directors shall guarantee that they have adequate time and energy for the fulfillment of their due duties. Directors shall attend meetings of the board of directors and offer specific opinions on issues deliberated. A director that is unable to attend a meeting of the board of directors may authorise another director in writing to vote on his or her behalf, and the principal shall independently assume legal liability. No independent director shall entrust any non-independent director to vote on behalf thereof ...

97 Any deviation from the *Governance Guidance* is subject to the CSRC's approval. Otherwise, the constitution and any modifications cannot be registered with the CSRC.

company, shall not make use of official powers to accept bribes or other illegal income, and not encroach upon the company's assets.

As with the *Bankruptcy Law 2006*, article 136 articulates the obligation of diligence and the duty of loyalty as two independent duties.⁹⁸

The CSRC's *Constitution Guidance* recommends five 'diligence' obligations although some of them do not fit so well with the duty. Strictly speaking, only the third and fourth obligations fall within the definition of the traditional duty of care. Directors have an obligation to understand the nature of the business and should be responsible for any disclosures made by the board.⁹⁹ The first and fifth duties bear a resemblance to the duty to act lawfully.¹⁰⁰ Mixing the duty to act lawfully with the duty of care could be confusing. This mixing may be particularly confusing, in cases where directors intentionally violate laws, when liability for breach of duty of care is primarily based on negligence. The second obligation requiring equal treatment of all shareholders is similar to the duty to act in good faith for a proper purpose, which requires directors to act bona fide for the benefit of the corporation and for a proper purpose.¹⁰¹ Although the issue of whether common law and equitable remedies are available should not be an obstacle to the interchanging of the duty of good faith and the duty of care, two possible fundamental issues arise from this lack of distinction when dealing with a good faith case.¹⁰² First, should the judiciary be asked to exercise self-constraint in second-guessing a board's decision? Second, given that the duty of care focuses on the quality of business decisions, should that quality be given more weight than the legality and legitimacy of the impugned decision? While further discussion on article 98 is outside the scope of this article, discharging the obligation of diligence, from

98 *Constitution Guidance* (n 85) art 136. Article 98 provides:

Directors shall comply with laws, administrative regulations and these Guidelines, and shall bear the following diligence obligations towards the company:

- (1) Exercise the rights accorded by the company prudently, seriously and diligently to ensure that the commercial activities of the company comply with laws and administrative regulations of the State and the requirements of various economic policies of the State and the commercial activities shall not exceed the scope of business stipulated in the business licence;
- (2) Treat all shareholders equally;
- (3) Get a timely grasp of the status of the company's business and management;
- (4) Issue a written confirmation opinion for the company's regular reports, and ensure the veracity, accuracy and integrity of information disclosure by the company;
- (5) Provide the relevant information and materials to the board of supervisors truthfully, and shall not hinder exercise of official powers by the board of supervisors or the supervisors; and
- (6) Any other diligence obligations stipulated by laws, administrative regulations, ministry rules and these Guidelines.

Note: The company may, based on the specific circumstances, include additional requirements in its articles of association with respect to the diligence obligations of the company directors ...

99 See, eg, Redmond (n 5).

100 Austin and Ramsay, *Principles of Corporations Law* (n 60) 451–7.

101 Redmond (n 5) 465–71.

102 See, eg, Ramsay and Austin, *Company Directors* (n 6) 699.

the perspective of the CSRC, requires, at a minimum, an understanding of the corporation's business and responsibility for any disclosures made.¹⁰³

The *SSE Listing Rules* and *SZE Listing Rules* provide an improved, although minimal, explanation of the obligation of diligence. For instance, section 3.1.5 of the *SSE Listing Rules* reads:

The directors' loyalty duty and diligence duty shall include:

- (1) attending the meeting of the board of directors in person, acting with due diligence and reasonable prudence, and expressing opinions explicitly on all the matters under consideration. In case of absence for any reason, a proxy shall be selected cautiously;
- (2) carefully reading all the business and financial reports of the listed company as well as any significant media coverage on the company, keeping informed of and paying continuous attention to the company's operations and management, the material matters that have occurred or are likely to occur and the impact of such material matters, reporting in a timely manner to the board of directors the problems existing in the company's operations, and may not shirk his responsibility under the excuses that he is not engaged directly in operation and management of the company or has no knowledge of the matter or situation; and
- (3) performing other fiduciary duty and due diligence duty as set forth in the *Company Law* or acknowledged by the public.¹⁰⁴

The first part of this section arguably includes a duty not to fetter discretion,¹⁰⁵ requiring directors to consider every matter raised for discussion when making decisions for their firm. The second part further clarifies the obligation of diligence by emphasising the significance of carefully reviewing business, financial and other essential reports. A monitoring duty is also imposed requiring familiarity more than mere awareness of the corporation's business operations. Again, as shown below, there is still no precise differentiation between the obligation of diligence and the duty of loyalty.

The last legislative document, the *Director Selection and Conduct Rules 2013*, while it also blurs the duties,¹⁰⁶ nevertheless allocates an entire chapter to the directors' obligation of diligence.¹⁰⁷ While not all provisions in the chapter are relevant to the common law duty of care, it significantly ameliorates the ambiguity in interpreting the obligation of diligence. Article 26 not only confirms that directors should be familiar with the business of a corporation but also mandates that directors' decisions should balance possible risks against benefits.¹⁰⁸ The balancing requirement can be regarded as a preliminary step toward developing a standard for the obligation of diligence,

103 *Guidance for Constitutions of Listed Companies 2019* (n 85).

104 *SSE Listing Rules* (n 75).

105 About the duty not to fetter discretion, see Austin and Ramsay, *Principles of Corporations Law* (n 60) 525 [8.300.9].

106 Article 4 requires that '[d]irectors shall have the duty of loyalty and diligence to the listed company and shall not use the listed company to seek illegitimate interests to harm the interests of the listed company or shirk their responsibilities to the company': *Director Selection and Conduct Rules 2013* (n 88) art 4.

107 *Ibid* arts 26–40.

108 *Ibid* art 26.

similar to the rule in some common law duty of care cases.¹⁰⁹ Articles 29 to 32 mainly focus on the attendance requirement of directors.¹¹⁰ These requirements, however, differ from those of the common law. Under common law, directors cannot be absent without justifiable reason, such as illness. If there is a period of continuous absence, despite having a good reason, directors have to consider resignation or designating a proxy alternative.¹¹¹ Chinese attendance requirements set two benchmarks. First, without legitimate reason, such as illness, studying overseas or working abroad, the SSE can declare a director who has missed more than half the meetings in a year unsuitable for directorship for a period of three years.¹¹² Second, irrespective of whether or not there are reasons, the supervisory board has to investigate directors who are absent from more than two-thirds of the meetings in a year for breach of the obligation of diligence.¹¹³ It would appear that the SSE is very tolerant of continuous absence and quite lenient on absence without justification. The low benchmark for meeting participation requirements may be problematic because some directors could take advantage of it to avoid difficult board discussions yet avert contravention of the obligation of diligence. Many articles in this chapter also stress the significance of knowing the company's business. One noticeable difference compared to other laws and rules on the diligence obligation is that article 40 mandates that independent directors must spend no less than 10 days annually in gaining an understanding of the firm's business.¹¹⁴ It is unclear whether it is sufficient for independent directors to spend 10 days or more acquiring corporate business-relevant information to demonstrate that they have a good understanding of the business or if it is a mere formality requirement, with no real implication on a director's actual knowledge of the company.

In summary, after examining the existing laws and rules on the obligation of diligence, it seems that most of the explanations of the duty revolve around the obligation of diligence. This suggests that Chinese statutes are more concerned with how diligently directors are working rather than whether they are exercising necessary and reasonable care and utilising skills in the course of fulfilling their duty. It remains unclear whether the obligation of diligence and the duty of loyalty are two separate duties. Except for article 26 of the *Director Selection and Conduct Rules 2013*, which stipulates a risk-benefit balance requirement when directors are deciding corporate issues, no statute or rule articulates the standard of care that directors should exercise to discharge the duty. Furthermore, as Chinese statutes pay little attention to requisite skills, there are no starkly different standards across

109 See *Vines v Australian Securities and Investments Commission* (2007) 73 NSWLR 451, 557 [600] (Santow JA), 603 [814] (Ipp JA). The standard of care 'can only be answered by balancing the foreseeable risk of harm against the potential benefits that could reasonably have been expected to accrue to the company from the conduct in question': at 603 [814] (Ipp JA).

110 *Director Selection and Conduct Rules 2013* (n 88) arts 29–32.

111 Austin and Ramsay, *Principles of Corporations Law* (n 60) 548.

112 *Director Selection and Conduct Rules 2013* (n 88) art 31.

