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### Twenty-Five Years On – The Establishment and Application of Corporate Fiduciary Duties in PRC Law

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*FIDUCIARY LAW ACROSS HISTORY AND LEGAL SYSTEMS*

**TWENTY-FIVE YEARS ON – THE ESTABLISHMENT AND APPLICATION OF  
CORPORATE FIDUCIARY DUTIES IN PRC LAW**

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***Forthcoming in Evan Criddle, Paul B. Miller & Robert H. Sitkoff, eds., The Oxford Handbook of Fiduciary Law (New York: Oxford University Press, 2018).***

**Introduction**

Although Chinese history evidences a substantial use and understanding of something like fiduciary obligations, especially in the private enterprise and clan organization contexts,<sup>1</sup> this chapter will focus far more narrowly on: (i) developments in law and regulation in the People’s Republic of China (PRC) after the early 1980s; and (ii) the advent and elaboration of what the Anglo-American legal system calls “corporate fiduciary duties”: the law, regulation and/or jurisprudence-based duties of orthodox corporate fiduciaries -- elected corporate directors and increasingly board-appointed corporate officers (and in a more limited sphere the controlling shareholders) -- of a corporate legal person established in law owed to that corporate legal person and/or the shareholder investors (or the non-controlling subset of such equity owners).<sup>2</sup>

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<sup>1</sup> See, for example, Teemu Ruskola, *Conceptualizing Corporations and Kinship: Comparative Law and Development Theory in a Chinese Perspective*, 52 STAN. L. REV. 1599, 1649-1651, 1656-66 (2000) and Denis Twitchett, *The Fan Clan’s Charitable Estate, 1050-1760*, in CONFUCIANISM IN ACTION 97, 101-2, 105-114 & 117-20 (David S. Nivision & Arthur Wright eds., 1959).

<sup>2</sup> Below I also address fiduciary duties in modern China in the partnership context as well. See *infra* notes \_\_\_ and accompanying text.

This limited focus is not meant to imply that other jurisdictions in “Greater China” – *i.e.*, Taiwan or the Republic of China, the Hong Kong or Macao Special Administrative Regions, or Singapore – do not matter, or do not have very substantial and well-articulated traditions of fiduciary law and/or corporate fiduciary duties. Quite the opposite in fact, as all of the above-named jurisdictions have long and sophisticated traditions in precisely these areas, several explicitly formed by the Anglo-American common law and equity courts systems (*e.g.*, Hong Kong, and Singapore).

My focus on the *Reform-era PRC* here seems desirable because of the extraordinary relevance of the PRC’s legal and governance system for the developing global economic, political and legal orders, and because this area of the law in China has grown from what only twenty-five years ago was a blank slate. Indeed, many readers may be surprised that there is any notion whatsoever of fiduciary law (in this case, the separate doctrine of corporate fiduciary duties) – formal or applied -- in China.

These truths also support the focus here on *corporate fiduciary duties* law specifically, rather than an analysis of broader developments in fiduciary law in modern China.<sup>3</sup> At the present time, PRC-domiciled or controlled corporate entities

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<sup>3</sup> An area where there is a tremendous amount of activity and even passage of substantive laws, with asserted application to the law of corporate fiduciary duties. *See*, for example, Zhonghua Renmin Gongheguo Xintuo Fa [PRC Trust Law] (passed by the 21st Standing Comm. of the 9<sup>th</sup> Nat’l People’s Cong., Apr. 28, 2001, effective the same date) available at [http://www.npc.gov.cn/englishnpc/Law/2007-12/10/content\\_1383444.htm](http://www.npc.gov.cn/englishnpc/Law/2007-12/10/content_1383444.htm), arts. 25-9 (duties of trustees; *see infra* note \_\_\_ and accompanying text regarding the – in my view, misguided -- effort by some Chinese academics to use the Trust Law as an adjunct to regulate corporate fiduciary duties); and what is designed to be the first book of “General Principles” in a PRC

stand as the largest – whether by market capitalization or revenues – in the world.<sup>4</sup> Moreover, the PRC’s economic reform program commenced in the late 1970s designed to create a “Socialist Market Economy” has resulted in the formation of hundreds of thousands of PRC-domiciled legal person enterprises that are (i) the domestic drivers of China’s remarkable growth story over almost three decades and (ii) the leading identity of China’s “going out” policy of investment in and acquisition of foreign firms and assets. A deeper understanding of how these entities so important to both China’s domestic economy and the global economy are governed, the checks on and accountability for entity leadership or control parties – many with significant political not economic or legal endowments -- provided by new, and explicitly legal, conceptions of fiduciary duties, and how these principles mesh, or don’t, with the formal legal system and the all embracing political system, would seem critically important in the present age.

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Civil Code (thus to be followed by books on Contracts, Property, Torts, Marriage and Family and Inheritance) Zhonghua Renmin Gongheguo Minfa Zongze [General Rules of the Civil Law of the PRC] (passed by the 5<sup>th</sup> Session of the 12<sup>th</sup> Nat’l People’s Cong., Mar. 15, 2017, effective Oct. 1, 2017) available at <https://www.dimt.it/images/pdf/GeneralRules.pdf>, arts. 80-84 (duties of directors, supervisory board members and officers of for-profit enterprise legal persons) & 163-172 (duties of agents) (meant as an updating on the 1986 General Principles of Civil Law, Zhonghua Renmin Gongheguo Minfa Tongze [General Principles of Civil Law of the PRC], (passed by the 4<sup>th</sup> Session of the 6<sup>th</sup> Nat’l People’s Cong. on, and effective, April 12, 1986) Guowuyuan Fazhibangongshi [Legislative Affairs Office of the State Council], GONGSI FALU GUIZHANG SIFA JIESHI QUANSHU [COMPENDIUM OF COMPANY LAW, REGULATION AND JUDICIAL EXPLANATIONS], Beijing: Zhonguo Fazhi Chubanshe [China Legal System Publishing House], 2006 [hereinafter Compendium of Laws], at 1-111 [hereinafter GPCL]).

<sup>4</sup> Three of the first five of Fortune’s 2017 Global 500 (by revenues) are PRC corporatized state-owned enterprise groups. *See* <http://fortune.com/global500/list/>. Many other PRC firms appear in the top 50.

Finally, some might also question an analysis of the creation and elaboration of corporate fiduciary duties in the PRC circumstance because such legal duties originate in the Anglo-American, common law (and equity), and capitalist contexts, an environment radically distinct from the modern PRC's traditional Chinese *cum* Soviet-inspired, civil law tradition-like, Socialist governance and legal systems. In my view, this is not now a valid objection, given the extraordinary rise of the PRC's corporations, their explicit (if partial) modeling on U.S. corporations, their interaction with global capital markets acting as a prod for engagement with the U.S. model, the – at least rhetorically -- celebrated virtues of separation of ownership and management as a spur to production efficiency and the efficient allocation of capital through functioning capital markets, the rise of a shareholder rights movement in the PRC for public companies and close corporations alike, and – as readers of this chapter will see -- the large amount of time and resources China's legislators, regulators, courts, academics, civil society actors and others have dedicated to creating, explaining, contesting and implementing (whether via adjudication or enforcement) corporate fiduciary duties in the civil context.

In this chapter I proceed as follows. First, I provide a short history of the contested advent of explicitly legal corporate fiduciary duties into the PRC legal system after 1978, with due attention to the concurrent “legal construction”<sup>5</sup> and “corporatization without privatization” programs implemented by China's post-Mao and post-Great Proletarian Cultural Revolution administrations. I describe there three pathways of development: (i) academic; (ii) regulatory; and (iii)

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<sup>5</sup> In Chinese “*fazhi jianshe*”, what foreign observers often perhaps misleadingly call “legal reform”.

judicial/jurisprudential. Second, I detail how the substantive legal concepts we associate with corporate fiduciary duties have been injected into Chinese law and regulation, by which institutions, and with what legal, regulatory or economic policy aims. Third, I canvas how these substantive legal principles have gained life, or not, in application by state institutions (like the judiciary or the Chinese securities regulator) or at the urging of private claimants. Fourth and finally, I provide a premature consideration of what this particular development path, both its advances and frustrations, means for the assumption and implementation by China of complex legal doctrines originating in distinct legal, political and economic systems by technically competent, bureaucratically autonomous, and politically independent – or not -- state institutions embedded in a vastly different tradition. As I hope to show in this chapter, the ostensibly narrow story of corporate fiduciary duties in the modern PRC has significant meanings for future development of the broader “institution” that is the entire governance and legal system of China.

## The Advent of Corporate Fiduciary Duties in PRC Law and Regulation

Basic conceptions of orthodox corporate fiduciary duties entered Chinese law and practice through at least three separate tracks: (i) academic; (ii) regulatory (and tied to the first “overseas” (*i.e.*, pre-1997 “Handover” Hong Kong) listings of PRC-domiciled corporate issuers); and (iii) jurisprudential.

