

Article

Trends and Development of the Directors' Duty of Loyalty in China: A Case Analysis

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Abstract: Covering a central theme in corporate law development, this paper discusses the pragmatic utility of the common-law-originated duty of loyalty of company directors in the civil law context of China. The reception of legal transplantation in a host environment remains a contentious theme, and it seems to be an opportune time to study relevant cases that have been adjudicated since China's statutory inauguration of the directors' duty of loyalty in 2005, in the sense that more than 10 years of practice has resulted in ample evidence on the practical effects of this transplanted duty. Through an analysis of 526 cases on the basis of eight attributes, we discovered some commendable features, including increasing accessibility of the law and a differentiation of various types of directors' duties of loyalty. Meanwhile, the selective adoption norm customary to Chinese culture has to a certain extent compromised the intended goals of greater legislative clarity, judicial consistency and in turn balanced and sustainable businesses, demonstrated in several incompatibilities between transplanted duties and domestic legal institutions. Reshaping the conventional transplantation ideal that commercial laws are easily transferable, the paper suggests the construction of a broad collateral regime for greater congruence between laws and existing institutions.



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1. Introduction

For centuries, one of the sacred centrepieces and also the messiest parts of corporate law has been the substance of the duty to which company directors are subject—a topic both doctrinally complex and pragmatically vital to promoting entrepreneurship, sustaining effective long-term relationships with stakeholders [1] (pp. 12–14) and balancing the impacts of corporate operations on the economy and the community, thus bringing about “a cultural change in which companies conduct their business.” [2] (p. 2). While countless variations tailor the general obligation to specific contexts [3] (pp. 1399–1400), the two groupings initiated in English law and now widely referred to in almost all comparative corporate law studies, namely the duty of care and the duty of loyalty, form the major tenets of the directors' duty. The duty of care rests primarily on the law of negligence to guard against managerial incompetence. The fiduciary duty of loyalty, on the other hand, traces its origin back to the English courts of equity. This duty has now developed into a well-rounded concept embodying a host of duties, with its intrinsic substance acknowledged and adopted in common and civil law families, albeit with degrees of variation [4] (p. 340).

The duty of loyalty was for decades an alien concept in China, and this continued to be the case even after the inception of the Chinese Company Law in 1993. However, the directors' duty of loyalty regime is no longer statutorily absent since China's 2005 Company Law reform introduced the common law categorisation, in the hope of conforming to

prevalent international business standards and developing a market-based sustainable economy in this fast-growing nation [5] (p. 361).

Legislative intents notwithstanding, it remains intriguing how this “most demanding and litigated obligation imposed on corporate managers” [6] (p. 1076) functions in practice, not only in terms of its rich factual nature, but also in its adaptation to the civil law setting of China. Even in common law jurisdictions where this duty came to fruition, legal scholarship tends to point to the “complicated and nuanced” [7] (p. 930) nature of the law of fiduciary duties in itself, critiquing codification as a “pedantic” move [8] (p. 119). Likewise, leading commentators on the fiduciary obligation have concluded that it is “atomistic” and “elusive” [3] (p. 1400), [9] (p. 915). The rich substance of the duty of loyalty would, in the eyes of opponents, render codified rules either meaninglessly abstract or extremely complex, aiming to be inclusive of all contingencies. Thus, the likely effects that follow codification would either be courts being at liberty to interpret (or ignore) differences in substance of the duties, or the law being “frozen” and developments being impeded as business circumstances evolve [10] (p. 464). This provides adequate grounds for examining real judicial practices.

A brief scrutiny of the field provides further compelling reasons for testing the pragmatic fit of this transplanted duty regime in China. While legal transplantation advocates have faith in the mobility of “autonomous and apolitical” corporate and commercial laws that are seen as less socially embedded [11] (p. 572) [12] (p. 206), the extent to which background institutions have an impact on the pragmatic utility of law remains controversial. After all, real-world practice is notorious for diverging from the principles in codes [13] (p. 206). In a field of law such as the duty of loyalty, which is renowned for its complexity and fluidity in almost every jurisdiction, research based on judicial practice is indispensable to ensure that established legal principles are capable of reacting to and accommodating the reality. Against the contextual backdrop of China, examining the fit of judicial practice to the literal construction of the law on the directors’ duty of loyalty appears crucial.

Having examined the need for pragmatic insight into the field of the directors’ duty of loyalty, discerning readers will immediately be aware that this is also a favourable time to assess the real-life effects of China’s 2005 codification of the duty of loyalty. Practices in more than a decade may provide valuable information and evidence for us to observe the trajectory and problems in relation to the legislative approach and the enforcement of the duty.

Compared with previous work, this paper has its original elements. First of all, judicial applications of the directors’ duty of loyalty in China have hitherto been under-researched. Even though there has been a quantity of literature concentrating on directors’ duties of loyalty in China [14–16], statistical findings are thus far scarce. The most influential of these has been the research conducted by Professor Xu et al. [17]. Their research covered both the duty of loyalty and the duty of care and was based on a detailed analysis of 40 cases related to directors’ duties in China. Other research in the field tended to cover one or two elements of the duty of loyalty, for instance, Professor Hou’s work [18] focusing on the corporate opportunity doctrine and involving an analysis of 10 cases. Building upon and juxtaposing itself with existing research, the present study focuses on the discussions of directors’ duty of loyalty and is built on a much bigger statistical base of 526 cases, involving a complete examination of all available cases relating to “duty of loyalty” that have been adjudicated in more than a decade, since China’s statutory inauguration of the directors’ duty of loyalty.

Taking account of directors’ duties of loyalty in the Chinese socio-cultural setting via the legal transplantation lens also adds originality to the paper. While a number of works devote to the contentious debate of legal transplantation, they mainly comment from the jurisprudential or theoretical perspective [19–21]. Kanda and Milhaupt’s work [22] is perhaps one of the exceptions in the field, examining legal transplants in the context of directors’ duties. However, their work was based upon directors’ fiduciary duty in Japanese corporate law. The fit of these common law-originated duties within the Chinese context

thus far has not been given adequate thought. We strive to fill this gap by offering a careful consideration of socio-cultural factors that might have impacted on legislative and judicial practice, such as the selective adoption method that could be traced to Confucianism, and the long-standing non-litigious culture. The uniqueness of the Chinese context makes these arguments multi-faceted and complicated. For example, rather than simply criticising the problems caused by selective adoption, we see this method as a double-edged sword with both positive and negative impacts on the trajectory of directors' duties of loyalty in China: The selective transplantation of rules and the connecting pragmatic view of law is efficient in making laws rapidly responsive to the nation's fast-changing economic and social needs. Meanwhile, it could also lead to the result that only urgently needed foreign rules are transplanted, and then in a scattered manner, leaving some necessary complementarities out of the picture.

This research should provide an essential primer for legal practitioners and in-house counsel who deal with directors' duties and corporate governance issues on a regular basis, and legal and business theorists on corporate law and governance. This article identifies the judicial trajectory and problems in application, in the hope of building up a more effective framework of the duty of loyalty. The research outcome will also be of interest for legislators and policy makers to understand potential problems in the application of the law, identify directions for reform and promote sustainable development of businesses and the Chinese economy.

The article is structured as follows. It commences with an overview of the fiduciary origin of the directors' duty of loyalty and its legal evolution in China in Part 2. Part 3 describes the methodology used in the research, including case selection methods, categorisation standards, potential limitations and the significance of the research. It then summarises the statistical findings in relation to all publicly available cases adjudicated under the statutory duty of loyalty, providing practical insights into the accessibility of the codified duty of loyalty and the consistency of judicial applications, the two most important codification agendas highlighted by Chinese legislators. The statistics analysis in Part 3 lays a foundation for the following interpretative analysis in Part 4, which appreciates the factual-specific and fluid nature of the duty of loyalty. Both the outer confines and intrinsic substance of the duty of loyalty in China are examined, to test the results reported in Part 3, particularly the degree of judicial consistency. Part 5 adopts a comparative approach and examines factors that affect the congruity of law and institutions. Part 6 contextualises suggestions for future legislative reform. Reform proposals underpinned by three criteria are suggested. The last section concludes the paper.

2. Legislative Agendas Underpinning the Borrowing of the Duty of Loyalty in China

2.1. An Overview of the Duty of Loyalty and Its Equitable Origin

It is always helpful to start with the origins of a legal conception if one wants to fully understand its confines and intended applications, particularly for a well-loaded term such as the duty of loyalty. Two analogies have thus far been drawn to delineate the nature of a director's duty of loyalty in the common law world—trustee-beneficiary, and agent-principal. In the early development of company law in common law jurisdictions, the director-company relationship was mostly treated as analogous to the trustee-beneficiary construct, for instance by frequent usages of "cestui que trust" [23]. In comparison, the corporation-principal analogy has been less influential in the development of directors' duties, not least owing to the "notoriously slippery and difficult to define" concept of agency itself [24] (p. 1). However, one may still find expressions of this analogy from time to time, most eminently in the remarks of Cairns LJ in *Ferguson v Wilson* [25].

Be that as it may, trust and agency analogies do not make that much difference when it comes to understanding the essence of the duty of loyalty, when both analogies trace their origins back to a fiduciary concept developed by the courts of equity, which literally means faithfulness [26]. The strong influence of equity can still be felt today in English law in the complex underlying connotations of the duty. Some statutory provisions clearly do

state the corresponding equitable principle, or “at least something quite close to it”. [27] (p. 178). This potent jurisprudential basis implicates those directors are to act in good faith for the interests of their company and are subject to an “equitable disability”—i.e., their fiduciary functions are governed by a set of proscriptive rules that disable them from acting in certain ways, for instance keeping any unauthorised profits of office [28] (p. 314).

In good part owing to the flexible equity nature of the directors’ duty of loyalty and the concern that additional specification invites abuse in practice [29] (p. 1043), there have been strong objections in common law jurisdictions to “rigid” codification and “invariable appl(ication) strictly and to the letter” [8] (p. 119). The UK made a notable codification attempt in Chapter 2 of Part 10 of the Companies Act 2006 [30], setting out seven general duties of directors. Meanwhile, this codification does not reduce the considerable scope of judicial interpretation or remove the law-making power of courts, as evidenced in s. 170 (3)–(4) of the Companies Act 2006 [30].