113 *Ibid.*

114 Article 40 states that '[i]n principle, the independent director shall spend no less than ten days each year on the site of the listed company to understand the daily operation, financial management and other standard operations of the company': *Director Selection and Conduct Rules 2013* (n 88) art 40.

the obligors of the duty. For instance, it would appear that the same duty applies to both executive and non-executive directors. Notably, most of the detailed rules apply only to listed firms. This calls for further assessment as to whether the rules could functionally apply to non-listed firms. However, the gap between theory and practice could be extensive in China due to the rapid development of society and increasing demand for societal harmony.¹¹⁵

III FORMING A DUTY OF CARE: PRIVATE ENFORCEMENT OF THE DUTY OF CARE

When statutes are silent on the standard of care and other issues relevant to the obligation of diligence, elucidation may come from observing the law in action. Unless they are administrative review cases that aim to set aside punishment decisions of the CSRC for contravention of the obligation of diligence, Chinese obligation of diligence cases are often initiated by private parties with pecuniary compensation consequences.¹¹⁶ Through studying judicial precedents, the compensatory, remedial function of the obligation of diligence can be precisely exhibited. It also may provide a standard of care for private enforcement.

Shanghai, a gateway city and the most vibrant business hub in China, has around a million corporations generating a gross domestic product of around USD550 billion per annum.¹¹⁷ As Shanghai is the apex of the Chinese economy, its judiciary is notable for its responsiveness and efficiency across China.¹¹⁸ Moreover, with a high volume of corporate law cases, Shanghai is at the forefront of litigating complicated corporate legal issues. When private parties are active in the economy, disputes on how to manage firms naturally arise. A search of the case database of Wolters Kluwer reveals that Shanghai has the highest number of duty of care cases.¹¹⁹ For this reason, Shanghai was chosen as the sample city to research the enforcement of the duty of care in China. The first search term used was ‘obligation of diligence’ (qinmian yiwu 勤勉义务), focusing on the reasoning and grounds (caipan liyou ji yiju 裁判理由及依据) of judgments. To retrieve the most recent cases that reflect the most updated information on the obligation of diligence, the judgment publication date was restricted to between 1 January 2017 and 1 April 2020. Since we are only interested

115 Weng, ‘Inside or outside the Corporate Law Box?’ (n 43) 156–7.

116 《中华人民共和国行政处罚法》 [Law of the People’s Republic of China on Administrative Penalty] (People’s Republic of China) Standing Committee of the National People’s Congress, Order No 76, 22 January 2021 (‘*Law on Administrative Penalty*’).

117 ‘Gross Domestic Product (GDP) of Shanghai Municipality in China from 2010 to 2019’, *Statista* (Web Page, 2020) <<https://web.archive.org/web/20201205155144/https://www.statista.com/statistics/802355/china-gdp-of-shanghai/>>.

118 严剑漪 邱悦 [Yan Jianyi and Qiu Yue], «上海启动司法体制综合配套改革» [Shanghai Launches Judiciary Reform] *China Court* (Web Page, 30 September 2017) <<https://www.chinacourt.org/article/detail/2017/09/id/3011203.shtml>>.

119 The Kluwer’s database includes all the cases on the Chinese Judgment Online: ‘China Law & Reference’, *Wolters Kluwer* (Web Page) <<https://law.wkinfo.com.cn/judgment-documents/list?tip=>>>. The only reason that we prefer the former is that the selection criteria and searching mode are much more user friendly helping us efficiently capture the most comprehensive cases on the topic.

in private enforcement cases, rather than criminal cases and jurisdictional disputes, civil cases (minshi anjian 民事案件) and judgments (panjue 判决) were selected. The search returned 65 valid results. Each case was examined to exclude irrelevant cases, such as the wrongful application of the duty,¹²⁰ resulting in 33 cases relevant to the obligation of diligence.

The information was meticulously extracted. A Chinese case is usually written in a way that allows the judge to analyse issues in dispute to justify the application of the relevant law without a fixed pattern. Hence, there is no standard approach to categorise cases to tease out information relevant to the enforcement of the obligation of diligence. The entire judgment has to be read with the purpose of locating the particular information that is sought. Accordingly, preparing the questions to be answered by this method of data collection is particularly critical.

The core of the duty of care is the standard of care.¹²¹ Any discussion must recognise the traditional wisdom, maturity and practical experience of common law jurisdictions. Determining the standard of care required is complicated as legislatures are very often confronted with a dilemma: applying the same standard of conduct, namely exercising the same care a reasonable person would take for his own business affairs, when reviewing could, in effect, harm a director's entrepreneurship autonomy.¹²² This is because hindsight bias may eclipse the justification of ex post review. Further, the reviewer may not possess the same information as the director.¹²³ Some jurisdictions choose to differentiate the standard of review from the standard of conduct, such as the US state of Delaware,¹²⁴ whereas others believe a singular standard should be sufficient to support the duty of care, such as the UK.¹²⁵ This Part of the article attempts to discern the proposition upheld by Chinese courts regarding the standard required to discharge the duty of care. But what of Chinese courts? If a divergence of the standards is supported, to what extent is it diverged? Further, how is the standard to be structured so as to be fair and just? In UK company law, for example, consideration has long been given to incorporating individual director's skills in order to increase the standard of care to protect the interests of a firm.¹²⁶

The discussion centred around the following case studies relates to the questions being asked in Part I: 1) what does 'obligation of diligence' mean in practice, and

120 The cases mentioned 'duty of care' or 'duty of diligence'. However, they do not apply article 147 of the company law in the judgments. Therefore, as irrelevant cases, they are excluded.

121 Redmond (n 5) 412–13.

122 Melvin Aron Eisenberg, 'The Divergence of Standards of Conduct and Standards of Review in Corporate Law' (1993) 62(3) *Fordham Law Review* 437, 447–8.

123 Ibid 453.

124 William T Allen et al, 'Function over Form: A Reassessment of Standards of Review in Delaware Corporation Law' (2001) 56(4) *Business Lawyer* 1287, 1300–11.

125 David Kershaw, *The Foundations of Anglo-American Corporate Fiduciary Law* (Cambridge University Press, 2018) 155–60 <<https://doi.org/10.1017/9781316135891>>.

126 CA Riley, 'The Company Director's Duty of Care and Skill: The Care for an Onerous but Subjective Standard' (1999) 62(5) *Modern Law Review* 697 <<https://doi.org/10.1111/1468-2230.00232>>; Paul L Davies, *Gower's Principles of Modern Company Law* (Sweet & Maxwell, 6th ed, 1997) 560–4; Vanessa Finch, 'Company Directors: Who Cares about Skill and Care?' (1992) 55(2) *Modern Law Review* 179 <<https://doi.org/10.1111/j.1468-2230.1992.tb01871.x>>.

2) what is the current practice regarding the duty of care? In answering the first question, two issues have been identified: a) whether a duty of care and loyalty is mixed in practice, and b) whether there is any practical implications with naming the duty of care as an ‘obligation of diligence’. The second question raises a further three issues in clarifying how the duty is set up and enforced in practice: a) what the standard of care is, b) whether Chinese courts have judicial deference to business decisions, and c) if a private party can alter the standard of care.

Directors owe a duty to their company and/or shareholders to take reasonable care in performing the duties of their office. In some common law jurisdiction cases, provided the directors acted honestly and were not guilty of ‘gross or culpable negligence in a business sense’, they could not be made responsible.¹²⁷ In the seminal case, *Re City Equitable Fire Insurance Co Ltd*, the standard of care owed by directors is that of the ordinary prudent person.¹²⁸ The linchpin is how to define ‘reasonable’. In Delaware, the assessment of reasonability has been designed to reflect the policy of primarily encouraging entrepreneurship.¹²⁹ In Australia, the standard of conduct and standard of review are generally consistent, and an improved burden-of-proof business judgment rule protects autonomous entrepreneurial decisions made by directors.¹³⁰ It could be theoretically and practically valuable to discern the proposition of Chinese courts on these issues.

A What Does ‘Obligation of Diligence’ Mean in Practice?

1 *Mixing the Duty of Care and the Duty of Loyalty*

The majority of cases use ‘duty of loyalty and diligence’ (zhongshi qinmian yiwu 忠实勤勉义务) to describe both the obligation of diligence and the duty of loyalty. It seems, in practice, judges favour the generic name when legislative clarification is lacking. Furthermore, there is evidence that the duty of loyalty standard is applied when adjudicating an obligation of diligence case.¹³¹ This is illustrated in *Chen v Shanghai Shulin Software Ltd Co*. The defendant Zhu, who

127 Austin and Ramsay, *Principles of Corporations Law* (n 60) 566 [8.340.3], quoting *Re City Equitable Fire Insurance* (n 62) 427 (Romer J).

128 *Re City Equitable Fire Insurance* (n 62) 477 (Romer J).

129 Delaware law installs a strong business judgment rule demanding the plaintiff to rebut a series of presumptions that directors are poorly informed, are acting in bad faith or have a personal interest conflict. It is deemed as a de facto standard of review requiring gross negligence to find directors culpable: Eisenberg (n 122) 441.