First, I address the “academic” story, and how the success of academic resistance to Anglo-American style fiduciary duties in 1993 spurred countervailing initiatives by regulators and the judiciary in the decade before 2005:<sup>6</sup>

Prior to passage of the 1994 PRC Company Law, for most senior PRC academics there was only disdain and outright rejection of the Anglo-American idea of corporate fiduciary duties and a business judgment rule subject to private enforcement before common law judicial institutions. Instead, most PRC academics understood a stronger affiliation between China’s then just-developing corporate law system and the doctrinal tradition alleged to hold sway in two other “East Asian” (meaning “Confucian” heritage) and “civil law family” jurisdictions with their own “modern” assumption of capitalist institutions and technologies: Japan and Taiwan.

What was that doctrinal tradition? Both Japan and Taiwan originally structured their relatively weak notion of corporate directors’ duties on a Roman law concept which arrived in Asia *via* Japan’s immediate translation into Japanese

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<sup>6</sup> I have told this story before, and so some of this material on the “academic” contest over fiduciary duties in early 1990s China is taken from: Nicholas Calcina Howson, *The Doctrine That Dared Not Speak Its Name – Anglo-American Fiduciary Duties in China’s 2005 Company Law and Case Law Intimations of Prior Convergence*, in TRANSFORMING CORPORATE GOVERNANCE IN EAST ASIA 193 (Hideki Kanda, Kon-sik Kim & Curtis Milhaupt eds., 2008) [hereinafter *Doctrine That Dared Not*].

and almost word-for-word enactment of Germany's *Bürgerliches Gesetzbuch* (BGB) from the end of the 19<sup>th</sup> century, that of "mandate" (*mandatum* in Roman law). The "mandate" (*weiren* in *kanji* for Japan's statutes, and *weiren* or sometimes *weituo* in Han characters) understood a consensual contract, written or oral, by which one party (the mandator) requests another (the mandatary) to perform a service without compensation, and the mandator promises to indemnify the mandatary against any loss. Under Roman law, the arrangement was necessarily gratuitous, as the mandatary was supposed to act pursuant to a moral duty, or as a friend of the mandator. Consistent with this moral charge, and balancing the indemnification obligation of the mandator, was a standard that required the mandatary to use something like reasonable care in performing under the mandate.

For corporate law, this doctrinal position is explicitly enunciated in what is now Section 330 of the Japanese Corporate Code (and was Section 254-1(3) of the Japanese Commercial Code)<sup>7</sup> with, "The relationship between a company and its directors shall be [construed] in accordance with the provisions regarding mandate", with the "mandate" idea further elaborated at Article 644 of the Japanese Civil Code which states that the mandatary (*i.e.*, the corporate director) has a duty of "due care of a faithful good manager" towards the mandator (*i.e.*, the company).<sup>8</sup>

These same provisions and doctrinal settlements were echoed directly in Article

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<sup>7</sup> See J. Mark Ramseyer & Masayuki Tamauya, *Fiduciary Principles in Japanese Law*, in OXFORD HANDBOOK OF FIDUCIARY LAW (forthcoming 2018) [hereinafter Ramseyer & Tamaruya].

<sup>8</sup> What Lawrence Liu glosses as a "professional negligence" standard for the duty of care aspect. See Lawrence S. Liu, *Global Markets and Parochial Institutions: The Transformation of Taiwan's Corporate Law System*, in GLOBAL MARKETS, DOMESTIC INSTITUTIONS: CORPORATE LAW AND GOVERNANCE IN A NEW ERA OF CROSS-BORDER DEALS 400, 406 (Curtis J. Milhaupt ed., 2003)

192 of Taiwan's Company Law (for the mandate relationship) and Taiwan's Civil Code (for the standard of care operating under the mandate relationship).

Japan and Taiwan each subsequently built upon the above-translated aspects of the German civil law system, both because of the strong U.S. influence on the two nations in the post-World War II period and because of increasing engagement by the firms of both jurisdictions with the global capital markets. Japan did this either by making explicit in 1970 a pre-existing (from 1899), or importing only in 1950, an apparently separate "duty of loyalty" into the Japanese Commercial Code and then the Corporate Code (one of two conflicting implications being that the "mandate" obligation did not encompass the duty of loyalty).<sup>9</sup> Taiwan built on the German-Japanese inheritance with a series of 2001 amendments to its Company Law specifically, which, like Japan, emphasized a separate "duty of loyalty" and made explicit the "mandate" basis (and associated standard of care) for directors' duties in the corporate law statute, as follows:

Article 23. The responsible persons of a company should loyally (*zhongshi*) implement their duties and do their utmost to take the duty of care (*zhuyi yiwu*) of a good/faithful manager (*shanliang guanliren*); if these duties are contravened so that the company suffers harm, then [such responsible persons] shall be liable for compensation of such harm.

The Japanese and Taiwanese developments sketched out above had a strong influence on senior PRC law corporate law academics (and key drafters of the PRC's

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<sup>9</sup> At Section 254 (now Section 355 of the Corporate Code). See Hideki Kanda & Curtis J. Milhaupt, *Re-examining Legal Transplants: The Director's Fiduciary Duty in Japanese Corporate Law*, 51 AM. J. COMP. L. 887 (2003), but also see *contra* Ramseyer & Tamaruya, *supra* note \_\_ (judging that the unilingual U.S. occupation official who was the engine behind the 1950 amendment "did not know what he was doing.")

first Company Law in the early 1990s) because those individuals identified Japan and Taiwan as like “East Asian” (Confucian heritage) political units with a “civil law”-styled legal system. As the PRC commenced corporatization of formerly state-owned assets in the late 1980s and early 1990s and simultaneously began to grapple with the substantive legal norms that would be applied to the new “corporate” and “legal” entities, those same academics vigorously critiqued the idea of incorporating Anglo-American style corporate fiduciary duties into China’s law, and conversely supported a strong declaration of doctrinal affinity to the Roman Law “mandate” idea (as carried through Japanese and then Taiwan law) in China’s hoped-for equivalent of a civil code. There is no finer articulation of this posture than the 1993 writing by the late Professor Wang Baoshu, China’s leading company law academic in the late 1980s and early 1990s and an important participant in the drafting of the PRC’s first corporate law, after the promulgation of the form of the 1994 PRC Company Law lacking any real nod to corporate fiduciary duties:

For China’s legislators and corporate law scholars, we must conform to our own national situation (*guoqing*), and introduce doctrine that is consistent with China’s legal tradition.... Most importantly, the [fiduciary duties] system originally comes from the Anglo-American system, which is very unfamiliar (*mosheng*) for China – a nation used to a very long tradition of the civil law system. If we use this concept to explain the relationship between a director and the company, it will be difficult for people to become accustomed to it or accept it in their hearts. Conversely, if we introduce the mandate (*weiren*) concept to explain the relationship between a company and its directors, it conforms quite well to the customs and traditions of the Chinese people. We must pay attention to the fact that whenever we seek to evidence that the director’s position is determined by the mandate doctrine, there must be corresponding stipulations [describing that doctrine] in the company law.... First, we should add further stipulations to the General Principles of the Civil Law regarding the mandate [relationship];... second, we should clearly

stipulate in the [1994 PRC] Company Law that the relationship between the directors and the company is determined by the stipulations on mandate.<sup>10</sup>

In the actual legislation, Wang Baoshu's position won the day -- mostly. For, as noted below, the 1994 PRC Company Law contained no pronouncement of Anglo-American style corporate fiduciary duties, even if the new Chinese company statute did not declare, explicitly, affiliation with the "mandate" doctrine, and the never-passed PRC civil code was not able to carry the same concept into that basic law. (There was a momentary, pre-2006, effort by some PRC academics to use Article 25 of the PRC Trust Law -- asking trustees to "be attentive to duties and perform their obligations honestly, in a trustworthy way, prudently and effectively" -- to regulate corporate fiduciaries,<sup>11</sup> but the passage of the 2006 PRC Company Law made this project moot, and to my knowledge no PRC court has ever ruled on a question of corporate fiduciary duties with reference to the PRC Trust Law provisions on the duties of trustees.) This doctrinally-determined failure to include corporate fiduciary duties in the 1994 PRC Company Law not only made the eventual 2006 PRC Company Law expression of just those duties shocking, but also spurred the

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<sup>10</sup> Wang Baoshu, *Gufen Youxian Gongsi De Dongshi He Dongshihui* [Directors and the Board of Directors at Companies Limited by Shares], 1 WAIGUO FAXUE SHIPING [FOREIGN LEGAL STUDIES COMMENTARY AND EXPLANATION] 5, 5 (1994).

<sup>11</sup> See the slightly muddled suggestion by Professor Liu Junhai in XIANDAI GONGSIFA (DI ER BAN) [MODERN COMPANY LAW (SECOND EDITION) 506-7 (2011) ("As China adopted the Trust Law in April 2001 and the trust obligations stipulated in the Trust Law are higher than the obligations... of mandate under the [PRC] Contract Law, we could also use trust obligations to describe the relationship between the company and its directors, supervisors and senior executives in the PRC.") It is a good thing that no court or regulator in the PRC has, to date, taken up this suggestion, because the obligations of a trustee are starkly different from the obligations of a corporate director or manager who shareholders *want* to take some risk in furtherance of shareholder wealth maximization (as protected by the business judgment rule).

public markets regulator and China's judicial institutions to pick up the slack prior to 2006, which regulatory initiative I turn to now.