2.2. *The Problems of the 1993 Chinese Company Law and Improvements in the 2005 Law*

2.2.1. Clarity and Accessibility

In China, the privileges of incorporation and limited liability have been obtainable since the inception of the first Company Law in 1993 [31]. However, the duty of loyalty regime initially did not find a proper place in this framework, much owing to the fact that the pragmatic integration of government administration with enterprise in China had largely reduced the need for an individual legal regime governing directors, who would have been directly disciplined or removed by administrative orders in cases of managerial unfaithfulness or incompetence. As such, the 1993 Company Law did not conceptually distinguish between the duty of loyalty and the duty of care. Even though directors were required under Art. 59, §1 to “perform their duties faithfully”, there was no explanation of embedded behavioural standards or their interconnections to other loosely scattered provisions restricting directors’ behaviour [31] (Arts. 59–62 and 123 §2). One of the primary reasons for codifying directors’ duties in the 2005 reform was thus a desire to enhance legislative clarity by eliminating statutory imprecision and overlaps in the 1993 framework, particularly as regards the duty of loyalty.

2.2.2. Interest-Balancing and Consistency in Application

Another axiom underlying almost all legal reforms to the directors’ duty is interest-balancing, namely to both protect and deter directors in making management decisions, so that the enterprise can “flourish freely in a climate of discipline and accountability” [32] (para 9). China is no exception in this regard. Admittedly, the 1993 Company Law regime was not quite satisfactory when it came to the deterrence of directors’ misbehaviour. Aside from the sparsely articulated provisions discussed above, directors would only have been held liable for breach of duty under the 1993 regime if the principal company could prove that there was a breach, that the company suffered actual losses and that the damage was primarily caused by the breach [31] (Art. 63). Compensation for damage was the only remedy to a breach, largely restricting the provenance of redress methods. Taking the doctrinal deficiencies of the 1993 regime into account, placing the directors’ duty of loyalty on a clear statutory footing was well-received during the 2005 Company Law reform on the grounds that it would render Chinese company law more coherent, clearer and accessible [17] (p. 58).

2.2.3. Conformity to International Legal Development

Other than the above-stated doctrinal considerations, one must also acknowledge the fact that a nation’s legal development normally marches in step with its policy imperatives. Indeed, a broader view would see this legislative move in tune with China’s policy status, poised to attract foreign and private investment. Introducing the mainstream categorised duties of directors could be seen as part of China’s promise to provide more effective investor protection in the hope of consolidating a market-based economy. Influenced by

contemporary studies of “law and economics” and “law and finance”, a number of Chinese scholars also trust that the introduction of directors’ fiduciary duties, an important part of developed market economy mechanisms, would help to reduce agency costs and constitute a well-functioning investor protection mechanism in China [17] (p. 60).

2.2.4. The 2005 Company Law in Response to these Problems

On the basis of these legislative expectations, the enactment of the 2005 Company Law placed the directors’ duty of loyalty on a statutory footing, in line with China’s civil law affiliation. This directors’ duty regime remains intact in the 2018 Company Law [33]. Embedded in Chapter Six, codified directors’ duties have made major improvements in the following three aspects with regard to the duty of loyalty, reflecting the legislative aims identified above:

1. Seeking to increase the clarity of laws, by way of initiating a duty framework entailing a “common law style classification”, consisting of both the duty of loyalty and duty of care [33] (Art. 147, §1) [34] (p. 189).
2. Seeking to improve the coherence of provisions and provide more clarification of the implications of the duty of loyalty, by way of combining individual duties that were originally scattered in Art. 60 to Art. 62 of 1993 Company Law [31] as specifics of the duty of loyalty (now Art. 148, §1 [33]). A new catch-all provision was also added in paragraph (8), in the hope of grasping the fluid nature of the duty of loyalty and affording judges more discretionary power, by way of prohibiting all “other acts inconsistent with the duty of loyalty to the company” [33] (Art. 148, §1(8)).
3. Seeking to conform to international business standards and incentivise investors, by way of expanding the remedial realm [33] (Art. 148, §2). This is accomplished by transplanting an equity remedy originally only available to fiduciary breaches in common law—the disgorgement of unauthorised profits [33] (Art. 149).

Laudable legislative agendas notwithstanding, it remains to be seen to what extent judicial practice applies to the letter and fulfils expectations. The following section contributes in this regard, by investigating whether the codification improves in general on the accessibility of the law and the consistency of judicial applications.

3. Statistical Summary of Our Findings of Reported Cases—Improved and Contextualised Accessibility of the Law

3.1. A Description of the Case Collection Method

This paper uses a widely-used electronic database—Wolters Kluwer (威科先行)—as the main search engine for the study. This research searched the key word phrase—“duty of loyalty” (忠实义务)—in all cases published under the category of “civil law cases relevant to companies”, the cut-off judgement date being 1 January 2018, aiming to cover all available cases adjudicated in the decade following the enforcement of codified duties. The search employing the key term “duty of loyalty” initially returned 1112 cases. These cases then were filtered, eliminating the following four types: (1) judgements in which the court did not consider the issue of breach of the duty of loyalty, although the plaintiff or the defendant mentioned the key phrase in their statement; (2) decisions of the trial courts which were subsequently appealed, where appeal judgements were collected in the case set; (3) cases that were recorded more than once; and (4) cases published with no party or court details, thereby presenting risks of inaccuracy and duplication. A collection of 526 cases was eventually compiled to draw statistical conclusions. The authors read all the cases, recorded patterns and drew inferences in relation to the following eight attributes: (1) the year of the case; (2) the level of the court in which the case was heard; (3) the geographic location of the court; (4) the identity of the defendant(s); (5) the identity of the plaintiff(s); (6) the type(s) of duty of loyalty involved; (7) whether or not the court considered the director was in breach; and (8) key company law provisions drawn upon by the court. Typical cases were further analysed, taking into account both the courts’ reasoning and other courts’ reasoning in cases with similar facts and claims.

It is also worth pointing out that the duty of loyalty in China is not restricted to regulating directors only. As stipulated in Chapter Six of the Company Law, provisions relevant to the duty of loyalty apply equally to directors, supervisors and senior managers of the company [33] (Art. 216(1)). We find that (1) case judgements involving senior managers and supervisors are of equally significant value to case judgements involving directors in comprehending the ingrained features of the duty of loyalty in China; and (2) in many cases directors undertake multiple roles and simultaneously act as senior managers. Therefore, we include duty of loyalty cases involving senior managers and supervisors to ensure the completeness of the case collection.

3.2. *The Methodology, Potential Limitations and Significance*

As with any observational study, potential limitations exist in collecting and analysing judicial decisions, the biggest being the selection bias. Our case collection may likewise present a partial picture of the total disputes concerning the directors' duty of loyalty, considering that in practice only a portion of disputes result in legal claims, and many claims may be settled prior to reaching the judgement stage. This is particularly true in China due to "its generally non-litigious culture." [35] (p. 747). Nevertheless, several factors help to mitigate selection bias in this paper. First, this study uses a more complete set of cases compared with previous studies on reported cases. We also read and filtered all the cases, to avoid the inclusion of irrelevant/repetitive cases. Second, the law concerning the duty of loyalty is far from crystallised owing to its fact-specific nature. This is especially the case in China, where no authoritative case precedent or judicial interpretation is available to supplement the legislation. A combination of content interpretative approach and comparative analysis will thereby be helpful in mitigating this problem, particularly in clarifying the boundaries and intrinsic substance of the duty of loyalty in China.

Another potential limitation of this work links to the interpretative analysis of judgement contents in Part 4, which appears circular or even "trivial" to some social scientists, given its primary reliance on reported facts and judicial reasoning. Yet the classic interpretative analysis in the legal context presents advantages that cannot be easily displaced by empirical means derived from other social science disciplines. After all, the judicial evaluation and creation of law "must depend upon fact-finding" [36] (p. 402), which is a feature that cannot be simply reduced to data and mathematics. To a large extent, scholarly usages of interpretative analysis can be likened to the way that judges develop the common law—pointing directly towards the understanding of law through appreciating the interaction of facts, arguments and the interpretative substance of judicial reasoning [37] (p. 64, p. 82). Such interpretative analyses of judicial reasoning appear particularly appealing when we consider the duty of loyalty, when the legal evolution depends significantly on case law development.

In this study, discretionary results are most likely to be discernible when it comes to analysing and categorising the type(s) of duty of loyalty involved in cases [7] (p. 930). This paper attempts to mitigate this limitation by adopting a dual categorisation method. It first followed the statutory categorisation approach set out in Arts. 147 and 148, §1 of China's Company Law 2018 [33], and divided the cases into five big categories: self-dealing (Art. 148, §1(4)), the exploitation of corporate opportunities (including engaging in the same kind of business as the corporation such as holding conflicting directorships) (Art. 148, §1(5)), the exploitation of corporate assets (including funds) (Art. 148, §1(1)–(3)), accepting bribes or taking benefits from third parties (Art. 148, §1 (6); Art. 147, §2) and not acting for a proper purpose (Art. 147, §1). Multiple reasons were also recorded when courts gave more than one reason for their decisions. 65 remaining cases did not fall neatly into any of the above categories owing to the rich nature of duty of loyalty. Given that the directors' duty of loyalty primarily originated and developed in the English law context, the authors, referring to English law and the Provisions of Causes of Action of Civil Litigations in China, further categorised these cases as "not acting in good faith to promote the success of the company" [30] (s.172) [38].

3.3. Primary Summary Statistics

3.3.1. The Accessibility of the Law Judging from Case Distributions

We begin with summary statistics describing the general accessibility of the law. Judging from the distribution of cases across the study period, the positive impact of codification in increasing the accessibility of the law is evident. As shown in Figure 1, prior to 2006, i.e., when the 1993 Company Law was still in force, the number of cases relating to the directors' duty of loyalty was almost negligible. However, there has been a clear increase in the number of cases heard on a yearly basis since the 2005 reform, particularly after 2011, indicating the growing popularity of resorting to the statutory duty of loyalty as a means of protecting the interests of the company and shareholders.