130 The business judgment rule means, so long as a majority of the directors have no conflicting interest (see ‘duty of loyalty’ below) in the decision, their decision will not later be second-guessed by a court if it is undertaken with due care and in good faith. The business judgment rule applies even if the business decision later turns out to have been unwise. In Australia, cases are showing the tendency to require directors to prove all conditions demanded by the rule are met, which does not necessarily mean that directors have fulfilled the duty of care. The next step of the litigation should be using the standard of conduct to decide if the directors exercised reasonable care. See, eg. *Australian Securities and Investments Commission v Rich* (2009) 236 FLR 1, 147 [7269] (Austin J).

131 «陈操宇与上海数林软件有限公司、朱松损害公司利益责任纠纷一案一审民事判决书» [Chen Caoyu v Shanghai Shulin Co Ltd and Zhu Song – Company Interests Dispute Case], 上海市杨浦区人民法院 [Shanghai Yangpu District Court, People’s Republic of China], 沪0110民初21373号 [Economic No 21373], 19 September 2019.

was chair of the board, failed to exercise reasonable care in reviewing a related transaction. The judges believed that there were two grounds for deciding that Zhu violated the obligation of diligence: 1) Zhu did not initiate a shareholder's meeting to approve the related transaction; and more importantly, 2) there was no evidence to show the transaction was entirely fair. The second ground is particularly problematic because it implies that the breach of duty of care can be exempted provided the impugned transaction is fair. This proposition is very similar to *Cede II* in the Delaware court, which has been widely criticised for combining the standard of care and review approach in the context of directors' duties and related transactions.¹³² However, presently, the apparent use of this approach in *Cede II* is merely anecdotal.

2 Diligence-Oriented Duty of Care and Definition of Diligence

The majority of cases pertaining to the duty of care centre on whether directors complied with their duty which, under the Chinese duty of care, focuses on diligence (qinmian yiwu 勤勉义务). The laws are not unequivocal and practical for enforcement.¹³³ The cases on diligence, as a segment of the duty of care, to some extent reveal the philosophy of law as understood by the Chinese judiciary. In *He Dongming v Shanghai City Construction Supply Ltd Co*, the taking of extended medical leave by the vice general manager of the company was not deemed a breach of the obligation of diligence but instead satisfied a contractual condition warranting termination of employment. Nonetheless, it is recognised that continuous participation in corporation management manifestly constitutes fulfilment of managerial duties.¹³⁴ In *Zhang Qiuxia v Shanghai Zhongyida Co Ltd*, Zhang, a supervisor of the supervisory board, was absent from shareholder meetings on eight occasions and missed several supervisory board meetings in two years and was disciplined by the SSE. The Court, without referring to the *Director Selection and Conduct Rules 2013*, appears to have agreed with the SSE that missing several meetings a year signifies a breach of the duty of diligence.¹³⁵ Therefore, even without an express statutory attendance requirement, case precedents suggest an expected attendance rate within the requirement of diligence, which is enforced even more strictly than the requirement for listed firms stipulated in the *Director Selection and Conduct Rules 2013*.

A large number of cases on the duty of diligence concern the submission of corporate stamps and credentials to successors, which could paralyse the future operations of the firm. Judicial opinions unanimously conclude that non-submission

132 Allen, Jacobs and Strine (n 79) 449.

133 *Company Law 2018* (n 42).

134 «何冬明诉上海城建物资有限公司追索劳动报酬纠纷一案二审民事判决书» [He Dongming v Shanghai Chengjian Co Ltd – Labour Salary Dispute Case], 上海市第一中级人民法院 [First Intermediate People's Court of Shanghai Municipality, People's Republic of China], 沪01民终2697号 [Economic Appeal No 2697], 16 May 2019.

135 «张秋霞与上海中毅达股份有限公司其他与公司有关的纠纷一审民事判决书» [Qiuxia Zhang v Shanghai Zhongyida Co Ltd], 上海市徐汇区人民法院 [Shanghai Xuhui District Court, People's Republic of China], 沪0104民初8991号 [Economic No 8991], 17 January 2020.

is a breach of the obligation of diligence.¹³⁶ While negligence is the basis on which the obligation of diligence is contravened, it appears that courts have not yet investigated whether the breach of the duty is intentional and in bad faith.

A significant part of the common law duty of care involves establishing a causal link between the damage caused and breach of the duty.¹³⁷ Causation can be determined based on whether it is in respect of breach of a common law duty of care or an equitable duty of care.¹³⁸ As the above cases show, the judiciary is very reliant on Chinese torts theory when analysing duty of care cases, which has also received some academic support.¹³⁹ When establishing a link between the breach of duty and resulting damage, Chinese courts consistently turn to torts law causation analysis, which is very similar to the ‘but for’ test under the equitable duty of care causation test in common law jurisdictions.¹⁴⁰

B Current Practice of Duty of Care

1 Judicial Definition of the Duty and Finding a Standard of Care

In the case of *Shanghai Fumin Culture Communication Ltd Co v Zuo*,¹⁴¹ Zuo, as the legal representative of the firm, failed to compensate 39 claimants in a timely manner and was sued for breaching his obligation of diligence due to the

136 See, eg, «上海浦道农贸市场经营管理有限公司与范云飞公司证照返还纠纷一审民事判决书» [Shanghai Pudao Co Ltd v Fan Yunfei – License Returning Dispute Case], 上海市闵行区人民法院 [Shanghai Minhang District Court, People’s Republic of China], 沪0112民初18451号 [Economic No 18451], 26 October 2018; «立劲哲有限公司损害公司利益责任纠纷一审民事判决书» [Thirdware Solution Ltd v Mong Weng Keong – Infringement of the Company’s Interests Dispute Case], 上海市黄浦区人民法院 [Shanghai Huangpu District Court, People’s Republic of China], 沪0101民初13791号 [Economic No 13791], 20 October 2017; «上海商润实业有限公司与徐建国损害公司利益责任纠纷一审民事判决书» [Shanghai Shangrun Co Ltd v Xu Jianguo – Infringement of the Company’s Interests Dispute Case], 上海市静安区人民法院 [Shanghai Jingan District Court, People’s Republic of China], 沪0106民初13754号 [Economic No 13754], 21 June 2017.

137 *Permanent Building Society (in liq) v Wheeler* (1994) 11 WAR 187, 241–8 (Ipp J).

138 Redmond (n 5) 426–45.

139 See, eg, Wang (n 9).

140 For establishing causation in torts adjudication, see, eg, 井龙 [Jing Long], «侵权责任纠纷中因果关系的判断标准-北京法院网» [The Standard of Establishing a Causation in Torts Case], 北京法院网 *BJGY* (Web Page, 9 April 2019) <<http://bjgy.chinacourt.gov.cn/article/detail/2019/04/id/3816273.shtml>>. For cases that use the approach in a duty of care adjudication, see, eg, «上海讯奇无线传媒有限公司与李一男、杨鸣等公司证照返还纠纷一审民事判决书» [Shanghai Xunqi Co Ltd v Li Yinan – License Return Dispute Case], 上海市闵行区人民法院 [Shanghai Minhang District Court, People’s Republic of China], 沪0112民初3449号 [Economic No 3449], 16 June 2017; «上海泰琪房地产有限公司损害公司利益责任纠纷二审民事判决书» [Shanghai Taiqi Co Ltd v Michael Murray Pierce – Infringement of the Company’s Interests Dispute Case], 上海市第二中级人民法院 [Second Intermediate People’s Court of Shanghai Municipality, People’s Republic of China], 沪02民终11661号 [Economic Appeal No 11661], 24 February 2020; «上海东欣置业发展有限公司与关键仪损害公司利益责任纠纷二审民事裁定书» [Shanghai Dongxin Co Ltd v Guan Jianyi – Infringement of the Company’s Interests Dispute Case], 上海市第二中级人民法院 [Second Intermediate People’s Court of Shanghai Municipality, People’s Republic of China], 沪02民终8900号 [Economic Appeal No 8900], 28 January 2019.

141 «上海福米文化传播有限公司诉左春举损害公司利益责任纠纷一案二审民事判决书» [Shanghai Fumi Art Co Ltd v Zuo Chun – Infringement of the Company’s Interests], 上海市第一中级人民法院 [First Intermediate People’s Court of Shanghai Municipality, People’s Republic of China], 沪01民终10301号 [Economic No 10301], 3 November 2017 (*‘Shanghai Fumi Art Co Ltd v Zuo Chun’*).

litigation legal expenses incurred by the 39 claimants.¹⁴² The judgment elucidates the requisite standard of care, stating

the obligation of diligence or duty of care means that when the powers of directors are exercised, they should be for the best interests of the corporation. Directors should pay attention to exercise the same care as an ordinary prudent person would for his own business affairs. Moreover, directors should take care to be as cautious as expected of a reasonably good administrator.¹⁴³

The judgment held that, as Zuo exercised due care in reviewing the claims and did not find any convincing reason to pay the claimants, his duty of care owed to his firm was not breached.