On what I call the "regulatory" track, it is no exaggeration to say that corporate fiduciary duties for both orthodox fiduciaries and controlling shareholders were injected into Chinese law from the early 1990s not by the PRC national legislature drafting company law or regulation but instead by the PRC's early securities regulatory bureaucracy and, once established, the China Securities Regulatory Commission (CSRC) alone and working with other administrative agencies. As I have recited in detail elsewhere,<sup>12</sup> in June of 1993 and thus before China had a company law statute, the PRC Commission on Restructuring of the Economic System (CRES) issued a letter to the Hong Kong Securities and Futures Commission making a gloss on Chinese characters ("*chengxin zeren*") then found in a CRES text supporting the establishment of PRC-domiciled companies limited by shares, the May 1992 "Opinions on Standards for Companies Limited by Shares" (Opinion on Standards for CLSs). The CRES letter was deemed necessary for the completion of the first initial public offerings and listings on the Hong Kong Stock Exchange (with American Depositary Shares (Receipts) for the same shares listed on the New York Stock Exchange) by PRC-domiciled issuers in the minds of PRC officials behind China's first attempts to access the global capital markets, because -- so it was believed in Beijing -- it provided an assurance to foreign investors that the issuer's directors and senior officers had traditional corporate fiduciary duties to the issuer. With the gloss on the Chinese characters "*chengxin zeren*" appearing in

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<sup>12</sup> See Doctrine That Dared Not, *supra* note \_\_, at 210-11.

the 1992 Opinions on Standards for CLSs, the Chinese government absorbed all then current Hong Kong (and thus English) corporate fiduciary duties jurisprudence into Chinese law, at least for PRC-domiciled issuers issuing stock and gaining listings in the pre-Handover Hong Kong capital markets. The June 1993 CRES letter stated that the four characters “*chengxin zeren*” appearing in the Opinions on Standards for CLSs and describing the duties of directors and senior management personnel:

... has the same type of meaning (*juyou leiside hanyi*) as *fiduciary duty* under Hong Kong law [with only the words “fiduciary duty” italicized above appearing in English in the otherwise Chinese language letter].

When in late 1993 the form of the 1994 PRC Company Law<sup>13</sup> was promulgated, not only was there no explicit statement of corporate fiduciary duties,<sup>14</sup> but in addition the four characters glossed in the CRES letter of June 1993 -- “*chengxin zeren*” -- were missing from the new company law statute now replacing completely the prior, regulatory, host for those important characters. In response, the CSRC immediately issued a regulatory “addendum” to China’s company law statute applicable to PRC-domiciled issuers with “overseas” listings, stating once again that directors and senior management personnel of such corporate issuers had the

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<sup>13</sup> Zhonghua Renmin Gongheguo Gongsifa [Company Law of the PRC] (passed by the Standing Comm. Nat’l People’s Cong. Dec. 27, 1993, effective July 1, 1994, and as amended Dec. 25, 1999 and Aug. 28, 2004) [hereinafter 1994 PRC Company Law].

<sup>14</sup> The 1994 PRC Company Law contained only a vague loyalty provision and a scattering of duty of loyalty-related prohibitions, at arts. 59 (echoing Japan’s Commercial Code Section 254-2 and later Corporate Code Section 355, instructing “loyal” (*zhongshi*) performance, protection of the interests of the company, and prohibiting acting for personal gain), 60 (prohibition against misappropriation of firm assets), 61 (prohibition against competition and unapproved related party transactions), 62 (confidentiality), and 123 (applying the foregoing provisions for limited liability companies to companies limited by shares).

previously glossed duty of “*chengxin zeren*”, still the vehicle for the absorption of the entirety of then Hong Kong jurisprudence relating to “fiduciary duty”.<sup>15</sup>

These rather unique moves by CRES and the CSRC designed to inject Anglo-American common law (specifically Hong Kong and English) corporate “fiduciary duties” into Chinese corporate governance and law were only the start of a sustained campaign by the PRC bureaucracy tasked with supervision of China’s listed companies to introduce and solidify corporate fiduciary duties in Chinese law, a campaign that culminated in the formal articulation of duty of loyalty and duty of care in the 2006 company statute described below. This project was implemented across a wide spectrum of administrative action, from non-legally binding “principles for corporate governance” at listed companies which went beyond the 1994 PRC Company Law to describe Delaware type corporate fiduciary duties of “care”, “loyalty” and “good faith”,<sup>16</sup> to the promulgation of the forms of articles of association required by PRC public capital markets issuers (without which issuers would not be granted listing approval). In the latter case, in 1994 the CSRC promulgated “mandatory” articles of association for overseas listing PRC-domiciled

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<sup>15</sup> See Doctrine That Dared Not, *supra* note \_\_, at 211.

<sup>16</sup> See Shangshi Gongsi Zhili Zhunze [Principles for Listed Company Corporate Governance] (promulgated by CSRC and State Econ. Trade Comm’n, Jan. 7, 2002), zhengjianfa [2002] 1, in XIANXING ZHENGQUAN QIHUO FAGUI HUIBIAN (XIUDINGBEN) [SECURITIES AND FUTURES LAW AND REGULATION CURRENTLY IN EFFECT (REVISED EDITION)] (China Securities Regulatory Commission ed., 2011) [hereinafter CSRC Laws and Regulations], at 925-9 [hereinafter 2002 Listed Company Governance Provisions], art. 33 (“Directors should undertake their responsibilities loyally (*zhongshi*), in good faith (*chengxin*) and diligently (*qinmian*) in accordance with the best interests of the company and the entire body of the shareholders.”).

issuers,<sup>17</sup> and then in 1997 “guiding” (but equally mandatory) articles of association for PRC-domiciled issuers listing only on China’s domestic exchanges.<sup>18</sup> (As noted below, the “guiding” articles of association for domestically-listing PRC-domiciled issuers were amended in 2006 to conform to the new 2006 PRC Company Law articulation of corporate fiduciary duties.) Chapter XIV and Article 16 of the Overseas Listing Mandatory Articles of Association force issuers to have corporate directors and senior management undertake the “*chengxin*” obligation (the pre-2006 proxy for “fiduciary duties” as described in Hong Kong law jurisprudence), and Chapter V and Articles 80 and 81 of the Guidance Articles of Association for domestically-listing PRC-domiciled issuers force issuers to have directors under obligations of loyalty (*zhongshi*), prudence (*jinshen*), and diligence (*qinmian*) (after 2006 the Chinese characters employed to signal a “duty of care” obligation), and act in a conscientious (*renzhen*) manner.

This same CSRC-led project took its most substantive turn with the promulgation of administrative rules (tantamount in many ways to statute) that directly imposed corporate fiduciary duties on specific corporate actors. For instance, in 2001 the CSRC promulgated its “Measures for the Acquisition of Listed Companies” which declared – without any basis in Chinese law at that time – that a

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<sup>17</sup> See Guanyu Zhixing “Dao Jingwai Shangshi Gongsi Zhangcheng Bibei Tiaokuan” de Tongzhi [Notice Regarding Implementation of the “Mandatory Articles of Association for Overseas Listing Companies”] (promulgated by the State Council Sec’s Comm’n & CRES, Aug. 27, 1994), zhengweifa [1994] 21, and the attached form of articles of association, CSRC Laws and Regulations, *supra* note \_\_, at 997-1008.

<sup>18</sup> See Guanyu Fabu “Shangshhi Gongsi Zhangcheng Zhiyin” De Tongzhi [Notice Regarding the Issuance and Promulgation of the “Guidance Articles of Association for Listed Companies”] (promulgated by CSRC, Dec. 16, 1997) zhengjian [1997] 16, and the attached form of articles of association, available at <http://chinalawinfo.com/newlaw2002/slc/slc.asp?db=chl&gid=19599>.

target board of directors, supervisory board, and high-level management had what amounted to fiduciary duties to the target firm (and the target's shareholders) in approving or recommending an external offer and pre-decision process requirements<sup>19</sup> that look much like those identified with the Delaware Supreme Court's 1985 *Van Gorkom* decision.<sup>20</sup>

Similarly, the CSRC also took the provocative step of declaring the existence of fiduciary duties for controlling shareholders (and thus giving rise to a common law-derived "oppression" claim for minority shareholders) in a series of enactments starting in 2002<sup>21</sup> and ending in 2005,<sup>22</sup> and thus before the same idea was made concrete in Article 20 of the 2006 PRC Company Law. This move was, and remains, provocative, because the long process of "corporatization without privatization" has resulted in a good number of corporatized state-owned enterprise assets where the resulting controlling shareholder(s) (and its (their) insider appointees) are identities of the supremely endowed PRC party state.