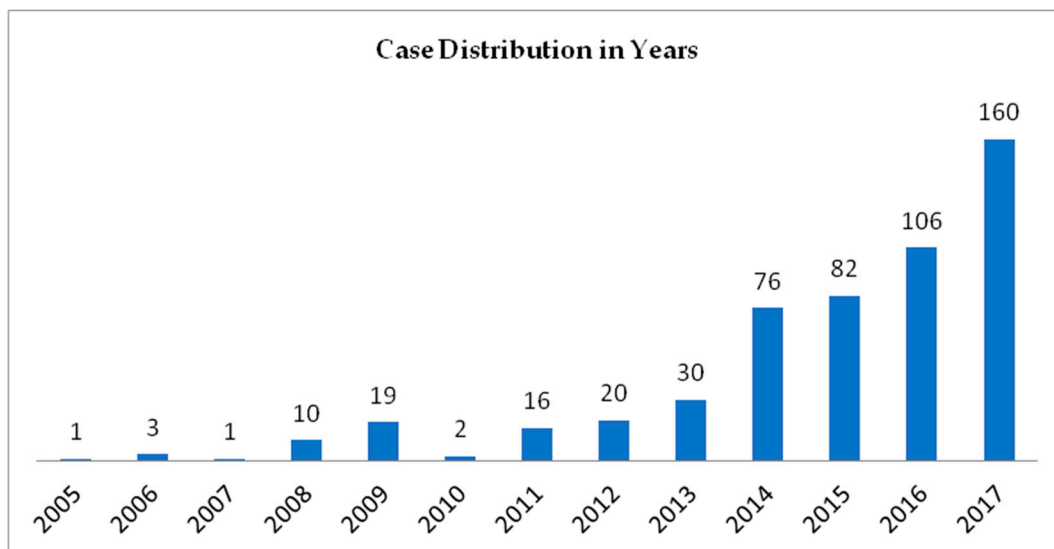


Figure 1. Case Distribution in Years.

Figure 2 shows the distribution of cases among courts at different levels. Of the total 526 cases, 278 were judged by courts of first instance, 229 were appeal cases and 9 were retrial cases. The wide availability of appeal mechanisms enhances various parties' further accessibility to the accurate application of the law, should they question the judgement of the first trial.

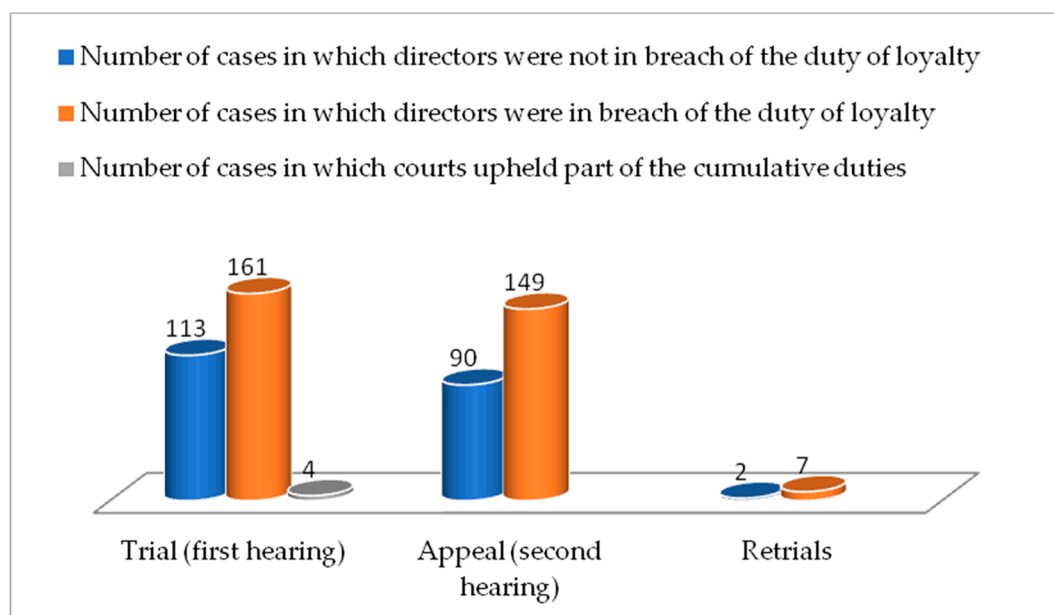


Figure 2. Distribution of Cases among Courts at Different Levels.

The geographical distribution of the cases shown in Figure 3 further demonstrates the widespread accessibility of the law. Existing cases were brought before and judged by courts in 31 provinces, autonomous districts and municipalities directly under the Central Government according to the codified duty regime, in stark contrast to the 4 cases judged under the 1993 Company Law.

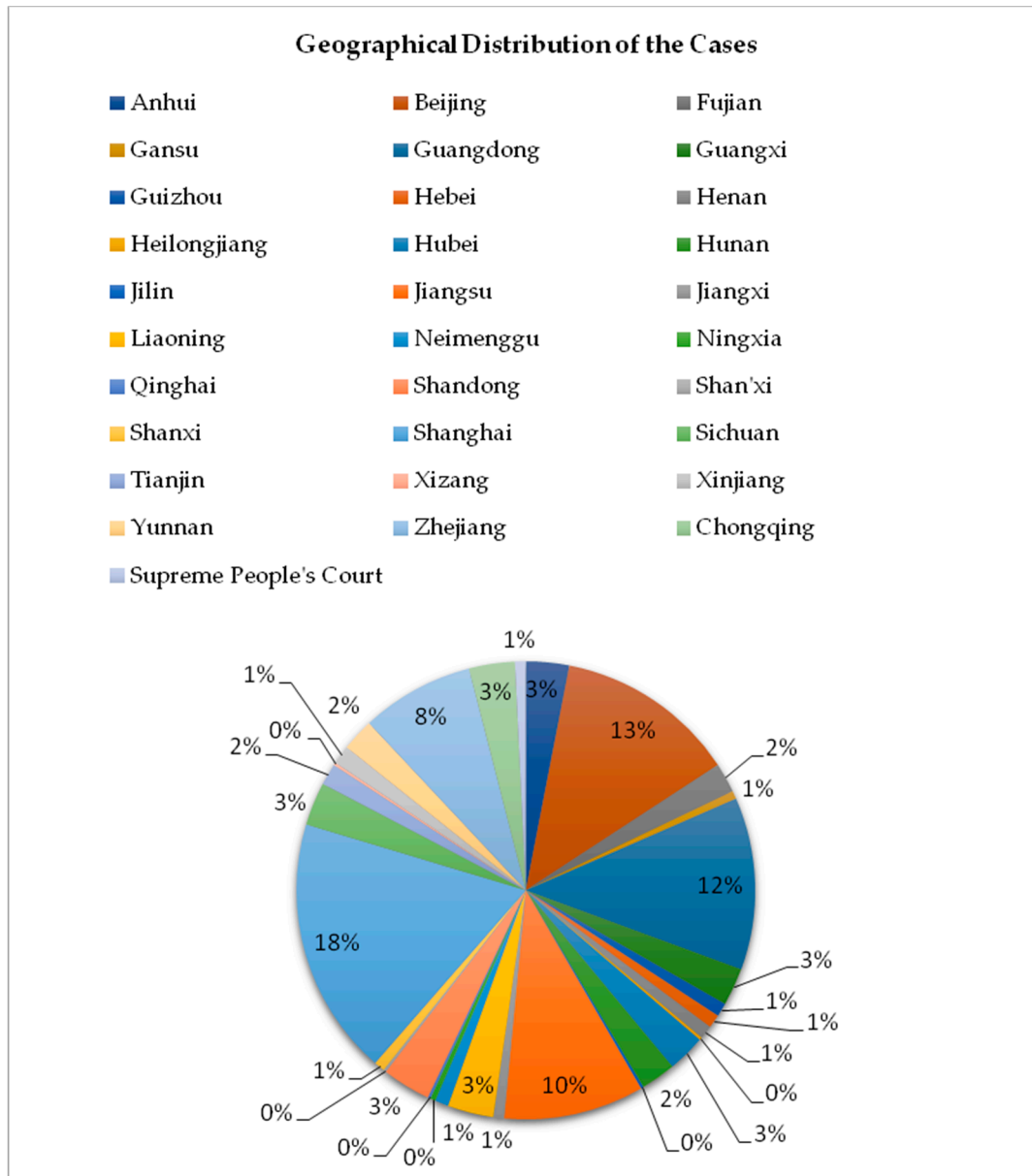


Figure 3. Geographical Distribution of Cases.

While the first three Figures show the growing popularity of enforcing the statutory duty of loyalty at a national level, there is implication that the even accessibility of law might be contextualised in practice, for instance, by the geographic distribution of the cases and company types. As evidenced in Figure 3, the overwhelming majority of cases were brought in a few economically developed regions, including Guangdong province, Jiangsu province, Zhejiang province, Shanghai and Peking. One possible explanation is that corporate activities are more intensive in these economically developed regions, leading to a comparably higher incidence of legal disputes.

The next result in Table 1 shows that the types of companies may impact on the even

accessibility of law. Almost all published cases involving accusations of breaching the duty of loyalty occurred in limited liability companies, the equivalent of private companies or close-held companies in common law jurisdictions. There were only 12 cases involving joint stock limited companies, analogous to public companies under English law.

Table 1. Types of Companies Involved in the Data Set.