While in this case the Court introduced the ordinary prudent person standard in reviewing the conduct of the directors, it also left open the question of what is ‘a good administrator’. Does the term introduce professional requirements similar to the duty of skills, which demands directors to use their individual skills? Or, is it a more circumstance-specific expression that calls for consolidating the conditions upon which the decision is based?

A later 2019 case offers more considerations for assessing the reasonability of directorial decisions. In *Yachang Art Print Ltd Co v Dai Hu*,¹⁴⁴ the CEO, Dai Hu, rented a warehouse to Jin Du Ltd Co to reduce maintenance and other overhead expenses. Due to illegal use of this rental space by Jin Du Ltd Co, claims were raised against Yachang Art Print Ltd Co. The plaintiff claimed that Dai Hu breached his duty of care by making this deal. The judgment opines that ‘any decisions made by directors should be in the best interests of the firm and should be what a rational subject [person], in similar circumstances and with justifiable reasons, would make’.¹⁴⁵ As Dai Hu made the decision in order to reduce the operational costs of the firm, which was in the best interests of the firm given the situation, it was held that Dai Hu did not breach his duty of care under company law. Although the meaning of ‘circumstances’ is not very clear, it nevertheless further refines the standard of review for duty of care cases.¹⁴⁶

Thus, the standard of review not only requires decisions to be those of a prudent ordinary person but also requires decisions to be assessed in light of the commercial environment within which the prudent ordinary person is situated. As

142 Under Chinese company law, the legal representative is a senior executive and owes the duty of loyalty and diligence to the firm, see 李洪健 [Li Hongjian], «论公司法定代表人的制度功能与定位修正» [Research on the Function and Improvement of Legal Representative] (2019) 21(4) 中国矿业大学学报(社会科学版) *Journal of China Mining University (Social Science Edition)* 37.

143 *Shanghai Fumi Art Co Ltd v Zuo Chun* (n 141).

144 «上海雅昌艺术印刷有限公司与戴虎损害公司利益责任纠纷二审民事判决书» [Shanghai Yachang Art Co Ltd v Dai Hu – Infringement of the Company’s Interests], 上海市第二中级人民法院 [Second Intermediate People’s Court of Shanghai Municipality, People’s Republic of China], 沪02民终11313号 [Economic No 11313], 25 December 2019.

145 *Ibid* 4.

146 For a recent common law case explanation of ‘the circumstances’, see *Australian Securities and Investments Commission v Healey* (2011) 196 FCR 291 (‘ASIC v Healey’).

both these cases were at the appellate court level,¹⁴⁷ it is anticipated they will have an impact on subsequent duty of care cases dealing with the review standard.

2 Judicial Deference to Business Decisions

The cases show that judges do not appear concerned about second-guessing managerial decisions. Indeed, it is usual for judges to make business decisions in duty of care cases. The most egregious case is *Shanghai Sengang Investment Management Ltd Co v Li Qiongjian*.¹⁴⁸ The case involved an executive director, Li Qiongjian, who launched a major renovation of the property of the firm to avoid multiple minor maintenances. This decision did not please some shareholders. Due to the lengthy renovation process, the firm lost clients and profits. The shareholders initiated derivative litigation claiming that Li had made a poor decision that breached his duty of care. After confirming the executive director's authority to make the decision to renovate, and having heard the justifications from the defendant's subjective view (claiming renovation was for the long-term development of the firm), the presiding judge declared that Li did not breach his duty of care because his decision was the best one in the circumstances.¹⁴⁹ Instead of investigating the decision-making process to maintain judicial deference, the judge, instead, confirmed the defendant made the right decision. It inevitably raises concerns on the issue that judges should not meddle with a business decision, which has been widely discussed in common law jurisdictions.¹⁵⁰ Common law jurisdictions are unanimous: the judiciary should either have a policy of refraining from making a business decision or adhere to a statutory business judgment rule to prevent courts from meddling with a business decision.¹⁵¹ While the majority of cases do not discuss this matter, some more recent cases are starting to articulate the need to refrain from meddling with business decisions.

147 In order to mitigate selection bias, we also researched some cases in a less developed area in China to verify the issues being raised through the case study of Shanghai's courts. We selected Shenzhen as the verifying sample and found a very small number of the duty of care cases. They show all issues being analysed before, such as mix of the duty of loyalty: see, eg, «丘振良等诉福建福日电子股份有限公司等公司债权人利益责任纠纷案» [Qiu Zhenliang et al v Fujian Furi Electronics Co Ltd – Disputes over the Interests of Creditors], 广东省深圳市中级人民法院 [Intermediate People's Court of Shenzhen Municipality, People's Republic of China], 深中法涉外终字第36号 [International Affairs No 36], 11 March 2015. Further, in terms of the practice of the standard, given the underdeveloped economy in the area and low number of cases, Nanjing cases show less development than the ones in Shanghai. The most frequently seen standard is that the directors need to fulfil all duties in the company's constitution as the duty standard: see, eg, «吴义海与毛路桥梁附件有限公司利益相关案» [Wu Yihai v Maolu Bridge Accessories Co Ltd – Interest-Related Cases], 江苏省南京市中级人民法院 [Intermediate People's Court of Nanjing Municipality, People Republic of China], 苏01民终1149号 [Civil No 1149], 27 April 2017.

148 «上海森港投资管理有限公司与李琼建损害公司利益责任纠纷二审案件二审民事判决书» [Shanghai Sengang Co Ltd v Li Qiongjian – Infringement of the Company's Interests Dispute Case], 上海市第一中级人民法院 [First Intermediate People's Court of Shanghai Municipality, People's Republic of China], 沪01民终9095号 [Economic No 9095], 20 September 2019.

149 Ibid.

150 See, eg, Kershaw (n 125) 23–38.

151 For US discussion, see Kershaw (n 125) 68–92. For UK analysis, see Davies (n 126) 644.

Shanghai Fenna Conveyor Belt Ltd Co v Song Houbo demonstrates some degree of concern for the second-guessing of business decisions.¹⁵² In this case, Song sued in relation to the illegal termination of a labour employment contract. The employer argued that the reason behind Song's redundancy was because he violated his duty of care as a legal representative, causing mass complaints to be made on the quality of the products. The judges first differentiated between removal from a senior executive position (regulated under article 147 of the company law) and the termination of an employment contract (a matter of labour law). Concern for second-guessing management business decisions was raised. The Court opined that

corporate business activity is a complex business operation, which invites business risk to every firm. Therefore, when making a business strategy, one needs to consider risk control and handle risk with care and prudence. People cannot judge the reasonability of the conduct of a firm or its staff based on ex-post knowledge.¹⁵³

While this case reflected on and discussed the issue of not second-guessing business decisions, it eschewed the duty of care issue and decided the case according to labour law. It therefore remains unclear whether the Court's comments are a policy for consideration by the judiciary or employers.¹⁵⁴ The road to establishing a mechanism to protect business decisions from a biased ex post review is still long and difficult to navigate.

3 The Duty and Private Contracts

As China does not have a law of equity tradition, the question of whether the required standard of care can be altered via private contracting is problematic. In *Xu Minhui v Xu Jiabing*, four company founders signed an agreement before incorporation, each promising that a more stringent degree of standard of care would be exercised. Xu Jiabing later breached this promise to the detriment of the interests of the company. Although the plaintiff lost the litigation case, the Court found that the agreement was amongst the founders of the company rather than between the defendant and the firm. The judgment confirms that 'although [the standard] established by the agreement is higher than the requirement of the duty of loyalty and care, as long as it does not violate mandatory law and the constitution of the firm, it should be valid'.¹⁵⁵ This case suggests that private contractual agreements can potentially set a standard of care not lower than a judicial standard of care.

In summary, courts have difficulty acknowledging that the obligation of diligence is a duty independent from the duty of loyalty. This lack of distinction means some cases apply the review standard of the duty of loyalty, such as the

152 «上海芬纳输送带有限公司与宋厚波劳动合同纠纷二审民事判决书» [Shanghai Fenna Co Ltd v Song Houbo – Labour Contract Dispute Case], 上海市第二中级人民法院 [Second Intermediate People's Court of Shanghai Municipality, People's Republic of China], 沪02民终1428号 [Economic Appeal No 1428], 6 May 2019.

153 Ibid.

154 Ibid.

155 «徐泯穗与徐佳冰其他与公司有关的纠纷一审民事判决书» [Xu Minhui v Xu Jiabing – Other Company Dispute Case], 上海市嘉定区人民法院 [Shanghai Jiading District Court, People's Republic of China], 沪0114民初13386号 [Economic No 13386], 17 August 2018.

entire fairness standard, when adjudicating duty of care cases. The ordinary prudential person is the existing test to decide whether directors have exercised due care on corporate matters, while circumstances conducive to the derivation of the business decision should be considered. Case precedents suggest that Chinese courts are not incorporating a more 'subjective' standard to include directors' skills in the standard of review. Diligence is a highly litigated topic, and the cases tend to concentrate on meeting attendance requirements and non-submission of crucial corporate credentials to successors. Indeed, the courts have applied a more stringent attendance rule on corporations without referring to the *Director Selection and Conduct Rules 2013*. Causation analysis under torts law is widely used to establish a link between alleged breach and resulting damage.