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<sup>19</sup> See Shangshi Gongsi Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies] (promulgated by CSRC, Dec. 1, 2002) zhengjianhuiling [2002] 10 available at <http://vip.chinalawinfo.com/newlaw2002/SLC/SLC.asp?Db=chl&Gid=42687>, art. 33 (holding that the duty of the target's board, supervisory board and high-level management is to not harm the lawful rights and interests of the shareholders or the company) and chapt. III (laying out the *Van Gorkom*-type requirements establishing conformity with the required duty of care).

<sup>20</sup> *Smith v. Van Gorkom*, 488 A.2d 858 (Del. 1985).

<sup>21</sup> See, for example, 2002 Listed Company Governance Provisions, *supra* note \_\_, art. 19 ("Controlling shareholders have a fiduciary duty (*chengxin yiwu*) to the listed company and the other shareholders.").

<sup>22</sup> See, for example, Guanyu Jiaqiang Shehuigongzheng Gudong Quanyi Baohu De Ruogan Guiding [Several Regulations Regarding Strengthening Protection for the Rights and Interests of Public Shareholders] (promulgated by CSRC, Dec. 2, 2004) zhengjianfa [2004] 118, CSRC Laws and Regulations, at 929-30, art. 5(i) (declaring that control parties/shareholders have "*chengxin zeren*", the same pre-2006 term of art used to describe corporate fiduciary duties in Chinese law).

Third, and finally, I address the “judicial” or “jurisprudential” track of developments. Below, and in connection with the modern application and enforcement of corporate fiduciary duties I describe in some detail how PRC judicial institutions work. Here I will simply report what my own research<sup>23</sup> has shown quite clearly – that even before the 2006 “legal basis” for corporate fiduciary duties or the corporate derivation action, China’s People’s Courts did in fact use and enforce corporate fiduciary duties, and enable procedural innovations like the corporate derivative action, in adjudications nationwide.

Here in very summary terms is what that research shows about pre-2005-6 developments in the PRC:

- Chinese judges did in fact, but relatively rarely, enforce basic corporate fiduciary duties (and apply related standards, including in the duty of care realm a business judgment rule) prior to 2005, in the absence of any legal basis or authorization for the same, and in situations where (i) the defendants had not breached their affirmative statutory, corporate constitutional, or contractual obligations, or (ii) the defendants had also

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<sup>23</sup> See, for example: Doctrine That Dared Not, *supra* note \_\_, at 193-4, 197-8, 213-6; Nicholas Calcina Howson, *Corporate Law in the Shanghai People’s Courts, 1992-2008: Judicial Autonomy in a Contemporary Authoritarian State*, 5 U. PA. E. Asia L. Rev. 303, 339 & 344 (2010) [hereinafter *Corporate Law in the People’s Courts*]; and Donald C. Clarke & Nicholas C. Howson, *Pathway to Minority Shareholder Protection: Derivative Actions in the People’s Republic of China*, in *THE DERIVATIVE ACTION IN ASIA: A COMPARATIVE AND FUNCTIONAL APPROACH* 243, 263-9 (Dan W. Puchniak, Harald Baum & Michael Ewing-Chow eds.) 2012 [hereinafter *Pathway to Minority Shareholder Protection*].

- violated such positive norms but the breach of fiduciary duties was nonetheless understood as separate and distinct;<sup>24</sup>
- At the same time, there is abundant evidence that the People’s Courts rejected or avoided taking corporate fiduciary duties-related cases, and/or rendered judgments avoiding invocation of such duties (often by invocation of the proxy described in the bullet point immediately below);<sup>25</sup>
  - The PRC People’s Courts enforced corporate fiduciary duties-type obligations *via* an important available proxy promulgated almost a decade before the 1994 PRC Company Law, the workhorse, *BGB*-origin, Article 4 of the 1986 GPCL<sup>26</sup> commanding “good faith” (and “fair dealing”) in the commercial realm;
  - What enforcement there was of corporate fiduciary duties was largely left to the securities regulator *via* the rendering of administrative sanctions against public company officers and directors (known not from the listings on the CSRC website which simply list “fiduciary breaches” (usually not related to corporate fiduciary duties, but disclosure breaches),<sup>27</sup> but from the Chinese

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<sup>24</sup> See The Doctrine That Dared Not, *supra* note \_\_; and Corporate Law in the People’s Courts, *supra* note \_\_, at 339-40.

<sup>25</sup> See Corporate Law in the People’s Courts, *supra* note \_\_, at 392-40.

<sup>26</sup> See *supra* note \_\_.

<sup>27</sup> The PRC Exchanges in Shanghai and Shenzhen also engaged in announcing reputational sanctions based upon so-called “fiduciary breaches”, also really disclosure defects and not breaches of corporate fiduciary duties. See Curtis J. Milhaupt & Benjamin Liebman, *Reputational Sanctions in China’s Securities Markets*, 108 COLUM. L. REV. 929 (2008).

press where a penalized director or officer contested the application of a penalty by the CSRC));<sup>28</sup>

- The Chinese courts enabled corporate fiduciary duties claims by permitting an *ad hoc* derivative action, nowhere authorized in legal or regulatory norms, and explicitly so as to work around the power of a defendant (a director) to block the claims of the formal beneficiary of the duties and the party suffering harm (the corporate entity);
- The PRC courts also allowed shareholder plaintiffs to bring claims on behalf of defendant-controlled entities explicitly as derivative actions but based on a 1994 Supreme People's Court "approving response" (*pifu*) formally only applicable to a foreign invested enterprise limited liability company but applied to entirely domestically-invested companies subsequently;
- The great majority of fiduciary duties cases handled by judicial institutions pertained to closely-held limited liability companies, and not widely-held companies limited by shares, and never to companies limited by shares with a public float;
- The overwhelming majority of fiduciary duties adjudications pertained to loyalty or breach of trust type claims, and not what post-2006 became available as duty of care cases;

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<sup>28</sup> See, for example, Corporate Law in the People's Courts, *supra* note \_\_, footnote 291 (report on Shenzhen Shenxin Taifeng Co., Ltd. directors contesting CSRC penalty).

- The People’s Courts struggled in duty of care cases with what they clearly intuit should be a “business judgment rule” equivalent (at least for cases where something less than “gross negligence” is implicated);
- The PRC courts were able to push back confidently against the inherited civil law status of entity “legal representative” and distinguish between that person’s duties as an agent and an elected director’s fiduciary duty to the legal entity;
- Chinese People’s Courts did look to other, like, judgments – even from external People’s Court systems -- for aid in adjudicating cases before them;
- The CSRC simultaneously acted as a substitute for the judiciary in the enforcement of basic duty of care doctrines against corporate directors (at public companies), both regularly-elected directors and so-called “independent directors”; and
- There is evidence from pre-2006 People’s Court adjudications of some institutional cross-fertilization, where the Chinese judiciary understood and enforced the CSRC-required mandatory or guiding articles of association provisions regarding corporate fiduciary duties (described above under the “regulatory” track) as independent legal obligations, and not merely contractual corporate constitutional commitments by the issuer, its directors and management and investors.<sup>29</sup>

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<sup>29</sup> See, for example, the 2006 Lu Jianming v. Shanghai Light Industry Machine Co. case opinions (Jingan District People’s Court, August 28, 2006, reversed by the Shanghai No. 2 Intermediate People’s Court, December 26, 2006) summarized in *Corporate Law in the People’s Courts*, *supra* note \_\_\_\_, at 433-6 (Shanghai No. 2

In sum then, it seems remarkably clear that before 2006, and thus in the absence of statutory authorization for corporate fiduciary duties claims, Chinese plaintiffs pursued such claims directly and/or derivatively against orthodox fiduciaries and controlling shareholders, Chinese judges accepted such claims after “case establishment”, and final judgments were written enforcing these apparently non-existent legal obligations.

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Intermediate People’s Court on the re-hearing: “... and the [Guidance Articles of Association for Domestic Issuers] invoked by the plaintiff do not come within the scope of law or administrative regulation”).

## Corporate Fiduciary Duties in PRC Law and Regulation After 2006

On October 27, 2005, the Standing Committee of the PRC's legislature, the National People's Congress (NPC), passed an amended form of China's 1994 company law statute, hereinafter the 2006 PRC Company Law.<sup>30</sup> One of the most important changes in the wholly revised statute was the inclusion of Article 148, an entirely new substantive provision that for the first time in the history of the PRC articulated corporate directors' and officers' fiduciary duties and in a fashion clearly sourced in the Anglo-American (and not European continental civil law) tradition:

Article 148. Directors, supervisory board members and high-level management personnel should abide by the laws, administrative regulations and company articles of association, and have a duty of loyalty (*zhongzhi yiwu*) and duty of care (*qinmian yiwu*) to the company. [Emphasis added.]