Types of Companies	Limited Liability Companies (Limited Companies)	Joint Stock Limited Companies	Joint Stock Cooperative Enterprises
Number of cases	513	12	1

While enforcement measures related to codified duties appear to be more accessible in the private business context, the limited use of the duty of loyalty in joint stock limited companies does not necessarily implicate that the codification is ineffective. Instead, this observation largely accords with established beliefs about the market-related benefits enjoyed by public companies. The fluid transferability of shares on security markets and resulting separation of ownership and control implicates the significant protection role that limited liability plays for public companies' shareholders [29] (p. 1047), which tends to prevail over most shareholders' incentives to bring claims against the directors. Additional to a better liquidity of shares in public companies, established empirical results concerning China, while not directly connected to the theme of the directors' duty of loyalty, also help to explain this disparity between private and public companies. These involve the limited effectiveness of the shareholder derivative action mechanism in public companies [39], alternative administrative sanction methods supplementing private litigations [17] (pp. 78–79) and the relatively high percentage of state share ownership in listed companies [40] (p. 451). The uneven accessibility of codified duties of loyalty in various companies thus indicates the inherent connections between various fields of law, both within and beyond the reach of corporate law, and further implicates the necessity of a coherent legal infrastructure in the effective implementation of the director's duty of loyalty.

3.3.2. Consistency in Enforcement of the Duty: Factors affecting the Judgement Results

Based on the assertion that quality of enforcement depends on the magnitude and consistent recognition of violations [41] (p. 5), this part discusses various factors which may have statistical impacts on court decisions as to whether directors were in breach of duty (The null hypothesis is usually some variation of the hypothesis that there is no difference between breaching percentages from different groups of cases [29] (p.1049)).

Overall, courts in China held directors/managers in breach of the duty of loyalty in around 60.3% of reported cases, as explicated in Table 2.

Table 2. The Overall Breach of Duty Rate.

All Cases	Directors Were Held in Breach	Directors Were Not in Breach	Directors Were Held in Breach of Duty for at Least One of the Claims (When a Case Involves Cumulative Claims against Directors)	% of Cases in Which Directors Were in Breach of the Duty of Loyalty
526	317	205	4	60.3%

We begin with the factors that do not appear to have any significant effect on the results or the quality of enforcement. First of all, the level of courts, as explicated in Figure 2, is not a factor that impacts significantly on the courts' application of the law. The *p*-value is 0.248, indicating that differences in levels of courts do not have statistically important impacts. An analysis of the breach of duty percentages in different years, as shown in Table 3 below (*p*-value being 0.769), also illustrates that there is no apparent

trend over time. Courts do not appear to be moving toward the trajectory of making more directors accountable for duty-breach.

Table 3. Case Judgements in Different Years.

Year	Not Breach	Partly Breach	Breach	Total
2005	0	0	1	1
2006	1	0	2	3
2007	0	0	1	1
2008	2	0	8	10
2009	9	0	10	19
2010	1	0	1	2
2011	8	0	8	16
2012	8	0	12	20
2013	11	0	19	30
2014	25	0	51	76
2015	38	0	44	82
2016	47	3	56	106
2017	55	1	104	160
Total	205	4	317	526

Table 4 illustrates that the identity of the plaintiff—whether a company, a shareholder representing the company, a senior manager or a member of the board—leads to no significant difference in results (the *p*-value being 0.278) [33] (Art. 151(1)).

Table 4. Identities of Plaintiffs.

Category	Total Number of Cases	Breach	No Breach	Partly Breach	% Breach in Total
Corporation plaintiffs	367	218	145	4	59.4
Shareholder plaintiffs	117	67	50	0	57.3
Executive board member plaintiffs	15	14	1	0	93.3
Supervisory board member plaintiffs	18	11	7	0	61.1
Other plaintiffs	8	6	2	0	75

Likewise, the identities of defendants have no significant bearing on the decisions made by the courts, as explicated in Table 5. The *p*-value is 0.058, indicating that the defendants' identity differences are not statistically important.

Table 5. Identities of Defendants.

Category	Total Number of Cases	Breach	No Breach	Partly Breach	% Breach in Total
Executive Board Member Defendants	175	103	72	0	58.9
Senior Management Defendants	160	89	70	1	55.6
Supervisory Board Member Defendants	38	24	13	1	63.2
Defendants with Dual Identities of Director and Senior Management	131	81	48	2	61.8
Other Defendants	22	20	2	0	90.9

In stark contrast, some factors do impact significantly on courts' decisions and as a consequence the consistent application of the statutory provisions, including the geographical distribution of the cases. According to Figure 4 below, courts in different regions seemingly have their own tendencies in terms of whether to hold directors/senior management liable for breaches of duties, which contribute to inconsistencies in judicial applications. The p -value was 0.000, indicating that the difference is statistically significant. To take the regions with the highest number of case judgements as an example, the percentage of courts holding directors liable for breach of duty ranged from 52% in Beijing, 56% in Shanghai, to 71% in Zhejiang province. It seems that courts in Zhejiang provinces were more willing than the others in terms of holding directors liable. The fact that Zhejiang being one of China's leading provinces in boasting the private economic sector and encouraging small and medium-sized businesses [42] might offer an explanation for their courts' willingness to hold directors liable for breach of the duty of loyalty. Their strong reliance on the private economy and small and medium-sized enterprises led to a regional policy and practice inclination towards the protection of corporations and investors, in the hope of attracting prospective investment when the market-related benefits enjoyed by investors in large corporations, such as liquidity and diversification, are not readily available to those in small and medium-sized businesses. Furthermore, the dominating business sector in Zhejiang is alternatively titled a "people-run economy" (民营经济), indicating its nongovernmental background. This might also have had an impact on their courts' general leaning to hold directors liable—after all, some directors in state-owned enterprises are appointed by state-owned asset supervision and management commissions [33] (Art. 67). In cases where those directors are incompetent or disloyal, they could be administratively penalised or removed by the commissions, thus to a certain extent reducing the necessity of utilising company law means.

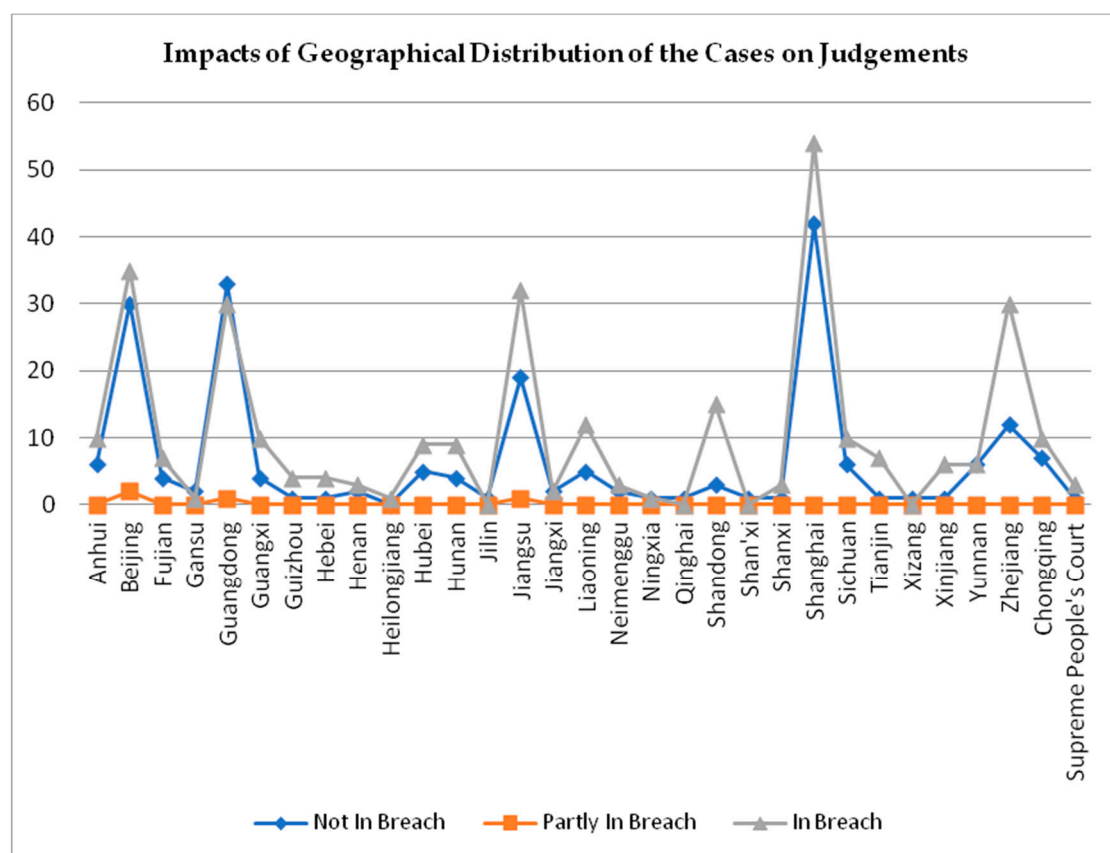


Figure 4. Impacts of Geographical Distribution of the Cases on Judgements.

When the cases are broken down based upon different causes of action, the results further exemplify the contextual nature of the duty of loyalty in China—courts hold directors liable more often in some contexts than in others. The *p*-value is 0.001, indicating that the difference is statistically significant, as shown in Table 6.

Table 6. Result Differences based on the Reasons of the Claims.