IV SHAPING A BETTER CORPORATE GOVERNANCE STANDARD? THE PUBLIC ENFORCEMENT OF THE DUTY OF CARE

Under Chinese company law, the public supervisory agency, the CSRC, is responsible for administering the obligation of diligence.¹⁵⁶ Considering public enforcement of the duty of care is not prevalent in other jurisdictions, the practice of the CSRC is unusual.¹⁵⁷ While the CSRC is provided with a superior level of power to police the conduct of directors of listed corporations, it can only supervise listed and public companies.¹⁵⁸ However, this limitation does not impede the authority of the CSRC to make corporate governance rules by enforcing article 147. Similar enforcement activities of other jurisdictions also focus primarily on listed and public firms as a general principle.¹⁵⁹ Therefore, it is necessary to consider the CSRC's decisions on public enforcement cases to sketch out an outline of enforcement of the duty of care in practice.

The CSRC has the power to discipline contraventions of article 147.¹⁶⁰ The ability to make penalty decisions for any contraventions differs from the authority of its Australian counterpart, ASIC, which only has the power to launch a statutory duty of care litigation case as a public plaintiff. Penalty decisions can be appealed to an appellate body in the CSRC. If management does not accept the appellate decision reached, an appeal may then be made to the court. Taking this next-level recourse action constitutes an administrative case.¹⁶¹ As per Chinese administrative punishment law and relevant practices, administrative courts usually do not adjudicate matters on the reasonability of administrative decisions but rather on

156 *Securities Law 2019* (n 82) ch 13.

157 An example of public enforcement can be found in Australia, but not in the US and UK. See, eg, Ramsay and Saunders (n 58).

158 *Securities Law 2019* (n 82).

159 Ramsay and Saunders (n 58).

160 *Securities Law 2019* (n 82) art 147.

161 *Law on Administrative Penalty* (n 116) art 6.

procedural legality and erroneous application of the law.¹⁶² Consequently, penalty decisions by the CSRC receive a relatively low degree of judicial interference. Historically, courts have seldom overruled the CSRC's decisions on the obligation of diligence unless procedural wrong is found. Hence, public enforcement by the CSRC with respect to the obligation of diligence is significant for setting up corporate governance standards.

The publication of administrative decisions, including penalty decisions, has been required since the first version of the Chinese securities law.¹⁶³ The CSRC website has set aside a division, called information disclosure (xinxi gongkai 信息公开), for publicising punishment decisions.¹⁶⁴ We searched the term 'the obligation of diligence' (qinmian yiwu 勤勉义务) and filtered results to restrict the time framework to within three years to find the most recent cases by the CSRC on the Chinese duty of care. We received 24 results.¹⁶⁵ Most of the cases are on violation of directors' disclosure requirements under the securities law and mention that violating directors' disclosure requirements is a manifest breach of the obligation of diligence under the corporate law. However, four ambiguous cases appear to discuss the obligation of diligence and draw a strong inference on the existence of managerial self-dealing.¹⁶⁶ Although the cases are not very helpful for the purpose of this article due to their distinctive context, they illustrate that confusion exists. There is no clear differentiation between the duty of care and the duty of loyalty even in administrative penalty practice. For clarity, the corporate law should articulate the defining characteristics of the duty of care and the duty of loyalty. The case study of CSRC's decisions is illustrative of the non-standards-based practice of Chinese duty of care. While recognising the differences of the standards of care between listed and non-listed companies in common law jurisdictions, the study intends to show the instrumentalism in enforcing the duty that makes its standard amorphous.

162 程琥 [Cheng Po], «行政诉讼合法性审查原则新探» [Research on Administrative Legality Principle] [2019] 19 法律适用 *Application of Law* 75, 76.

163 Securities law requires '[t]he decisions on punishing the securities violation of law made by the securities regulatory authority of the State Council according to the investigation result shall be disclosed': *Securities Law 2019* (n 82) art 174.

164 Case search website is available at *China Securities Regulatory Commission* (Web Page) <<http://www.csrc.gov.cn/>>.

165 *Securities Law 2019* (n 82) arts 63, 67, 193.

166 The relevant decisions are: «中国证监会行政处罚决定书（中国高科集团股份有限公司、余丽、周伯勤等13名责任人员）» [Decision on Administrative Penalty of China Securities Regulatory Commission (13 Responsible Persons Including China Hi-Tech Group Co Ltd, Yu Li, Zhou Boqin)], China Securities Regulatory Commission, [2017] 41, 5 May 2017; «中国证券监督管理委员会行政复议决定书（万玉龙）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Wan Yulong)], China Securities Regulatory Commission, [2017] 43, 23 March 2017; «监督管理委员会行政复议决定书（朱贤洲）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Zhu Xianzhou)], China Securities Regulatory Commission, [2019] 53, 16 May 2019; «中国证券监督管理委员会行政复议决定书（朱贤洲）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Zhu Xianzhou)], China Securities Regulatory Commission, [2019] 56, 16 May 2019.

The first and the most interesting finding from the administrative case studies is that the CSRC usually holds directors and senior management liable for not disclosing mandatory issues because they cannot prove that they have adequately fulfilled the obligation of diligence. Further, the CSRC justifies this practice by citing article 58 of the *Administrative Measures for the Disclosure of Information of Listed Companies*.¹⁶⁷ This administrative regulation serves an explanatory purpose for higher hierarchy laws.¹⁶⁸ However, the provision per se is arguably not clear enough to serve the CSRC's purpose.¹⁶⁹ In administrative enforcement cases, the CSRC applies a rigorous, if not excessive, assumption-of-guilt approach to punish contraveners of the obligation of diligence.

Under this approach, it is trivial to look further for shreds of evidence on the application of the business judgment rule in duty of care cases. Instead of demonstrating reluctance in becoming involved in ex post reviews of business decisions, the CSRC is almost applying a presumption-of-guilt principle in every case once it is found that there was a failure to disclose important information. For instance, in the case of [2018] 16,¹⁷⁰ the management of Hubei Yangfan Holding Co devised a fake deal with all necessary counterfeit documents, but no actual transaction, to inflate revenue. A non-executive director, Xu Jun, argued that it was impossible to discover this covert fraud and that he had diligently participated in every meeting. However, the CSRC opined that the

directors, supervisors and senior management failed to provide the evidence to prove that they have fulfilled their duty of loyalty and diligence to ST Guoyao [the firm] on all mandatory disclosure matters ... the claims of Xu Jun that he did not participate, had no knowledge of the fraud and that he was new to his position are not the statutory defences. Therefore, [he] is liable for the contravention.¹⁷¹

Secondly, although the standard of care is the focus of the administrative case studies, no case mentions the standard of care in a way similar to the ones being applied by the courts. This is unfortunate for our research purposes since it is difficult to discern whether the ordinary prudent person or another standard is preferable in deciding director misconduct cases. The cases nevertheless offer a number of reasons to justify the CSRC's decisions, which include vital information on the circumstances where a contravention of the obligation of diligence is established. For example, the case of [2019] 69 states that directors are obligated to know the business and finances of a firm and should exercise due care including

167 «上市公司信息披露管理办法» [Administrative Measures for the Disclosure of Information of Listed Companies] (People's Republic of China) China Securities Regulatory Commission, Decree No 182, 18 March 2021 ('*Measures for Disclosure*').

168 *Legislation Law 2015* (n 53).

169 *Measures for Disclosure* (n 167) art 58:

The directors, supervisors and senior managers of a listed company shall be liable for the genuineness, accuracy, completeness, timeliness and fairness of the information disclosure of the company unless adequate evidence shows they have fulfilled the obligation to be diligent and duteous ...

170 «中国证券监督管理委员会行政复议决定书（朱乔春）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Zhu Qiaochun)], China Securities Regulatory Commission, [2018] 16, 8 February 2018.