Article 148 is complemented by a new Article 149 that fleshes out specific prohibitions, violation of which sound in breach of the "duty of loyalty" at last proclaimed in statute,<sup>31</sup> and a cause of action for the same.<sup>32</sup> In addition, the 2006 PRC Company Law provides for: (i) fiduciary duties for *controlling shareholders* (buried in a clause facially authorizing third party creditors' veil-piercing claims);<sup>33</sup>

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<sup>30</sup> Zhonghua Renimin Gongheguo Gongsifa [The Company Law of the People's Republic of China] (passed by the 18<sup>th</sup> Standing Comm. of the 10<sup>th</sup> Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006) [hereinafter 2006 PRC Company Law] in Compendium of Laws, *supra* note \_\_, at 1-1 (emphasis added).

<sup>31</sup> Including misappropriation of company funds, causing the dominated company to guaranty other parties' debt, self-dealing, corporate opportunities and competitive businesses, etc. See 2006 PRC Company Law, *supra* note \_\_, art. 149.

<sup>32</sup> See 2006 PRC Company Law, *supra* note \_\_, art. 149(viii).

<sup>33</sup> See 2006 PRC Company Law, *supra* note \_\_, art. 20 ("Shareholders that oppressively use their shareholder's powers and cause losses for the company or other shareholders shall be responsible for compensation according to law.")

(ii) a new derivative law suit mechanism<sup>34</sup> allowing for lawsuits “on behalf of” the injured corporation by the supervisory board or directly by shareholders against both (a) directors and senior management personnel, and (b) “others” (*taren*), a term meant to include controlling shareholders acting in what the common law calls “oppression” to disadvantage minority shareholders;<sup>35</sup> and (iii) a much broader (at least compared to the 1994 statutory template) private right of action accruing to shareholders for lawsuits seeking remedies for breaches of law, regulation or the company articles of association by directors or senior management personnel where such actions directly injure the interests of shareholders.<sup>36</sup>

Revolutionary as the foregoing items were, the new dispensation on corporate fiduciary duties in the 2006 PRC Company Law did not set forth: (i) a standard for the newly-created duty of care prong, (ii) any instruction for judicial personnel or regulators regarding something like a business judgment rule for duty of care adjudications or enforcement actions,<sup>37</sup> or (iii) anything sounding in the

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<sup>34</sup> See my and Don Clarke’s critique of the new derivative action at Pathway to Minority Shareholder Protection, *supra* note \_\_, at 288-93.

<sup>35</sup> See 2006 PRC Company Law, *supra* note \_\_, art. 152 (in cases where there is a breach of Article 150 (the catch-all provision prescribing damages for breaches of law (*i.e.*, Articles 20, 148, and 149)), allowing shareholders to petition the supervisory board (or if there is no supervisory board, then direct to the People’s Courts) to bring suit “on behalf of the company” and, where there is refusal to act, then by the shareholders directly).

<sup>36</sup> See 2006 PRC Company Law, *supra* note \_\_, art. 153 (“when directors and high level management personnel breach law, administrative regulation or the stipulations of the company’s articles of association, thereby harming the interests of the shareholders, shareholders may bring an action in the People’s Courts.”)

<sup>37</sup> This has never stopped the PRC’s most influential judges from advocating for the explicit inclusion of a business judgment rule in the statute, or use of it in court adjudication and enforcement. See, for example, the November 2005 writing by two Supreme People’s Court Justices (one the Vice President of the Court) in the People’s Court Daily, Li Guoguang & Wang Chuang, *Shenqi Gongsi Susong Ruogan Wenti (I)*

separate “good faith” fiduciary obligation that has so fascinated the Delaware Chancery Court and the Delaware Supreme Court in the United States.

The proclamation of orthodox corporate fiduciary duties in the Chinese company law statute did not halt the separate but parallel initiatives regarding corporate fiduciary duties already commenced by PRC administrative departments more than a decade before and as alluded to above. Above, I have detailed how before 2006 the CSRC pursued its own unique program to inject corporate fiduciary duties into Chinese law and regulation applicable to publicly-held PRC companies limited by shares with a domestic or overseas listing. Suffice to say here that the CSRC and associated agencies did not withdraw from the action, but maintained their separate regulatory bases for injection of corporate fiduciary principles into Chinese law,<sup>38</sup> or conformed pre-existing norms to align more closely with the new statutory articulation of the law. For example, and as already noted above, the passage of the 2006 PRC Company Law made necessary a revision of the CSRC’s 1997 “guiding” articles of association for domestically-listing PRC-domiciled issuers to conform to the new 2006 PRC Company Law articulation of corporate fiduciary

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[*Several Questions on the Courts Adjudication of Corporate Disputes (Part I)*], PEOPLE’S COURT DAILY, Nov. 29, 2005, available at <http://old.chinacourt.org/public/detail.php?id=187288>; and three years later by two other Supreme People’s Court Justices (the first now ousted in the ongoing Anti-Corruption Campaign), Xi Xiaoming & Jin Jianfeng, GONGSI SUSONG: LILUN YU SHIWU WENTI YANJIU [CORPORATE LITIGATION: THEORY AND PRACTICE] 476 (2008).

<sup>38</sup> The instances are too many to recite in this chapter, but the CSRC and other PRC agencies have continued to promulgate rules, regulations, mandatory forms and policy pronouncements which command conformity with the post-2006 ideas of duty of loyalty (*zhongzhi yiwu*) and duty of care (*qinmian yiwu*), while continuing to use the post-1992 and pre-2006 term of art “*chengxin*” or “*chengxin zeren*”.

duties.<sup>39</sup> In much the same fashion, the CSRC amended its 2002 Listed Company Acquisition Rules introduced above to conform the target's board's fiduciary duties to the 2006 PRC Company Law Article 148 formulation.<sup>40</sup>

It is important to see the CSRC's success on one part of the fiduciary duties side in light of the fact that the CSRC was not completely successful in imposing its design for corporate law generally, or fiduciary duties specifically, on the 2006 PRC Company Law itself, or in the immediate aftermath of that statute's promulgation and effectiveness. For instance, the CSRC's proposed veil-piercing mechanism featuring a lower standard for controlling shareholder liability to creditors was frustrated by institutions tied directly to the (state) controlling shareholders of the PRC's corporatized state owned enterprises.<sup>41</sup> Similarly, in late 2007, the CSRC acting in concert with the Legislative Affairs Office of the State Council, released for public comment and submitted to the PRC State Council a draft omnibus regulation (*tiaoli*) designed to remake the 2006 PRC Company Law for listed PRC-domiciled companies called the "Articles for the Administration and Supervision of Listed

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<sup>39</sup> See Shangshi Gongsì Zhangcheng Zhiyin [Guidance Articles of Association for Listed Companies] (promulgated by CSRC, Mar. 16, 2006) zhengjiangongsìzi [2006] 38, CSRC Law and Regulations, *supra* note \_\_, at 938-48.

<sup>40</sup> See Shangshi Gongsì Shougou Guanli Banfa [Measures for the Administration of Acquisitions of Listed Companies] (promulgated by CSRC, July 31, 2006) zhengjianhuiling [2006] 35, CSRC Laws and Regulations, *supra* note \_\_, at 845-53, art. 8 (employing the new statutory formulation for both duty of loyalty (*zhongshi yiwu*) and duty of care (*qinmian yiwu*)).

<sup>41</sup> See Chao Xi, *Piercing the Corporate Veil in China – How Did We Get Here?* 5 J. Bus. L. 413, 423-7 (2011) (describing how the CSRC-proposed statutory language for the new PRC Company Law would have enabled piercing on a showing of lack of separation between controlling shareholder and legal person subsidiary and/or "co-mingling" of assets, not the higher standard finally written into Article 20 of the 2006 PRC Company Law of "abuse" (*lanyong*)).

Companies”.<sup>42</sup> These Articles sought (i) to collect in one administrative norm all of the pre-2006 administrative rules and pronouncements affecting corporate governance at PRC listed companies (including those items actually included in the 2006 PRC Company Law) and (ii) impose additional legal obligations, including in the fiduciary duties line alone: (i) elaborated fiduciary duties for orthodox corporate fiduciaries; (ii) *Caremark*-style<sup>43</sup> oversight duties; (iii) Sarbanes-Oxley-style certification of periodic reports and financial statements; (iv) controlling shareholders/parties fiduciary duties; (v) a mandate that target boards procure “fairness opinions” in public company M&A transactions; and (vi) a much-expanded private right of action for shareholders (acting directly or *via* the newly-authorized derivative action) to sue on fiduciary (not just disclosure) claims. This 2007 attempt to rewrite the corporate law passed by the PRC’s legislature in 2005 *via* administrative regulation issued by the PRC securities regulator after 2006 ultimately came to nothing, but demonstrates the ambition residing in the CSRC to craft and see to the enforcement of such corporate law norms, and stands as a marker for future enactments actually in law.<sup>44</sup>

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<sup>42</sup> Shangshi Gongsi Jiandu Guanli Tiaoli (Zhengqiu Yijian Gao) [Articles for the Administration and Supervision of Listed Companies (Comment Draft)], undated copy (and the PRC State Council’s Legislative Affairs Office explanation and transcripts of related hearings) on file with the author. See also LIU JUNHAI, ZHONGGUO ZIBEN SHICHANG FAZHI QIANYAN [RULE OF LAW FRONTIER FOR CHINA’S CAPITAL MARKETS] 164 (2012).