Causes of Action	Whether the Duty Was Breached			Total	
	Partly	No	Yes		
-					
Exploiting corporate opportunities (including engaging in the same kind of business as the corporation)	1	51	71	123	
	0.8%	41.5%	57.7%	100.0%	
Self-dealing (including connected transactions)	1	12	30	43	
	2.3%	27.9%	69.8%	100.0%	
Expropriating Corporate Assets (including Corporate Funds)	1	67	155	223	
	0.4%	30.0%	69.5%	100.0%	
Not Acting in Good Faith to Promote the Success of the Company	0	40	25	65	
	0.0%	61.5%	38.5%	100.0%	
Taking Bribes or Benefits	0	2	1	3	
	0.0%	66.7%	33.3%	100.0%	
Not Acting within Powers	1	33	35	69	
	1.4%	47.8%	50.7%	100.0%	
Total	Count	4	205	317	526
	%	0.8%	39.0%	60.3%	100.0%

A closer look at the cases based on different causes of action suggests a causal link between the degree of legislative clarity and judicial consistency. When the legislative wording is ambiguous, the attitudes of the judiciary are more likely to diverge in terms of whether or not to take a sterner line against directors. For instance, of the major sub-categories of duty of loyalty delineated in §1 of Art. 148 [33], exploiting corporate assets (set out in Art. 148, §1(1)–(3)) is relatively clear, whereas Art. 148, §1(5), which seeks to encapsulate the common law “no conflict, no profit” principle, is conceptually vague. In contrast with its common law counterpart, which is supplemented by case precedents and judges’ power to clarify the law, there lacks detailed guidance as to how to judge whether a business opportunity “belongs to the company” or the ambit of business that a company engages in. Both concepts directly affect the utility of the provision. This discrepancy in legislative meticulousness affects judicial practice directly. As shown in Table 6, in areas of law with less conceptual ambiguity, courts in all regions appear more confident and willing to impose legal prohibitions. For instance, under the categories of directors exploiting corporate assets [33] (Art. 148, §1(1)–(3)) and committing unauthorised self-dealing [33] (Art. 148, §1(4)), the overall rates at which directors were held liable for breaches were generally higher than the rates in areas where the direct application of current provisions is difficult, notably in the exploitation of corporate opportunities [33] (Art. 148, §1(5)).

The results above thus demonstrate an overall growing accessibility of the law since the 2005 codification, as well as the strong influence of contextual elements on accessibility and judicial consistency in China. These factors include not only the diverse levels of regional development, but also the unique styles of court rulings in different regions and, notably, the force of legislative meticulousness. The tension between centralised law-making and local implementation thus pragmatically bears on the effectiveness of law in the field, calling for a greater congruence of law and practice in China.

4. Interpretative Judgement Analyses—The Layout of the Duty and Resulting Inconsistencies in Application

This section further explores the link between legislative clarity and judicial consistency, by way of considering the linkages between the outcome and other attributes of the cases, including their facts, procedures and the court’s reasoning. This enables the appreciation of not only descriptive but also normative implications of the subject.

Even though, as remarked, “a definitive and categorical definition of the universe of acts that would constitute [breaches of the duty of loyalty]” [43] would be unwise, the conduct-regulating legal realm does call for more accurate conceptual delineation—after all, precision minimises actual wrongdoing. In this regard, the current duty of loyalty enshrined in Chapter Six of the 2018 Company Law [33] could do with some improvement, not only in the conceptual province but also the flow of the duty structure. As stated above, it was envisaged that Art. 147, §1 would outline the general scope of directors’ duties—the duty of loyalty and the duty of care—and Art. 148 would provide further factual specifics of the duty of loyalty [17] (p. 58, p. 60). What remains intriguing is the function of Art. 147, §2. It states that no director, supervisor or senior manager may accept any bribe or other illegal gains by taking the advantage of his or her powers or encroach on the property of the company. Company law does not specify whether this should be classified as the duty of loyalty or the duty of diligence. Judging by the nature of the provision, not accepting illegal gains or misappropriating corporate property reflects the principle that a director is not supposed to make secret profit, which is intrinsic to the fiduciary duty of loyalty. It is thus puzzling that this sub-article was not incorporated into Art. 148 as one (or two) of the specifics of the duty of loyalty; rather, it follows immediately after Art. 147, §1 as if it were part of an overall statement of directors’ duties. To further complicate things, the content of Art. 147, §2 overlaps with Art. 148, §1(1)–(3)—all three paragraphs of Art. 148, §1 concern the unauthorised exploitation of corporate funds, which is already covered by §2 of Art. 147, since it forbids a director to exploit corporate property.

A possible explanation for this confusing layout is that Chinese legislators, focusing on the policy imperative of attracting investment, did not place too much importance on the logical details of the Company Law in this regard. Indeed, a glance at the 2018 Company Law would reveal that the current flow between Art. 147, §2 and Art. 148 [33] completely imitates the structural formation of Arts. 59 to 62 of the 1993 Company Law [31]. However, this drafting convenience has resulted in pragmatic difficulties in two aspects. First, the unnecessary content repetition has rendered §2 of Art. 147 almost useless in practice. As shown in Table 7, there were 222 cases concerning the misappropriation of corporate assets (including corporate funds), and presumably this falls into the scope of Art. 147, §2—misappropriation of corporate property. However, no case has made explicit reference to this sub-article. The rest of the judgements involved rather perplexing legal citations: Art. 147 in general was cited 104 times. Art. 148 was cited 102 times and 10 cases did not refer to either Art. 147 or 148, the two company law provisions most relevant to directors’ duty of loyalty.

Table 7. Citation Frequencies of Company Law Provisions in Cases concerning the Misappropriation of Corporate Assets.

Relevant Provisions	Number of Citations
Art. 147	104
Art. 147, §1	20
Art. 147, §2	0
Art. 148	102
Art. 148, §1	36
Art. 148, §2	5
Cases with no citation of specific provision	10

The overall citation frequencies of company law provisions delineated in Figure 5 further demonstrates judicial inconsistencies—Art. 148, the major provision explicating all sub-categories of the duty of loyalty, was only cited in 30.2% of the investigated cases.

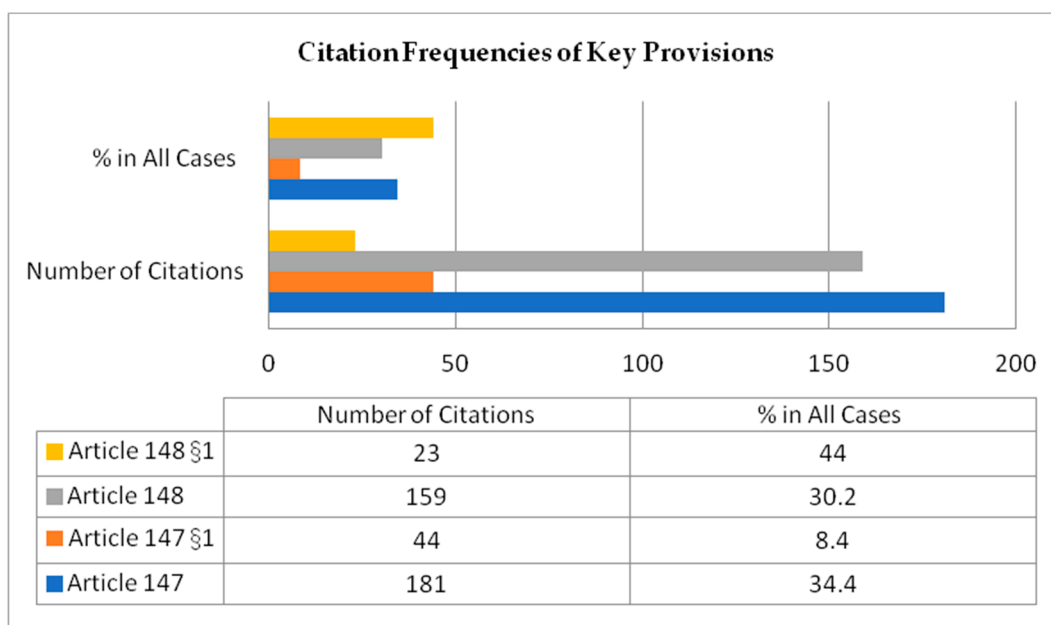


Figure 5. Overall Citation Frequencies of Key Provisions Concerning Directors’ Duty of Loyalty.

In addition to inconsistencies in citations of law, the confounding layout of the duty of loyalty has further resulted in “similar cases not being judged alike”—a significant issue in judicial practice [44]. For instance, *Wuxi Beijia Clothes Ltd. v Xu* [45] and *Xinjiang Tiandun Special Cement Ltd. v Wu* [46] had almost identical facts: the defendant director borrowed money from his company, taking advantage of his office in the company and failed to return the money in time. In the former case, the courts cited Arts. 147 and 148 §1 and treated the defendant’s behaviour as a breach of his duty of loyalty, focusing on him taking advantage of his office. However, in the latter case the court didn’t even view the matter as relevant to the duty of loyalty. Instead, the case was interpreted as an implicit contractual dispute based on the General Principles of Civil Law. While the amount of illegal profit accounted by the misbehaving director to the company under the former approach might in some circumstances be equivalent to the compensation awarded to the company under the latter, the respective jurisprudential bases underpinning these two remedial methods are completely different: the former is based on strict equity whereas the latter is based on contractual principles.

5. Factors Compromising Judicial Consistency—A Comparative View

To some extent the legislative loopholes identified above might be attributed to the short development period of Chinese company law in comparison with the centuries over which the legal systems in China’s common law counterparts have evolved [47] (p. 498). This brief period of development also affects the skills and experience of the Chinese judiciary. In the meanwhile, it would be wrong to overstate their effect. As vigilant readers might have already discerned from the *Beijia* and *Tiandun* case judgements discussed above [45,46], a major factor contributing to judicial inconsistency in China has been the absence of a coherent jurisprudential basis underpinning the conception of the duty of loyalty. This was largely caused by China’s legal transplantation pattern, characterised by the norm of selective adoption [48] (p. 208).

The selective adoption method can trace its origin back to Confucianism, a philosophy that has influenced Chinese society for more than 2000 years. As stated by the *Analects* of

Confucius, one should only follow other people's good qualities [49]. Legal transplantation in China has also been marked by the belief that "only the best elements should be borrowed from other systems (of law)" [50]. In modern Chinese jurisprudence, this selective adoption is justified by emphasising "actuality" as the most credible source of law, and the Chinese main conception of law as an instrument of public power that stands in stark contrast to the Western orientation towards private individuals [51] (p. 834). The yardstick of "best elements of law" is thus whether they are in line with the course of national economic and social development [52] (pp. 40–46). This pragmatic view of law and the selective transplantation of rules, while efficient in making laws rapidly responsive to the nation's fast-changing policy needs, may simultaneously lead to the result that only urgently-needed foreign rules are transplanted, leaving some necessary complementarities out of the picture.