171 *Ibid.*

making further inquiries when needed.¹⁷² Due to false disclosure on the progress of multiple projects of Shenzhen Ecobeauty Co, the CSRC decided to punish all board members of the firm. Although two directors questioned the progress of the projects before releasing relevant disclosure, the CSRC believed that mere questioning is not enough unless proper professional judgment has been exercised.¹⁷³

The case of [2017] 97 provides further relevant considerations to consider when discharging the obligation of diligence in information disclosure scenarios.¹⁷⁴ The executive directors fraudulently moved profits of 2015 to 2014 in order to meet key performance indicators. The directors who did not participate in the fraud argued that they voted for the disclosure based on independent outsider audits and accountancy reports.¹⁷⁵ However, the CSRC concluded that reliance on opinions of outsider third parties cannot exempt the director from their duty to exercise discretion in disclosure matters. Further, directors should guarantee the authenticity of the disclosed content.¹⁷⁶ In considering liability and punishment, the CSRC factored in the directors' work experience in the firm, position duties, history of fulfilling their duties of care, past opinions on similar cases, time spent in their current positions and their level of remuneration. It seems that the CSRC is much harsher on directors who benefit from relying on third-party professional opinions. However, the CSRC does not articulate what is required to constitute a satisfactory exercise of discretion on disclosure matters, which could invite criticism for being supportive of an assumption of guilt. Further, the CSRC does not categorise the majority of the consideration factors noted above as liability-relevant or punishment-relevant, which raises questions such as whether insufficient experience could be a defence for breaching the obligation of diligence or merely a consideration to reduce the punishment.

The CSRC nonetheless did offer some explanations on two of the above factors, namely non-remuneration and non-executive directors, when considering the liability and punishment of directors. In the case of [2017] 157, a non-executive director, Guangru Liu, was appointed as a figurehead and never participated in board activities.¹⁷⁷ Liu argued that he was not remunerated and was in a non-executive position. The CSRC clarified that these factors should not be relevant to

172 《中国证监会行政处罚决定书（美丽生态、八达园林、王仁年等18名责任人员）》[China Securities Regulatory Commission Administrative Penalty Decision (18 Responsible Persons Including Ecobeauty, Bada Garden, Wang Rennian etc)], China Securities Regulatory Commission, [2019] 69, 5 July 2019.

173 Ibid.

174 《中国证监会行政处罚决定书（哈尔滨电气集团佳木斯电机股份有限公司、赵明、梁喜华等23名责任人员）》[China Securities Regulatory Commission Administrative Penalty Decision (23 Responsible Persons Including Harbin Electric Group Jiamusi Electric Co Ltd, Zhao Ming, Liang Xihua etc)], China Securities Regulatory Commission, [2017] 97, 1 December 2017.

175 Ibid.

176 Ibid.

177 《中国证券监督管理委员会行政复议决定书（刘光如）》[China Securities Regulatory Commission Administrative Reconsideration Decision (Liu Guangru)], China Securities Regulatory Commission, [2017] 157, 9 November 2017.

deciding a director's culpability.¹⁷⁸ Therefore, it appears that the CSRC upholds the same standard of care for executive and non-executive directors.

In the case of [2019] 2, management of NB Sunlight Electronic Appliance Co Ltd altered accounting records by accelerating revenues and delaying expenses.¹⁷⁹ The non-executive director, Qiusheng Ou, argued that the accounting report was ostensibly so accurate that a non-executive director would not have been able to detect the fraud.¹⁸⁰ However, the CSRC does not regard the non-executive role as a factor that should mitigate the expected standard of care.¹⁸¹ Indeed, the CSRC in [2018] 54 categorically stated that the 'non-executive director position is not relevant to the standard of care'.¹⁸² Moreover, the CSRC surprisingly commented that 'considering a CEO is in charge of all operations, the standard of care should be more stringent and higher than other directors, supervisors and senior management'.¹⁸³ Nonetheless, the final decision of the case resulted only in the punishment of the CEO, rather than in the articulation of a different standard of care. There is no further case explaining what the 'more stringent and higher' standard of care involves.

Thirdly, although the standard of care applied is ambiguous in administrative penalty cases, it is still beneficial to investigate further whether the CSRC subjectively considers the director's individual skills in each case. It is then necessary to determine if the skill requirement is based on the special role of the director or the actual skills a director has personally. Case [2018] 63 provides a typical example.¹⁸⁴ It was also a financial fraud case, where the management of Shenji Group Kunming Machine Tool Co Ltd accelerated revenues and delayed expenses.¹⁸⁵ The CSRC found a non-executive director, Xiongsheng Yang, liable for breach of his duty of care together with the rest of the board. The CSRC believed that Yang's three-year experience on the auditing committee of the firm and personal professional experiences heightened his standard of care owed.¹⁸⁶ Further, it noted that Yang was a professor in accounting at a leading Chinese university. Therefore, personal skills are a factor when deciding on culpability. Admittedly, accounting expertise is the only skill, with the support of antecedent

178 Ibid.

179 «中国证券监督管理委员会行政复议决定书（欧秋生）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Qiusheng Ou)], China Securities Regulatory Commission, [2019] 2, 3 January 2019.

180 Ibid.

181 Ibid.

182 «中国证监会行政处罚决定书（五洋建设集团股份有限公司、陈志樟、王永敏等21名责任人员）» [Decision on Administrative Penalty of China Securities Regulatory Commission (21 Responsible Persons Including Wuyang Construction Group Co Ltd, Chen Zhizhang, Wang Yongmin etc)], China Securities Regulatory Commission, [2018] 54, 6 July 2018.

183 Ibid.

184 «中国证券监督管理委员会行政复议决定书（杨雄胜）» [China Securities Regulatory Commission Administrative Reconsideration Decision (Yang Xiongsheng)], China Securities Regulatory Commission, [2018] 63, 28 May 2018.

185 Ibid.

186 Ibid.

decisions, that the CSRC has expressly considered to date. This is due to most of the recent cases being concerned with financial information disclosure.

In summary, almost all of the CSRC's public enforcement cases focusing on the duty of care are relevant to information disclosure. The CSRC employs an assumption-of-guilt approach to require directors to show they have fulfilled their duty of care in disclosure matters, which significantly reduces the CSRC's burden of proof and need to illuminate the standard of care. This evidence-based approach also greatly diminishes the significance of discussions on the application of the business judgment rule in other public enforcement cases. Although the CSRC has never articulated the standard of care, it has incorporated a number of factors to assess the culpability and the punishment of directors, such as work experience. However, only factors such as knowledge of the business and financial matters of the firm, and exercising independent discretion, are relevant to culpability. Other factors, such as the executive/non-executive position of directors, are merely relevant to deciding the severity of the punishment. The CSRC also requires directors to employ personal skills when serving their duties, but all cases to date appear to only demand financial skills as a necessity. The current case study evidence examined supports an inference that public enforcement of the duty of care is very supportive of finding directors liable and is helpful in incrementally shaping a corporate governance standard of care for the market. The next Part of this article focuses on discussing the findings of previous statute analysis and private and public enforcement cases. Further, it considers the implications of these findings for forming a better duty of care mechanism in China.

V IMPROVING THE DUTY OF CARE MECHANISM IN CHINA

The statutory embodiment of the duty of care in China is phrased as an obligation of diligence. It nevertheless remains unclear whether the duty of care is independent of the duty of loyalty.

A Separating the Duty of Care from the Duty of Loyalty

Clarifying the independence of the duty of care is vital because separate duties call for separate standards. Without a standard, policing managerial shirking is difficult and inconsistent. Although some statutes and cases differentiate between the duty of care and of loyalty, the majority refer to the mixed phrase, the duty of loyalty and diligence. It can therefore be concluded that, from a practical perspective, very few cases use the standard of duty of loyalty to adjudicate duty of care cases. Notwithstanding that practitioners are generally aware of the distinction between these two duties, administrative agencies and judges tend to reference a generic name to be all-inclusive and avoid disputes. However, where the quality of a director's decision is in question and a court cannot rule out the possibility of a self-interested transaction, courts may desire to use the entire fairness standard instead to justify a business decision. Such a practice not only exposes business decisions to hindsight bias but also lowers the requisite

standard of care such that only egregiously irresponsible decisions with damaging consequences to the firm are considered as constituting a breach of the duty of care. The courts may have been aware of some core issues in setting up a standard, such as that decision-making circumstances do matter, but without the support of statute and written rules, this practice is not consistent or predictable enough. It is, therefore, imperative to separate the duty of care from the duty of loyalty and to establish a statutory standard of care to enhance the functionality and practicality of this corporate governance protective mechanism. Australia's *Corporations Act*, specifically sections 180, 182 and 183, provides an example as to how the two duties can be properly separated so as to improve the clarity of both.¹⁸⁷ Further, in adjudicating duty of loyalty cases, Australian law does not recognise the fairness standard. This may assist in reducing the chance of mixing the two duties even if the court needs to rule out self-dealing as a possibility.¹⁸⁸ Consequently, the standard of finding a self-dealing case rests on whether a conflict of interest exists.