<sup>43</sup> See *In re Caremark Int’l Inc. Derivative Litig.*, 698 A.2d 959 (Del. Ch. 1996).

<sup>44</sup> See my discussion of this episode and its meaning in Nicholas Calcina Howson, “*Quack Corporate Governance*” as *Traditional Chinese Medicine – The Securities Regulation Cannibalization of China’s Corporate Law and a State Regulator’s Battle Against Party State Political Economic Power*, 37:2 *Seattle U.L. Rev.* 667, 684-9 (2014).

2006 also saw a complete revision of the PRC's deeply flawed 1997 partnership statute, hereinafter the 2006 PRC Partnership Law.<sup>45</sup> That Law provides for three basic forms of partnership under Chinese law: (i) a general partnership (*putong hehuoqiye*) analogous to a general partnership under U.S. state law; (ii) a limited partnership (*youxian hehuo qiye*) analogous to the limited partnership form under U.S. state law but with no more than 50 limited partners permitted; and (iii) a special general partnership (*teshude putong hehuoqiye*) analogous to the limited liability partnership in U.S. state law. Because most of the provisions of the Chinese partnership statute must work for all of PRC general partnerships, limited partnerships and limited liability partnerships (which can be managed by partners or non-partner fiduciaries), there is no explicit declaration of generally applicable fiduciary duties obligations for partners similar to the clear articulation of such duties in the 2006 PRC Company Law for directors, officers and supervisory board members. Instead, the 2006 PRC partnership law describes a number of positive mandates, prohibitions and remedial provisions rooted in fiduciary norms and claims,<sup>46</sup> and in the case of limited partnerships a procedural

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<sup>45</sup> See Nicholas Calcina Howson, *Return of the Prodigal Form? Partnerships and Partnership Law in the People's Republic of China*, in RESEARCH HANDBOOK ON PARTNERSHIPS, LLCs AND ALTERNATIVE FORMS OF BUSINESS ORGANIZATIONS 390-411 (Robert W. Hillman & Mark J. Lowenstein eds., 2015)

<sup>46</sup> See 2006 PRC Partnership Law, *supra* note \_\_, arts. 32 (partners in general partnerships may not engage in activities which "harm the interests of the partnership enterprise" (an obligation that cannot be altered by contract); 28 (reporting obligation by managing partner of a general partnership or General Partner of a limited partnership (also cannot be altered by contract); 27 (for general partnerships where certain partners have been appointed to manage the partnership, the non-managing partners have a duty to "supervise" (*jiandu*) the managing partners); 32 & 70 (prohibition against partners in a general partnership carrying on competing businesses (not applicable to limited partners in limited

vehicle for fiduciary litigation analogous to the corporate derivative action. This limited partnership-specific quasi-derivative action, designed to provide a mechanism for the limited partnership and the partners to hold the limited partnership's General Partner accountable and clearly inspired by the limited partner's derivative action under the U.S. Uniform Limited Partnership Act,<sup>47</sup> comes only by negative implication: The 2006 PRC Partnership Law prohibits limited partners from involvement in management of the limited partnership.<sup>48</sup> However, one of the eight exemptions from that prohibition on limited partner action occurs where "in the event a General Partner neglects the exercise of its rights and powers, and a limited partner brings a lawsuit in the limited partner's own name to direct the performance of such rights and powers or in the interest of the limited partnership".<sup>49</sup> This authorized action by one limited partner in the interest of the limited partnership thus does not trip the overall prohibition against limited partnership involvement in limited partnership affairs, but is not truly "derivative"

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partnerships unless the limited partnership agreement states otherwise)); prohibition against related party transactions by partners with their own general partnership unless permitted by the partnership agreement (also not applicable to limited partners in limited partnerships unless the limited partnership agreement stipulates otherwise); 49 (expulsion of a partner who has caused losses for the partnership business because of an "intentional or serious wrongful act", an "improper" (*bu zhengdang*) act made in conducting partnership affairs, or for other reasons stipulated in the partnership agreement (very likely to include fiduciary breaches)); 96 & 99 (losses and unjust enrichment damages remedies for partners and/or partnership officers who misappropriate partnership benefits or property for their own interest, and for breach of the related party transactions and non-competition prohibitions); and 87 & 67 (provision for partnership liquidators to bring litigation or pursue arbitration on behalf of the liquidating partnership, possibly against partners that have breached their fiduciary-duties like obligations, as described above or as set forth in the governing agreement).

<sup>47</sup> See Revised Uniform Limited Partnership Act (2001), sections 1002-5.

<sup>48</sup> 2006 PRC Partnership Law, *supra* note \_\_, art. 67.

<sup>49</sup> 2006 PRC Partnership Law, *supra* note \_\_, art. 68(vii).

to the limited partnership because the claim and the proceeding accrue to one limited partner and not the limited partnership entire.

## **The Understanding, Application and Enforcement of Corporate Fiduciary Duties by State Institutions and Private Parties**

In this section, I provide a survey as to how the Chinese court system has engaged with the idea of corporate and partnership fiduciary duties in the period after 2006, and formalization of these doctrines in law.

To make any sense of the research observations regarding the private enforcement of corporate fiduciary duties before the Chinese judiciary reported below, however, it is necessary to outline the basic characteristics, practices, and issues associated with this PRC institution.

The Chinese People's Courts at all levels are part of a national bureaucracy separate from the PRC Ministry of Justice (which administers the legal and notarial professions) and under what is called the Supreme People's Court of the PRC. The Supreme People's Court, and the judicial bureaucracy it formally sits atop, is not a separate branch of the PRC Party State in the sense that the United States federal judiciary is separate from the U.S. executive and legislative branches under traditional "separation of powers" doctrine. Instead, the bureaucracy headed by the Supreme People's Court is under the Chinese legislature, the National People's Congress or NPC, just as the apex of executive government, the State Council, is formally subordinate to the same NPC.

Standing behind all of these formal "state" institutions nominally under the National People's Congress is the Communist Party of China, which assigns Party cadres advancing through the Party's *nomenklatura* to hold state or enterprise functions, and populates Communist Party-system committees which shadow (*i.e.*, govern) the fronting state or enterprise institutions to which they are attached.

Accordingly, each aspect of the bureaucratic institution that is the People's Courts system, from the Supreme People's Court in Beijing, to the provincial/major municipality Higher People's Courts systems and their subordinate Intermediate People's Courts and Basic People's Courts, have a "political legal committee" (*zhengfawei*), a local identity of the Chinese Communist Party Politburo's Political Legal Committee.

The idea of the Supreme People's Court in Beijing being in any sense "supreme" is largely illusory. While the Supreme People's Court formally sits atop the national judicial bureaucracy -- *i.e.*, each of the subordinate provincial/major municipal Higher People's Court systems -- most informed analysts of the Chinese judiciary understand that in fact the subordinate provincial/major municipal Higher People's Court systems are quite separate, very often acting in opposition to or beyond dictates from the central Supreme People's Court, even promulgating their own substantive and procedural rules determinative of adjudication (as indeed some of the Higher People's Court systems did before 2006 in trying to escape the bounds of a dysfunctional 1994 PRC Company Law).<sup>50</sup> Much has been made in recent years of the Supreme People's Court's "guiding cases" project commenced in

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<sup>50</sup> See, for example, pre-2006 PRC Company Law "Opinions" on the handling of issues arising in connection with corporate law adjudication under the 1994 PRC Company Law promulgated by the Jiangsu Province Higher People's Court (June 2003), Shanghai Higher People's Court (also June 2003) and the Beijing Higher People's Court (February 2004), at GONGSI YINAN WENTI JIEXI (DI SAN BAN) [DETAILED EXPLANATION OF DIFFICULT COMPANY LAW QUESTIONS] (Shanghai Higher People's Court ed., 2006), at 231-248. For example, the Shanghai Higher People's Court Opinion explicitly, if "temporarily", bars the People's Courts governed by the Shanghai Higher People's Court from accepting shareholders' legitimate claims seeking judicial invalidation of board or shareholders' resolutions where the corporate entity involved is a company limited by shares with a public listing (at Part I(B)(2)).

November 2010, which only prove (in my mind) the *non*-“supreme” nature of the Supreme People’s Court by the extent to which such model judgments have been entirely ignored by the People’s Courts in the rendering of actual decisions.

Thus, for example, the large municipality of Chongqing (a city directly administered by the center like a provincial unit in China) has the Chongqing Municipal Higher People’s Court bureaucracy which governs a number of Intermediate People’s Courts (identified as “No. 1”, “No. 2”, etc.) with specialized subject matter jurisdictions (e.g. criminal law, civil law (further separated into commercial law, economic law, intellectual property rights, etc.)), which Intermediate People’s Courts usually undertake an almost mandatory second hearing of cases adjudicated at the Basic People’s Court level. (I avoid the term “appeal” for reasons made clear below.) Some cases go direct to the Intermediate People’s Court level as the court of original jurisdiction, in which case the second hearing in this example would be performed by the Chongqing Municipal Higher People’s Court. Only rarely is the Higher People’s Court of a province or directly administered municipality granted original jurisdiction in a case, but if it is, then the second hearing would be directed to the Supreme People’s Court in Beijing.