Such was the case with the directors' duty codification in the company law context. Drafters and law professors, when discussing the aim of the 2005 reform, focused on the policy imperative—encouraging investment and facilitating an efficient market economy mechanism [53]. Affected by the consensus of the investor protection function of directors' duties and the increasing inclination of Chinese company law towards the market-oriented model, it is no surprise that the common-law-originated concept of the duty of loyalty was introduced alongside other reforms to company law [54] (p. 28). However, the underlying equity basis from which the concept initially derived, and accompanying judicial techniques, were left out in the transplantation (or deliberately omitted because of their remote relevance to investor protection). Chinese legislators did not clarify whether the codified duty of loyalty should continue to follow its conventional civil law route, which saw all directors' duties as tort-based, or go along the equity course developed in common law. Setting the rule at a high level of generality, compounded by the lack of an underpinning jurisprudential basis, causes confusion over the relationship between the statutory reformulation and habitual practice surrounding directors' duties [55] (p. 613).

This confusion is demonstrated in conflicting judicial explications of the duties, most notably surrounding diverse judicial understandings of the good faith criterion, the catch-all provision, as well as the judicial practices surrounding Art. 148 §1(5) [33].

5.1. *The Good Faith Factor*

5.1.1. The UK Perspective

Since its origin, there have existed different formulations to the "locus classicus of the company director's duty of loyalty" [56] (p. 151). The mainstream formulation in English law attaches primary significance to unwavering loyalty from the director by resting primarily upon the good faith criterion. The significance of this criterion stems from the trust-like nature of the board—with the aggregation of others' wealth at their disposal—and the resulting risk of managerial abuse. Seeking to restrict the powers of directors and combat the self-centred characteristic of human nature, equity courts have utilised the fundamental limitation applicable to all fiduciaries that their power be exercised in a bona fide manner in the interests of the beneficiary [8] (p. 119) in corporate contexts. As Lord Greene famously put it, directors need to "act bona fide in what (they) consider—not what a court might consider—is in the interests of the company, and not for any collateral purpose [57]".

In English law, an action not undertaken in good faith will conventionally be treated as a breach of trust and will entail liability, proscriptively defined as "carry(ing) the full range of remedies" [55] (p. 622). Meanwhile, as long as the court is satisfied that the board has acted bona fide in the general direction of promoting the interests of the company, discretion in deciding how to serve the beneficiary is entrusted to the fiduciary [56] (pp. 154–155). As stated in *Re Beloved Wilkes' Charity* [58] (p. 448), "the duty of supervision on the part of this Court will thus be confined to the honesty, integrity and fairness with which the deliberation has been conducted and will not be extended to the accuracy of the conclusion arrived at".

Some might suggest that this subjective duty expressed in general terms is hard to judge in practice, which adds to the difficulty of its implementation in factual scenarios. On the contrary, in practice thus far common law judges have been able to utilise its dynamic character and apply it in cases “where it has not previously been applied but the principle or rationale of the rule applies” [59]. In applying this duty, UK courts tend to tilt the balance slightly in favour of control and responsibility. There has been a degree of judicial discretion based on objective facts, which has substantially eased the testing process for the directors’ subjective state of mind, a typical example being *Regentcrest v Cohen* [60]. Jonathan Parker J held that if the directors gave unequivocal evidence that they had honestly believed that they had acted in the best interests of the company, and if that evidence was accepted, then there had been no breach [60] (para.80). However, he also noted that the greater the detriment to the company caused by the directors’ actions, the harder it would be for the directors to defend themselves against the company’s allegations of absence of good faith [60] (para.90) [59] (para. 52).

As with other legal principles, English law recognitions of the duty of loyalty also constantly evolve. While the conventional common law is broadly understood to be shareholder-centred [61,62], judicial authorities also emphasised the importance of stakeholder consideration by directors, particularly in advancing the interests of shareholders and in promoting the sustainable development of the business [63]. As evidenced in the UK’s Company Law reform that led to the enactment of the Companies Act 2006 [30], the central provision of the duty of loyalty—s. 172(1)—enshrines Lord Greene MR’s formulation of the good faith criterion [57], which was explained by the Company Law Reform Bill Guidance as follows: “the decision as to what will promote success [of the company], and what constitutes such success, is one for the directors’ good faith judgement” [64] (p. 64) [65]. In addition, directors were explicitly asked to take into consideration non-shareholder stakeholders’ interests and the long-term interests of the company. Corporate responsibility to promote sustainability including ethical, social, workforce, environmental and even philanthropic concerns are thus included in the corporate management agenda as the results of the enforcement of s. 172 of the Companies Act 2006, in which the enlightened shareholder value principle was enshrined, with increasing pressure on directors to take account of company’s social responsibilities. As explicated, the implementation of s. 172 (1) will help to reduce the “undue focus on the short term and the narrow interest of members at the expense of what is in a broader and a longer-term sense the best interest of the enterprise” [66] (para 5.1.17). Meanwhile, space is also given to directors’ business judgement, in the sense that the subjective standard directly linking to good faith still remains under s. 172(1) [30] when assessing whether a director is in breach; the court will determine whether the director’s act would promote the success of the company for the benefit of its members in the director’s view, rather than in the view of the court [67] (p. 108). It would also be entirely up to the directors’ discretion to determine the proper extent of stakeholder consideration for the promotion of shareholder benefits. The weighing of various considerations which a director would make in order to act in accordance with s. 172 (1) is essentially a commercial decision, which the court is ill-equipped to take. In the meantime, one might note that regardless of the scholarly divide on the proscriptive and prescriptive forms of the duty of loyalty, the good faith criterion remains important in English law, since it serves as the benchmark for testing the directors’ motives and purposes, no matter which form is adopted.

5.1.2. The Good Faith Assessment Standard in China

In the legislative context of the duty of loyalty in China, the duty to act in good faith in the interests of the company encompasses an area of “legislative vacuum”. This can be demonstrated by an examination of the legal provisions throughout. There is no legal provision in the Company Law 2018 as to whether the good faith element should be taken into consideration in judging duty of loyalty or even general directors’ duty cases. In addition, five existing Company Law Judicial Interpretations issued by Supreme People’s

Court that may be directly quoted in judgements all remain silent on this matter [68,69]. This is probably because the implementation of this duty would have led to judicial inconsistencies when the equity principles underlying it were not imported. While there have been some academic suggestions that China should take the subjective factor into consideration when judging cases involving directors' duties, thus far those views have not coalesced into a coherent position, and they are yet to be adopted by the authorities [70] (p. 962), [71] (p. 530). Regrettably, the absence of this normative yardstick for directors' behaviour renders judicial practice hugely divergent in this regard. For instance, in *Zhang and Others v Huang* [72] the plaintiff alleged and evidence proved that the chairman of the board had committed illegal trading and fraudulent activities, causing the company to sustain serious financial losses. This should have been a typical instance of the good faith consideration in the common law context. However, the Chinese court, without the express legislative requirement of good faith, had to resort to the General Principles of Civil Law to judge the matter, and the final judgement did not even mention directors' duties, in spite of the plaintiff's claim. Some might argue that the reason of the court not referring to directors' duties was probably because the firm involved was a joint stock cooperative enterprise. However, in other cases involving this form of business organisation, courts had no difficulty in referring to directors' duties in Company Law [73]. In *Beijing Yanqihu International Gulf Club Ltd. v Pang* [74] the plaintiff claimed that the defendant director knowingly allowed the company to purchase excessive goods and caused the company significant loss, which prima facie involves a judgement call on good faith. However, the Court, following Art. 147, seemingly equated the directors' duty of acting within their powers with acting in good faith, and doubtfully held that the director was not in breach of any duty since "there was no evidence indicating that he had violated laws, administrative regulations or the articles of association" [74]. These judgements suggest contradictory judicial understanding concerning the duty of acting in good faith, which may also explain some aspects of our statistical analysis.

In the set of cases that we collected, there are a number of cases which, if judged through the eyes of common law, would call on a good faith consideration. However, without legislative prescription or underlying guidance, Chinese courts have demonstrated diverse attitudes. Some merely give a vague decision, drawing on Art. 147 in general without specifying whether the director was in breach of the duty of loyalty or the duty of care [75]. Some interpret a breach of the duty of loyalty as tortious in nature, insisting that actual damages to the company must be proved [76]. Some have equated the director's duty of acting in good faith for the interests of the company to other fiduciary duties, such as the duty of acting within his powers [77] or even the duty of care [78]. Diverse judicial interpretations and applications with regard to the good faith consideration call for a statutory clarification, and—perhaps more importantly—a unified understanding of the ideological underpinnings, which would render the duty more consistently applicable in China.

5.2. Understandings of Art. 148 §1(5) and Its Equitable Origin—The No Conflict No Profit Principle

Central to the corporation-trust analogy in English law has been the incorporation of material aspects of trustees' duties into the company law context, particularly the prohibition of the exploitation of self-interest by a fiduciary [79]. This principle, summarised as "no conflict, no profit", is not based upon principles of morality, but upon the consideration that "human nature being what it is, there is a danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those he was bound to protect [80]".

In English law, over the years the "no conflict no profit" principle has evolved to encompass different facets of this fiduciary duty of loyalty, which gradually gained independent statutory formulations. Meanwhile, this equitable principle still underpins the important general duties of directors prescribed in the Companies Act 2006, most prominently the declaration of interests in proposed transactions or arrangements [30] (s. 177),

not making personal use of the company's property, information or opportunities [30] (s. 175 (2)), and not receiving benefits from third parties in exchange for the exercise of directorial powers [10] (p. 515), [30] (s. 176). To take s. 175 as an example, this covers a situation in which a director has, or can have, a direct or indirect interest that conflicts, or possibly may conflict, with the interests of the company. The strictness of the equitable principle is evidenced in relevant statutory formulations and judicial practices, in the sense that when considering whether a director has been in breach of this duty, it is immaterial whether the company could take advantage of the property, information or opportunity [30] (s. 175(2)).

A similar provision in Chinese Company Law can now be found in Art. 148 §1(5) [33] governing directors' exploitation of corporate opportunities. A literal interpretation of this provision entails the result that a director's attempt to seek opportunities that belong to the company is prohibited by law, unless such behaviour could be ex ante approved or ex post ratified by the shareholders' collective will, which bears similarity to the English law position prior to the 2006 codification [30] (s. 175 (4)(b), (5), (6)) [81].