B Adding Factors to Substantiate the Standard of Care

Following from the analysis of the existing law and its enforcement in China, it can be concluded that the need for a more detailed statutory duty of care is especially crucial in a primarily civil law legal system where case law is still not binding. As statutes and rules do not articulate a standard of care, we barely have any judicial cases that recognise the ordinary prudent person test as the requisite and appropriate standard to use when adjudicating matters involving an alleged breach of a director's duty of care. However, there is strong evidence showing that both courts and the CSRC consider that directors need to equip themselves with the necessary knowledge of the firm's business and finance matters. Courts have also mentioned a 'good administrator' as a benchmark paragon to calibrate the fulfilment level of a director's duty, which showcases the intention of the judiciary to incorporate a certain degree of industry standard to discharge the duty of care. However, it could be challenging to discern a generic industry-wide professional standard of care considering the complexity and diversification of businesses in commercial markets.¹⁸⁹ The Chinese judiciary and the CSRC have frequently mentioned that positional roles should be considered in order to decide duty of care cases fairly. Further, court cases show that decision-making environments need to be factored in when assessing whether directors' conduct has been consistent with their duty of care. It perhaps suggests that China could adopt the reasonable and prudent person standard, supplemented with circumstances and position expectations factors, which have been adopted in some English corporate law cases, such as *Overend & Gurney Co v Gibb*.¹⁹⁰ This could establish an explicit and viable standard, allowing the specifications and idiosyncrasies of a firm and positional requirements to be factored into consideration.

187 Redmond (n 5) 386.

188 Ibid 505.

189 Ramsay and Austin, *Company Directors* (n 6) 246.

190 *Overend & Gurney Co v Gibb* (1872) LR 5 HL 480, 486–7 (Hatherley LC). This is the standard of care referred to by Ramsay and Austin: Ramsay and Austin, *Company Directors* (n 6) 250.

A possible problem of adopting such a standard is how best to consider the circumstances upon which management makes a business decision. An iconic Australian case, *ASIC v Healey* ('*Healey*'), provides a shortcut for defining what constitutes a corporate circumstance.¹⁹¹ Six specific circumstances have been emphasised in *Healey* to increase the degree of flexibility available when applying the duty of care standard: 'the type of company, the provisions of its constitution, the size and nature of the company's business, the composition of the board [of directors], the director's position and responsibilities within the company'.¹⁹² These factors could be adopted initially as the cornerstone of the Chinese duty of care, thereby allowing for future modifications based on practical and case experience.

C A Subjective or Objective Standard of Care

It could be relatively straightforward to derive an objective standard of care. An objective standard is essential not only for increased efficiency of judicial applications but also for the market supervisory agency to establish a corporate governance standard by explaining the law in particular case decisions. Therefore, the CSRC can further enrich the consideration of the above six circumstances and what constitutes position expectations in its future decisions. Through the amalgamation of decisions, the CSRC can establish corporate governance norms to shape Chinese corporate industry standards to protect firms and shareholders. However, the problematic issue is whether a more 'subjective standard', which enables an individual director's personal circumstances to be reasonably considered, needs to be installed. As per previous research on the CSRC's decisions for administrative punishment, it seems that the 'subjective standard' received some support in practice. Whereas, in court judgments, there is no evidence to support that the judiciary has considered a 'subjective standard'. This is a compelling finding. To be clear, a more 'subjective standard' is not purported to benefit directors when a director's ability is lower than that of an ordinary prudent person. Such application would incrementally chip away the ordinary prudent person standard by underscoring the features of an inadequate individual. The 'subjective standard' should be designed to protect the interests of firms. Firms hire directors for their skills and expertise. In most cases, the unique and above average abilities of the directors are the reasons they are employed.¹⁹³ In other words, directors are appointed in the hope of exchanging money for value. Omitting consideration of the 'subjective standard' will simply reduce the employment contract value of the role of a director, which essentially means responsibility for a company's management could potentially be given to a mediocre MBA graduate. Therefore, the 'subjective standard' usually heightens the ordinary prudent person standard, rather than acknowledging and assisting those directors with standards lower than that of an ordinary prudent businessperson.¹⁹⁴

191 *ASIC v Healey* (n 146).

192 *Ibid* 330 [165] (Middleton J).

193 Kershaw (n 125) 240–2.

194 Ramsay and Austin, *Company Directors* (n 6) 251–2.

The 'subjective standard' is supposed to facilitate the obtaining of compensation by investors in private enforcement cases, while the objective ordinary prudent person standard should be a perfect instrument for market regulators to establish industry corporate governance norms. However, the question is why does this logic get reversed in Chinese practice? In terms of private enforcement, given the fact that the statutory standard of care is mostly missing, the judiciary pays more attention to constructing a general standard in order to uphold the consistent application of the law. Deviating from the objective standard to adopt a 'subjective standard' might enlarge the uncertainty surrounding the elusive corporate law provision on the obligation of diligence and further reduce the court's credibility in offering litigation participants a convincing dispute resolution. Therefore, Chinese courts have reasonably opted to have a consistent standard, rather than to have a set of better standards. In terms of public enforcement, most of the duty of care cases are disclosure-related. Typically, a disclosure case involves the market regulator facing many aggrieved public investors having been misled by false or inaccurate information. Again, since there is no clear ordinary prudent person standard established in law, the CSRC enjoys a certain degree of freedom to prioritise enforcement efficiency, which involves rendering quick punishment decisions to appease the anger of public investors. Therefore, the CSRC, in many cases, discusses a director's higher-than-normal abilities as a basis for justifying a finding of culpability.

Therefore, the reversed enforcement logic upheld by the judiciary and the CSRC has produced a situation of inconsistent standards on the duty of care of directors. In practice, the CSRC's non-governance-standard-setting application of law considerably dampens the authority of the law and increases the unpredictability of administrative punishment enforcement case outcomes. On the other hand, courts are struggling to adjudicate duty of care compensation cases, which on some occasions have obviously failed to serve justice to the aggrieved. A statutory standard of care needs to be established. While at first instance, this proposition calls for the construction of an essential duty of care standard, the 'subjective standard' is still valuable for protecting firms and investor interests when they expect their directors and management to perform according to their high remuneration. Therefore, it is worth considering establishing a second dimension to the duty of care standard to adequately protect the expectations of investors and firms. This means that if directors and management have abilities higher than that of the ordinary prudent person, they should use this ability when fulfilling their duty of care.

The objective of encouraging entrepreneurship autonomy of directors and senior management appears to be in direct opposition to arguments for imposing a duty of care. Therefore, it is necessary to also adopt mechanisms to protect risk-taking decisions by directors whilst maintaining a reasonable expectation for performance. Unfortunately, any existing mechanisms in Chinese law and practice are like missing jigsaw pieces. The business judgment rule is the most frequently discussed method of protecting the decisions of directors. As discussed, it appears that most jurisdictions either have this rule or implement a similar

concept when adjudicating cases in practice.¹⁹⁵ Considering previous judgments and administrative punishment decisions, China appears to have a tradition of second-guessing business decisions of directors. Hence, having a statutory business judgment rule is sensible to ensure directors endeavour to make value-maximising, but necessarily risky, transactional decisions for the benefit of their company.

The defence of reliance on a third party is also crucial to rationalise the duty of care mechanism. The CSRC presently does not allow directors to rely on the opinions of outside professionals, which seems too harsh and demanding a burden for any director, as no one is an expert in every area. Although it is quite unlikely that the CSRC believes directors should have expertise covering all foreseeable situations, rejecting the defence of reliance at first instance simply makes punishment reasoning more efficient. The pursuit of efficiency is also evident in the non-executive director standard of care cases. To apply the same standard of care to executive and non-executive directors could be too simplistic and unfair because it is unrealistic to expect their knowledge of firm-specific information to be at equivalent levels, if not significantly different. This practice, nevertheless, is consistent with the CSRC's presumption-of-guilt approach. Admittedly, punishing irresponsible directors protects both the company and investors. However, a fair and just duty of care mechanism that protects the interests of both directors and investors can benefit the company even more significantly. The establishment of a reliance defence system and a different standard of care for non-executive directors can improve the soundness of punishment logic and offer convincing decisions that assist in furthering the CSRC's regulatory authority. The contextual focus of cases involving reliance on third parties or non-executive directors should be defining the circumstances when directors should not rely on others and the appropriateness of the non-executive standard of duty of care, respectively. After all, in a jurisdiction without the law of equity as tradition, such as in China, the lucidity of the law and self-constraint of adjudicators are the lifeblood of a credible and efficacious duty of care mechanism.