As noted above, each Higher People’s Court system, and the Supreme People’s Court in Beijing, has a “political legal committee” with significant power over the operations of the People’s Court system it is attached to, and – most importantly – adjudication and enforcement of specific cases (often through separate “adjudication committees” (*shenpan weiyuan hui*) that are established inside the given court system). When queried on the function and power of each

People's Court system's "political legal committee", most Chinese judges and judicial cadres will say that such committees generally accept mere "filing" (*beian*) of already-issued judgments, and are only consulted prior to judgment "particular" (*teshu*) or "complex" (*fuza*) cases, where there is "conflicting" authority (substantive legal or institutional), or which might have an impact on "social stability" (*shehui wending*), portraying the committees as assemblages of expertise called in to professionally direct consistent and principled adjudication and enforcement. In fact, these committees do far more, and are instruments designed to guaranty the implementation of Party policy that can be radically distinct from publicly-promulgated law or regulation. Obviously, the existence of these committees diminishes the autonomous or independent character of the People's Courts' judicial tribunals as adjudicatory and enforcement bodies, at least as compared to judicial institutions under a full separation of powers model. However, there is an abundance of literature contesting the value of this kind of Party domination of judicial institutions. Some have argued that they have, or can have, an entirely benign role – in ensuring that Chinese judges act in accordance with state law and regulation and not personal whim, or that they apply the law with an eye to specific circumstances. An example of this latter function in the commercial sphere occurred during the 2008 financial crisis, when the Party – acting through such political legal committees -- directed the judiciary to hold back on enforcing China's bankruptcy laws and creditors claims thereunder so as not to destroy manufacturing businesses and throw people out of work.<sup>51</sup> At the same time, many

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<sup>51</sup> See Corporate Law in the People's Courts, *supra* note \_\_\_, at 374-7.

analysts of the Chinese legal order, in particular external observers, understand Party committees as anything but benign, and an instrument of the deprivation of substantive legal and procedural rights in the interest of social control for criminal cases, the channel through which Party and state actors (including those acting through corporations) are favored or protected against private claims or justified enforcement, or the way in which all manner of “group” actions (i.e., involving many claimants) are choked off because of political fears of collective or popular action, etc. I do not mean to rehearse this important discussion here,<sup>52</sup> although I do want to emphasize the existence of important committees inside the People’s Courts of China which are separate from a given panel of judges formally adjudicating a case, much less writing a published opinion, even on something as facially non (facially)-sensitive as corporate fiduciary duties claims.

Specifically, civil cases that include a claim of breach of corporate fiduciary duties (or some other claim that can be understood by outside observers, or are understood by People’s Court judges, as corporate fiduciary duties breach claims) must first surmount the “case establishment” process, whereby the People’s Court with jurisdiction will allow the claim and permit the case to proceed. This is a very important step in China’s judicial process for civil litigation, and is often the place where People’s Courts stop litigation dead because of lack of technical understanding or confidence, lack of autonomy, or political considerations. If a case is allowed to proceed, and much like litigation in the civil law system, the Chinese

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<sup>52</sup> See the summary of two contrasting views on these questions by two of China’s leading law academics, and members of the same law faculty, He Weifang and Zhu Suli, at Sida Liu, *Beyond Global Convergence: Conflicts of Legitimacy in a Chinese Lower Court*, 31 *Law & Soc. Inquiry* 75, 81 (note 4), and 92-3 (2006).

judiciary plays a leading role in collecting evidence – with an emphasis on documentary evidence -- from the parties and analyzing it for the purposes of making a decision. While there are court hearings in civil cases in China, any review of judgments makes clear that the panel of judges or the People’s Court with jurisdiction renders judgments largely based on documentary submissions and evidence, and some minimal judicial interrogation of the parties and related actors. Thus, it is rare to see People’s Court judges sitting passively (or objectively) and deciding between disputing briefs submitted by zealous advocates for the parties to the action. In many cases, the parties will ask for a second hearing at the next highest level of the People’s Courts, but uniformly because they “don’t” submit” to the first judgment on the merits, and rarely with specific allegations that there has been a procedural defect or misapplication of law. Accordingly, the next higher level of the People’s Courts charged with a second adjudication will undertake a re-hearing of the case entirely *de novo*, asking again for submission of all required evidence (again, largely document-based), interrogating the parties and related individuals, and applying whatever law or regulation it deems appropriate and regardless of what law the first level of People’s Court thought applicable or made the basis for its prior ruling. This is one of the aspects that makes research on corporate fiduciary duties litigation in China so difficult, because the student of these processes is presented with two litigations before two distinct People’s Courts, with two separately-developed bodies of documentary evidence, testimony, and two often unrelated applications of law. The judgment on the re-hearing is

deemed the final judgment in the case, and the judgment that is to be enforced against the parties.

As is well-known, the modern PRC does not have what is called a common law system, which in this context means that each civil judgment is specific to the case, and the judgment neither looks to prior precedent arising from similar cases in the same Higher People's Court system or in China nationally, nor stands as precedent for other People's Courts decisions in the future. This, of course, is an important facet of PRC adjudication of corporate fiduciary duties disputes, precisely because fiduciary duties adjudication is so closely tied to and dependent upon common law-style adjudication and the understanding and application of precedential decisions. Indeed, in any legal or governance system, Anglo-American style corporate fiduciary duties for orthodox fiduciaries and control parties alike are paradigmatic of, and indeed rely upon, two things: (i) *ex post* application of broadly-drawn standards against obligors at the urging of the named beneficiaries of the obligation (as compared to *ex ante* compliance with bright line rules by the obligors entirely on their own); and (ii) the concept of state civil institutions that have the requisite technical competence, institutional autonomy, and political independence to adjudicate and enforce those standards (a) in the context of extremely complex factual circumstances, and (b) in common law-based systems at least, as aided by historical lines of adjudication and resulting jurisprudence in prior cases similar and dissimilar.

Accordingly, any analysis of state and private understandings of corporate fiduciary duties in modern China must focus on consideration of the PRC

institutions tasked with *ex post* application of such standards, the PRC People's Courts or what is generalized as the PRC "judiciary". While there has been very significant development in the Chinese judiciary since the end of the Great Proletarian Cultural Revolution to date, all observers would agree that the vast judicial bureaucracy comprised of the People's Courts formally arrayed under the PRC Supreme People's Court continues to face significant constraints – even regarding non-political, non-social control matters like corporate governance and property rights disputes -- with respect to technical competence, bureaucratic autonomy, and political independence. Here is how I tried to distinguish these three aspects in a 2010 writing on the corporate law adjudication of the courts under the Shanghai Higher People's Court (footnotes omitted):

"Autonomy" in the context of the PRC People's Courts should be distinguished from two other important concepts: "competence" and "independence". Competence is the easier concept to understand, and goes to the technical expertise of judicial institutions in evaluating fact- and law-complex disputes. For example, competence refers to the extent to which Chinese People's Courts can adjudicate corporate fiduciary duty of care cases with the very rich facts and difficult application of law those entail,... The idea of autonomy is distinct from "independence" although the two concepts may be stops on a single continuum. [Judicial a]utonomy in the PRC context is the ability of the judicial institution to act with its own institutional authority, even if in Chinese parlance it has no "legal basis" (*falü yijū*) to act. Examples of demonstrated autonomy presented [here]... are the many cases where the... People's Courts accept, hear and decide cases on corporate fiduciary duties,... when the PRC judiciary has no legal basis for such action. Judicial independence is still another idea, and goes to the ability of courts and judicial officers to act independently from, and against the interest of, political or military power.<sup>53</sup>

For an example of how these three conceptual distinctions operate, or not, together in the context of this chapter, consider how when faced with a shareholder

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<sup>53</sup> See Corporate Law in the People's Courts, *supra* note \_\_, at 327-8.

derivative claim of breach of duty of care brought against the directors and officers of a corporatized Chinese state-owned enterprise (with the directors being political cadres scaling the Communist Party's *nomenklatura* system) a PRC People's Court would understand or invoke sophisticated corporate law doctrine and important but complex facts in evaluating *competently* the fiduciary duties breach claim, act *autonomously* in first accepting the case and then enforcing the corporate fiduciary obligation of care where there is not yet a legal basis (as there was not prior to 2006) for either the derivative action or the duty of care itself, and then be able to act *independently* in enforcing that fiduciary obligation against Party, state or military officials with vastly greater political power.