In the absence of a unified underlying jurisprudential root, discrepancies between the law in books and the law in practice are often evident. As exemplified in the implementation of Art. 148 §1(5) [33], when the equity principles underlying it were not imported, the implementation of this duty led to judicial inconsistencies in several aspects. In terms of the conditions that need to be proved to trigger the duty, some courts follow the equitable route and apply this duty regardless of whether directors cause losses to the company. For instance, in *He & Chengdu Sensaier Ltd. v Chengdu Tuolai Microwave Technique Ltd.* [82], the fact that the plaintiff company Sensaier Ltd. was not able to provide evidence of actual losses did not prevent the court from holding the director liable for being in conflict of interest, based on the fact that during his time as part of Sensaier's senior management, he was also acting as the manager of Tuolai Ltd. However, some courts interpret a breach of the duty of loyalty as tortious in nature, insisting that actual damages to the company must be proved, as was the case in *Guangzhou Hetai Automobile Sale Ltd. v Ling* [83]. Still others, perhaps to avoid the difficulty of defining the nature of the claim, merely give a general decision on whether the duty of loyalty was breached, without specifying the particular kind of duty of loyalty and even without referring to relevant Company Law provisions [84].

As there is no authoritative interpretation, different judicial explanations were also made available for the phrase "operating the same category of business" as stipulated in Art. 148 §1(5). In *Yantai Zhonglian Textile Ltd. v Yantai Ruihefeng Textile Ltd.* [85], a broad interpretation was given: "if the business engaged in by the concerned director/senior manager is of competing nature to his/her original employer, these two businesses can be deemed as within the same category." In stark contrast, in *Shenzhen Qizhikang Food Ltd. v You and Others* [86], the courts insisted on the plaintiff company proving that the defendant's own business had generated "substituting or market-sharing effects" to the plaintiff company in reality, and the fact that business scopes stated on the business licences were overlapping was not deemed adequate evidence.

Diverse judicial explanations on the scope and implications of Art. 148 §1(5) understandably generate further divergence in terms of burden of proof. In *Huang and Others v Du & Kunming Jinhua Ltd.* [87], the plaintiffs were able to prove that the defendant company had gained profit but were unable to assert that the profit was as a result of the defendant director conducting competing business. The court, taking into account the fact that the plaintiffs were outsiders to the defendant company, stipulated the importance of the reverse of burden of proof and held that the defendants bore the burden of proving the source of profit [87]. In stark contrast, when similar claims arose in *Tuerke (Tianjin) Sensor Ltd. v Ma & Tianjin Demingfu Ltd.* [88], while the court was convinced that the defendant Mr. Ma, a senior manager of the plaintiff, was in breach of Art. 148 owing to him simultaneously working for Demingfu Ltd., a competing business to the plaintiff company, the court ended up providing no redress to the plaintiff company, as it was

unable to provide evidence proving “the exact amount of income that Mr. Ma received from Demingfu Ltd., and whether the profit gained by Demingfu Ltd. was owing to its conducting competing business” [88]. Requesting the plaintiff, a complete outsider to Demingfu Ltd., to supply evidence on Demingfu’s internal operational details, is, to say the least, an onerous requirement. Not surprisingly, due to the high and often conflicting standards of burden of proof, the rate of success in claims of directors exploiting business opportunities of the company is comparatively low.

5.3. *Compatibilities between Related Laws*

A more mundane problem generated by the lack of jurisprudential underpinnings and authoritative interpretations of the law is incompatibilities between connected laws. While on paper the formulation of the directors’ duty of loyalty follows the common law categorisation route, relevant procedural laws embedded in the civil law context are yet to undergo complementary adjustments. Until now, breaching the directors’ duty of loyalty cannot constitute an independent cause of action under Chinese civil procedural law. The only option for plaintiffs who wish to initiate a litigation on behalf of a company against the director(s) is to draw on Art. 256 of the Provisions of Causes of Action of Civil Litigations—damaging the company’s benefits [38]. This type of dispute has been classically defined as tortious in nature in Chinese law, with actual damages that have occurred to the company as an essential prerequisite and compensation as the chief remedial method. However, Art. 148, §2 of the 2018 Company Law [33] follows the equitable route and provides that the director in breach of his duty of loyalty must account for his profit to the company, even if there is no loss to the company. This palpable contradiction between company law remedy and civil procedural law has generated huge judicial discrepancies.

As evidenced in practice, the new remedy of disgorging unauthorised profits has been sitting uneasily alongside the conventional tortious thinking on the duty of loyalty, which holds strictly to losses and causation rules. A typical example was *Shanghai Suofeima Hydraulic Equipment Ltd. v Columbo* [89], in which the Court held that the director was in breach of his duty of not engaging in competing business, but the plaintiff company could not acquire financial relief, because there was no evidence proving “the causal link between the company’s loss and the defendant’s behaviour”. Based on tortious thinking, the judgement did not even mention the remedy choice of disgorging unauthorised profit. For the company, this remedial response to its claim was no different from losing the case, giving the additionally painful fact that it had to bear the litigation cost. This is unlikely to have effective deterring impact on similar wrongdoing directors, given that they were not penalised for their conflict-of-interest performance. This type of judgements implicates the deep roots of the tortious view of the duty of loyalty in China, and the inconsistencies this generates.

5.4. *The Limited Effect of the Catch-All Provision*

It would not be fair to say that no legal professional in China is aware of the legislative loopholes connecting to the duty of loyalty, caused by fragmented transplantation practice. A noticeable effort made by Chinese legislators was to provide courts with grounds for penalising wrongdoing directors whose behaviour is not explicitly prohibited in the current form of the duty of loyalty. This is accomplished by inserting a catch-all provision in Art. 148, §1(8) [33]. It goes without saying that if the equity jurisprudence of the duty of loyalty were to be widely acknowledged in China, this catch-all provision would play an important role in judicial practice. Even if the facts did not fall within a specific sub-rule prescribed in Art. 148, §1(1)–(7), the principle of fiduciary loyalty characterising an “open-ended standard of behaviour” [90] (p. 920) might still apply, and this catch-all provision would then provide convenient legitimacy for the application of a penalty.

However, this catch-all provision is yet to carry significant weight in judicial practice in China. As noted by Min Liu, a judge sitting on the Supreme People’s Court, although plaintiffs often bring legal actions on the basis of “all sorts of reasons”, in practice the

reasons explicitly listed in legal provisions serve as a convenient and important yardstick for the courts, both substantively and procedurally. If the claim fits into one of the listed categories, the case will be heard; but if not, the likelihood is that the claim will not even pass the initial formal scrutiny and will be rejected by the courts [91]. Even if such claims are eventually heard, the result is often not promising for the plaintiff(s), since the elements explicitly listed serve not only as procedural requirements, but also as substantive standards for Chinese courts to make their final decisions. In cases involving duty of loyalty claims, this likely results in: (a) courts being more inclined to reject a claim if it is not expressly prescribed in Art. 148, §1(1)–(7); and (b) a minimal effect of Art. 148, §1(8). The restrictive effect of the catch-all provision is fully demonstrated in our collected judgements. As shown in Figure 6, only 8 out of 526 cases explicitly referred to Article 148, §1(8), illustrating both the provision’s minimum practical impact and, more importantly, the limited scope of the duty of loyalty in the Chinese law context. This does not sit well with the nature of the duty of loyalty, which was originally developed to respond to “factual situations that no one has foreseen and categorised” [92] (p. 24).

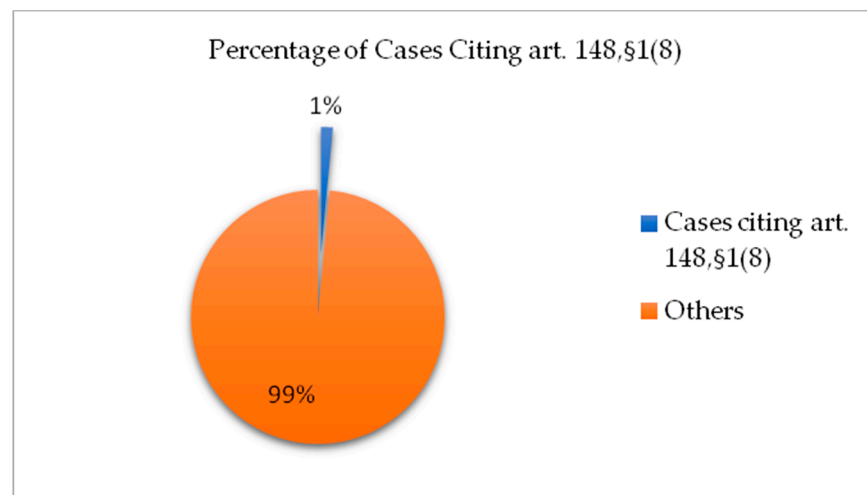


Figure 6. Percentage of Cases with Explicit Citation of the Catch-all Provision—Art. 148, §1(8).

6. Suggestions for the Future

There is no silver bullet that will fix all the complications concerning the duty of loyalty in books and judicial practice. Legal reforms to advance the legislative clarity and judicial consistency surrounding directors’ duty of loyalty in China would understandably entail a range of changes, not only to the wording of company law, but also to the underpinning jurisprudential bases and even procedural mechanisms. This is not to suggest that China needs to transplant the entire equity mechanism underlying the common law duty of loyalty. Instead, judicial interpretations and clarifications on the ideological basis of the duty could be based on either equity principles or traditional tort interpretations, or a combined use of both, provided that it could be clarified under what circumstances the judicial opinions should be formulated in line with different principles. After all, even in common law jurisdictions, courts acknowledge that to respond to fiduciary duty-based claims, “greater assistance may be found in the common law principles regulating claims in tort or, perhaps, contract.” [93] (p. 74) Whichever option is chosen, clearly articulated authoritative interpretations in this regard are urgently needed, so that the boundaries and substance of key concepts relevant to the duty of loyalty may be elucidated.