VI CONCLUSION

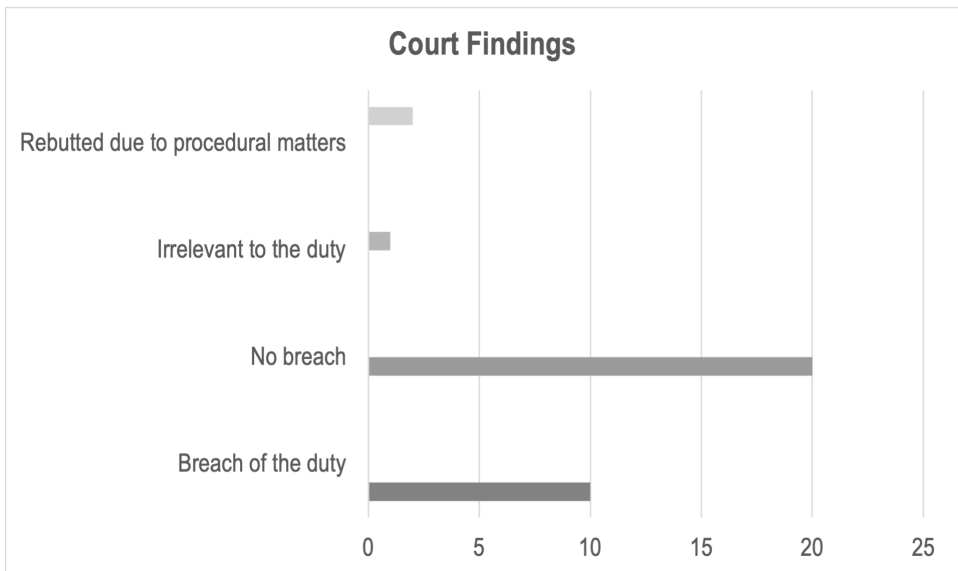
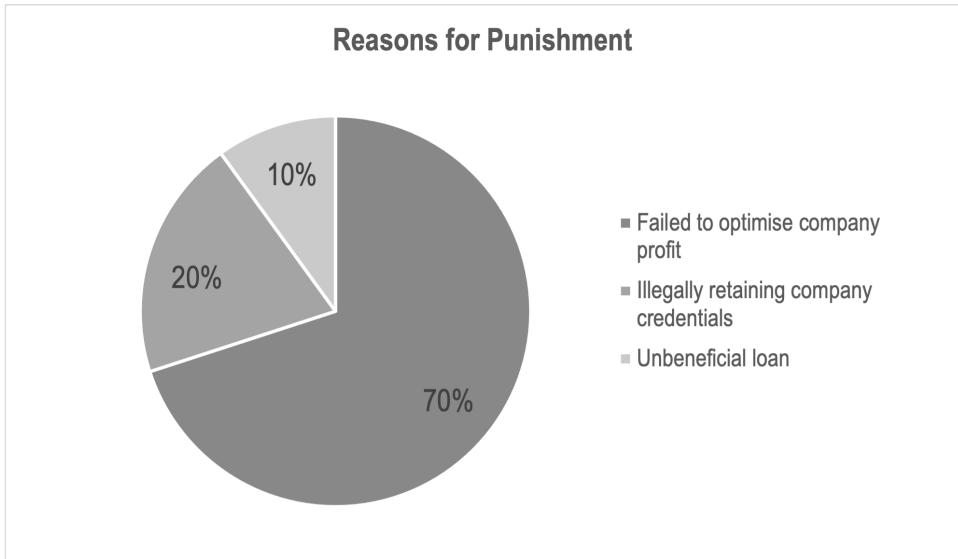
For over two decades China has instituted directors' duty of care in order to curb managerial shirking problems. Given that Chinese corporate ownership structures are concentrated, and directors' discretionary business decision power is less than that of their counterparts in common law jurisdictions, the Chinese duty of care not only focuses predominantly on directors' diligence but is also referred to as the obligation of diligence. While it still has segments relevant to directorial decision quality, the standard of care ought to be the core issue of the statutory duty. Even though the statutory duty of care under corporate law remains vague and elusive, many commercial laws and administrative rules offer further

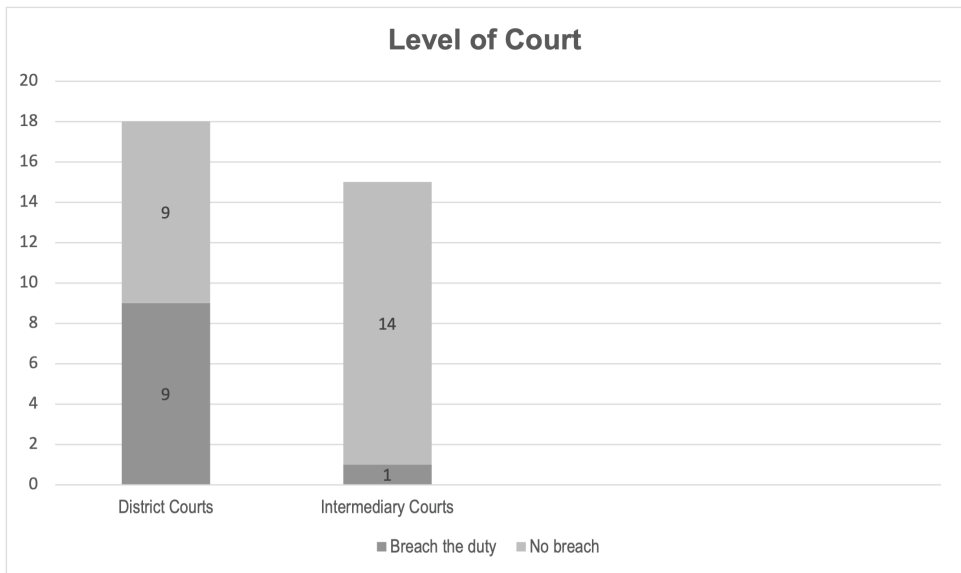
195 For an example of a jurisdiction that has the statutory business judgment rule, see Eisenberg (n 122). For an example of a jurisdiction that believes its adjudication policy can take the same effect as the statutory business judgment rule, see Riley (n 126).

explanations of this duty. The laws and rules, however, provide non-systematic and fragmented information on the duty of care standard, which does not help draw a complete outline of the Chinese duty of care review standard, as they are usually constructed to serve their own unique purposes. This observation justifies a survey on the enforcement of the duty to discern how the judiciary and other agencies cope with the legislation deficiency.

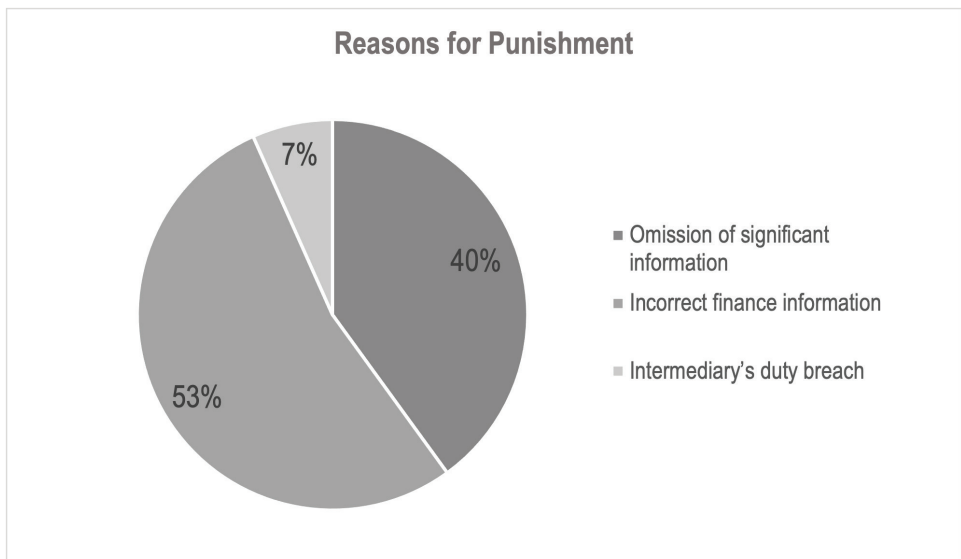
In most cases, the Chinese judiciary deals with private enforcement claims, while the CSRC takes care of duty of care cases involving listed firms from a public enforcement perspective. While both of them struggle in practice due to the lack of clarity over the statutory duty of care, many judgments and administrative decisions provide enriched explanations of the duty. There is practical evidence suggesting that China has established a very preliminary system explaining the duty of care mechanism. The system, however, is distorted due to idiosyncratic incentives and purposes of the judiciary and the CSRC. Further, the vagueness of the duty of care may allow for parties with powerful political connections to apply pressure on judges to 'interpret' the law in their favour, whereas a clearer standard of care may reduce such abuses of discretion. In order to rectify the distortion and prevent potential abuse, the Chinese legislature should consider installing a statutory duty of care standard. Additionally, empirical evidence shows that the objective ordinary prudent person standard might be too simplistic for both the courts and the CSRC. Instead, it appears that the objective standard needs to include decision-making circumstances and position expectations elements to meet the practical demands of each case. As a director's individual ability has already been used in some cases to assess culpability, it is worth considering installing a second dimension to the statutory duty of care standard that elevates the general objective standard to account for idiosyncrasies. Admittedly, without further statutory guidance, it would be challenging for the Chinese duty of care mechanism to progress in the current civil law environment systematically.

APPENDIX I: JUDICIAL DECISIONS STATISTICS





APPENDIX II: CSRC DECISION STATISTICS¹⁹⁶



¹⁹⁶ There are 24 CSRC decisions in total, some of which were administratively reconsidered. Accounting for the reconsidered decisions only, there are 15 final decisions, all finding management breached the duty. The main reasons for the 15 decisions are shown in the following pie chart.