Furthermore, it is critical that operational considerations and complementary mechanisms are in line with the set jurisprudential basis to make the enforcement of the legislation easier. Even if substantive equity principles are not transplanted, accompanying procedural techniques can still be embodied to increase the flexibility of the law in this regard—for instance, by introducing the reversal of the burden of proof requirement in cases involving

conflicting directorships and self-dealing transactions. To enable this, an adequate number of authoritative guiding cases are necessary to provide detailed guidance on factual applications of the duty of loyalty, so as to eliminate judicial inconsistencies between law in books and law in practice. A summary of the suggestions is shown in Figure 7.

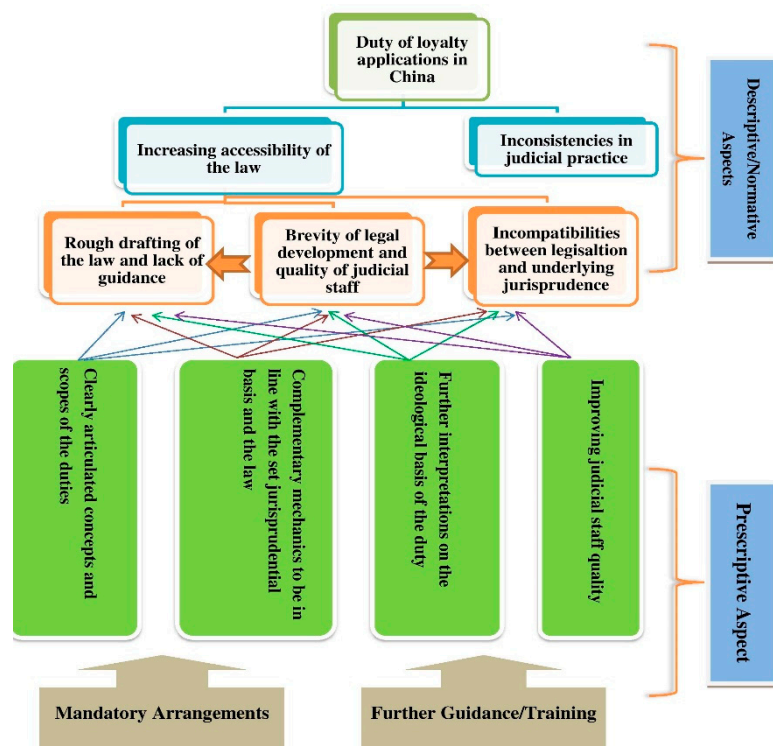


Figure 7. A Multi-Pronged Approach to Tackle the Problems in Duty of Loyalty Applications.

6.1. Themes of Reform Proposals for more Effective Directors' Duties of Loyalty in China

In the following section, our analyses offered throughout the paper and some reform proposals will be set out according to the important criteria which were set as the legislative goals of the 2005 Company Law reform, as discussed in Part 2: accessibility, consistency, and effectiveness. We will also explain the relationships between these criteria and predict the future development of directors' duty of loyalty in China based on the consideration of these criteria.

6.1.1. Consistency

First, a consistently applied legal regime dealing with directors' duties was an important goal as we discussed in previous sections, and thereby is a main theme for reform suggestions. Problems of inconsistency can be observed in scenarios such as the applications of law with ambiguous wording, and where cases with identical facts are dealt with in different manners or based on different laws. Therefore, the theme of a consistent system of law could be pursued with a focus on legislative clarity and accuracy, which may also be enhanced by multiple measures such as providing authoritative guidance to judges in China.

6.1.2. Accessibility

In order to promote the effectiveness of directors' duties, particularly in terms of realising the law's deterrence and protection functions, one of the goals for our reform proposals, as explicated before, is to make sure that the law related to directors' duties may be easily understood and evenly accessed by genuine and legitimate claimants.

6.1.3. Effectiveness

If law is viewed as a tool for social engineering, i.e., regulating or shaping the behaviours of members of society, its effectiveness must be measured by the extent to which it fulfils its objectives. The aims of law can be divided into preventive or curative objectives. A preventive law is effective if it deters undesirable behaviours and prevents wrongs from occurring. A curative law is effective if it can remedy wrongs *ex post* and compensate the wronged parties [94]. The effectiveness of directors' duties of loyalty thereby should be measured against both objectives to accommodate the dual nature of these duties. First, the law seeks to deter directors from causing damage to their companies. Second, the law also seeks to adequately compensate companies which have suffered losses. Since it both deters and compensates, an effective system of law related to directors' duties can only be achieved through legislation that is able to offer multiple relief methods and accessible mechanisms that are readily available to claimants who wish to bring litigation, in order to deter directors from misconduct.

6.2. Integrating Identified Problems and Reform Proposals with Themes

We believe that the criteria described above are essential to create a healthy trajectory for the future development of directors' duties of loyalty in Chinese company law. These theme-oriented goals may be achieved through a variety of reform proposals as discussed in this article. Importantly, accessibility may be improved through judicial interpretations and clarifications of the ideological basis of the duty, more detailed guidance on equity principles or tort interpretations, clearer legislative wording and better accompanying procedural techniques. A variety of reform proposals based on our statistical findings and analyses can be categorised according to one or more of the stated criteria. These correspondences are detailed in Table 8.

Table 8. Reform Proposals and their Bearings on Accessibility, Effectiveness and Consistency.

Reform Proposals	Accessibility	Consistency	Effectiveness
Clearly articulated concepts and scope of directors' duties		✓	✓
Complementary legal mechanism in line with a clear jurisprudential basis	✓	✓	✓
Further interpretations of the ideological bases of the duty	✓		✓
More sophisticated draftsmanship and competent judges	✓	✓	✓
Consistency between literal interpretation of the law and application with discretion		✓	✓
Compatibilities between related laws including procedural laws		✓	✓
Re-evaluating the catch-all provision	✓		✓

7. Conclusions

While the directors' duty of loyalty has long been a part of company law in different jurisdictions, related legal boundaries have not been well defined. This has particularly been the case in China, where the duty of loyalty was formally codified into the 2005 Company Law and preserved in the 2018 Company Law. While an extensive body of scholarship in China praised the transplantation of this common-law-originated duty in facilitating investor protection, thus far the large body of literature has spawned relatively little in terms of the jurisprudential logic of its legislative formulation. In particular, the status of its judicial applications has hitherto been surprisingly under-researched. This

article seeks to correct the current scholarly imbalance by way of investigating on the implementation status of the codified duty of loyalty in China.

Following an overview of the legal evolution in the field, Part 2 reviews the legislative agendas of introducing the duty of loyalty regime into China, and reveals several commendable features of China's transplantation attempt, e.g., a differentiation of the types of directors' duties and an enlargement of the remedial scope. We observed in Part 3 an overall increasing trajectory in relation to the accessibility of the law at a national level, although this is regionally unbalanced and contextually dependent. In the meantime, summary statistics and interpretative analyses of judgements presented in Parts 3 and 4 showed that the practical utility of the codified duty of loyalty, particularly regarding consistent applications, has been affected by both doctrinal and contextual elements. Even though the market-oriented approach including the duty of loyalty has been transplanted in China for better protection to companies and shareholders, key facets of the common law duty of loyalty such as the equity base have not been assimilated into China's current company law infrastructure. Even though there is no non-arbitrary or undisputed way of mapping out the precise degree to which judicial practice is measured consistently, our research found that the initial high hopes of this law-making experience have not been fully borne out, as explicated in Part 4.

In investigating contributory factors, research has postulated a close link to Chinese judges' limitations in terms of precedent creation. Additionally, as revealed by the comparative analysis in Part 5, a word change on its own in the company law context is unlikely to cure all the pragmatic problems in China regarding duty of loyalty applications. In common law jurisdictions such as the UK where the duty of loyalty originated, equity principles still serve as underlying ideological tenets and provide theoretical justifications/explications of the confines of the duty, whenever new factual scenarios emerge. While Chinese legislators borrowed the common-law-style categorisation of the duty of loyalty and the duty of care, the fiduciary nature that formulated the current confines of the duty of loyalty, and accompanying judicial techniques, were left out in the transplantation process, much owing to the selective adoption norm customary to Chinese culture. As revealed in Part 5, judicial inconsistencies in the field of the duty of loyalty, exemplified by the explicit standard of good faith assessment, diverse judicial interpretations to Art. 148 §1(5), and the limited effect of the catch-all provision, were all rooted in the absence of a clearly identified jurisprudential basis for the duty of loyalty. These somehow compromise the declared legislative agendas of providing a greater degree of clarity and consistency and promoting more healthy and sustainable businesses. They also acknowledge the need for greater congruence between Chinese law and existing institutions. In response to these findings, and with the purpose of building a more effective directors' duty of loyalty mechanism by making it more accessible and consistently applied throughout the courts at different levels, we have made a number of reform proposals in Part 6, including more clearly articulated concepts and a clarified scope of directors' duty of loyalty, further interpretations of the jurisprudential bases of the duty, consistency between literal interpretation of the law and application with discretion, compatibilities between related laws including procedural laws, and a re-evaluation of the catch-all provision. As a key component of the company law regime with high expectations, we believe that the directors' duty of loyalty has the potential to become an effective and ingenious accountability mechanism for both limited liability companies and joint stock limited companies in China. As a milestone for Chinese company law and corporate governance reform, the directors' duty of loyalty system in China also needs specific local variations to fit with the many national-specific characteristics of China.

Further contributing to the contentious general theme of legal transplantation, the paper demonstrates that even in the sphere of commercial law, where rules are regarded as easily transferable [95], deeply engrained ideologies still set boundaries to the function of transplantation. Diverse applications of the legal rules setting out directors' duty of loyalty in China, particularly the variations as regards the good faith element and the

no-conflict, no profit principle, are prime examples of the irritations resulting from legal transplantation and adaptation. The construction of a broad collateral legal regime on the basis of national contextual specifics will thus be necessary to eliminate the disparity between the host legal environment and transplanted configurations.

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