This three-pronged understanding of the People's Courts in action allows me finally to offer a last set of introductory observations bearing broadly on "political independence" considerations, all of which determine the reality of even seemingly straightforward fiduciary litigation before the PRC courts:

First, the more politically important the actor in a lawsuit in China is, the more sensitive and therefore subject to various kinds of interference the lawsuit will be. The management and controlling shareholders of major companies in the PRC – especially companies which are the result of "corporatization without privatization" of pre-existing state-owned enterprise assets – are very likely to be influential politically, nationally or locally (especially where the corporate entity is headquartered, where it employs workers and where it pays taxes) and in fact will usually be tied directly to local or national state or Party organizations. As a result, effective pressure may be brought against local People's Courts to protect such

powerful actors from claims against them, especially where such individuals and organizations directly control the courts *via* appointments and direct budgetary power. As noted above, Party “political legal committees” embedded inside each Higher People’s Court system have the power to issue, and do issue, instructions to the People’s Courts directing them on how to rule on certain cases. Some jurisdictions have a specific rule mandating that when a party from outside that area sues a locally-headquartered or active enterprise, the People’s Court receiving the claim must get permission first from the local Party Committee to hear the case (or provide “case establishment” described above), or the court must rule in accordance with the instructions of the local Party organ.<sup>54</sup>

Second, there is a long-standing hostility to the possibility of lawsuits involving multiple plaintiffs or the interests of multiple parties in China regardless of the political backgrounds of named defendants, and thus both reluctance of the People’s Courts to get involved with such lawsuits and rules and practices which express the Party State’s own aversion to them. The aversion to multiple plaintiff cases here can be different from the “local protectionism” *cum* protection of political actors alluded to above, and is rooted in the Party State’s nervousness regarding any kind of mass action by non-politically- or economically-privileged citizens outside of the control of the Party or the Party State, and especially before a formally autonomous institution with, sometimes, ideas of its own. There is ample evidence

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<sup>54</sup> See reference to such practices, still very much in effect, from the past two decades: D. Guo, *Shixing Sifa Duli Yu Ezhi Sifa Fubai [Implementing Judicial Independence and Preventing Judicial Corruption]*, 1 *Falu Kexue [Law Science]* 5, 8 (1999) and Y. Wu, *Sifa Duli Yu Difang Baohuzhuyi [Judicial Independence and Local Protectionism]* 16 *Hunan Gong'an Gaodeng Zhuanke Xuexiao Xuebao [Journal of the Hunan Higher and Specialized Institutes of Public Security]* 18, 19 (2004).

that the Higher People’s Courts instruct lower level courts not to take multiple plaintiff lawsuits at all.<sup>55</sup> The 2003 Supreme People’s Court judicial “regulations” finally allowing the People’s Courts to accept false and misleading disclosure claims under the PRC Securities Law<sup>56</sup> also limited the scope of such claims any party could bring before the judiciary, and mandated procedural restrictions for the bringing of such claims – importantly for this chapter, the size of any plaintiff group included as formal plaintiffs in any group action. These latter constraints have been strictly adhered to by the People’s Courts from the very start, when the first group claim against a securities issuer (Daqing Lianyi) in 2003 required the original group of 381 plaintiffs to be divided into smaller groups of ten to twenty people.<sup>57</sup> Similarly, the Supreme People’s Court in 2005 sought explicitly to push multi-plaintiff litigation to the lowest possible level of the People’s Courts to ensure that such groups wouldn’t physically carry their claims to provincial/directly-administered municipality capitals (on appeal from the Intermediate People’s Court level) or the

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<sup>55</sup> See, for example, the instruction reported in my Corporate Law in the People’s Courts, *supra* note \_\_, at 404-5 (for corporate and securities litigation, including derivative action-like corporate claims and class action-like securities disclosure claims) and the similar instruction from the Shanghai Higher People’s Court to that system’s subordinate People’s Courts described in Pathway to Minority Shareholder Protection, *supra* note \_\_, at 255 (mandating refusal of all cases involving more than ten plaintiffs).

<sup>56</sup> See Supreme People’s Court, Zuigao Renmin Fayuan Guanyu Shenli Zhengquan Shichang Yin Xujia Chenshu Yinfa De Minshi Peichang Anjian De Ruogan Guiding [Several Provisions on the Adjudication of Civil Suits for Damages Arising Out of False Representations in Securities Markets], issued Jan. 9, 2003, available at

<sup>57</sup> See *Daqing Lianyi An Jiannan Tuijin* [The Daqing Lianyi Case is Pushed Ahead With Difficulty], Nanfang Zhoumo [Southern Weekend], Aug. 14, 2003, available at <http://finance.sina.com.cn/roll/20030814/1108406286.shtml> and Robin Huang (Hui), *Private Enforcement of Securities Law in China: A Ten-year Retrospective and Empirical Assessment*, 61 AM. J. Comp. L. 757, \_\_ - \_\_ (2015).

Beijing center (on appeal from provincial/directly-administered municipality Higher People's Courts).<sup>58</sup> Even the lawyers who might take such cases are subject to constraints before the plaintiff group gets to court – in March 2006, for example, the All China Lawyers Association (a non-autonomous and state-controlled body that governs the legal profession alongside the PRC Ministry of Justice and its subordinate judicial bureau) issued a “guiding opinion” applicable to all lawsuits with ten or more plaintiffs, mandating that any law firm intent on taking such cases report that fact to state bodies and “accept supervision and guidance” from the state in connection with such cases.<sup>59</sup> Moreover, expensive lawsuits involving multiple claimants with *de minimus* damages claims are further inhibited in the PRC because of the lack of, or restrictions on, useful litigation financing or cost-allocation mechanisms like: lawyers' contingency fee arrangements, a “loser pays” rule, a “common fund” mechanism (where the shareholder plaintiff's legal fees come from the corporate recovery not the real plaintiffs in interest), the availability of a judicial order wherein the company that is the formal plaintiff bears the case financing burden (even if the underlying claim ultimately fails), or a South Korean and Taiwan style quasi-governmental institution charged with bringing (and thus financing) such lawsuits. <sup>60</sup>

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<sup>58</sup> See Supreme People's Court, Zuigao Renmin Fayuan Guanyu Renmin Fayuan Shouli Gongtong Anjian Wenti De Tongzhi [Notice on the Question of the Acceptance by the People's Courts of Joint Litigation Cases], issued Dec. 30, 2005, available at [www.law-lib.com/law\\_view.asp?id=149701](http://www.law-lib.com/law_view.asp?id=149701), at para. 1.

<sup>59</sup> See All China Lawyer's Association, Guanyu Lushi Banli Quntixing Anjian Zhidao Yijian [Guiding Opinion on the Handling by Lawyers of Mass Cases], Mar. 20, 2006, available at [www.acla.org.cn/pages/2006-5-15/s34852.html](http://www.acla.org.cn/pages/2006-5-15/s34852.html).

<sup>60</sup> Don Clarke and I canvas these case financing obstacles in Pathway to Minority Shareholder Protection, *supra* note \_\_, at 258-60.

Of course, corporate fiduciary litigation brought under the derivative action mechanism is *not* (necessarily) a “class action” familiar from securities law enforcement -- where a large number of similarly-placed securities purchasers sue *qua* plaintiffs on false or misleading disclosure through a collective action –enabling mechanism which makes the claim feasible in financial terms. Nor does fiduciary litigation require multiple plaintiffs. In theory, a single shareholder could trigger a derivative claim where the formal resulting plaintiff is the harmed corporate entity the corporate fiduciaries have failed. Notwithstanding, in modern China the Party State and People’s Court officials alike will understand immediately how derivative lawsuits pertaining to widely-held or listed companies, even where formally there is a single plaintiff (the company), will implicate the interests of a large number of common shareholders, on one side, entering the courthouse to do battle with politically powerful insiders and controlling shareholders, on the other. Thus, the sensitivity to “group”, “mass”, or multiple-plaintiff claims noted in other areas of the Chinese legal system in action exists also for corporate fiduciary breach claims, especially for widely-held or listed PRC companies.

To be specific with respect to the application and enforcement of fiduciary duties and the adjudication of corporate fiduciary duties claims by the PRC People’s Courts after 2006, my own research over more than a decade as well as the studies of others<sup>61</sup> has shown the following issues that touch on the core concerns

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<sup>61</sup> See, for example, Wang Jun, *Gongsi Jingyingzhe Zhongshi He Qinmian Yiwu Susong Yanjiu – Yi 14 Sheng, Zhixiashi De 137 Panjueshu Wei Yangben [Analysis of Litigation Regarding Company Management’s Duties of Loyalty and Care – Using 137 Judgment Opinions from 14 Provinces and Directly Administered Municipalities]*, 5 *Beifang Faxue [Northern Jurisprudence]* 24 (2011) and Wang Jiangyu, *Enforcing*

regarding the competence, autonomy and independence of China's judicial institutions in navigating these kinds of claims (and indeed many others). Again, because of space limitations I present these conclusions in summary form:<sup>62</sup>

- Whereas in the pre-2006 context, there was ample evidence of the People's Courts applying doctrines like corporate fiduciary duties without legal (statutory) authority or what Chinese lawyers fetishize as a "legal basis", after 2006 and the inclusion of Article 148 of the 2006 PRC Company Law and a clear legal basis for such doctrines,<sup>63</sup> this is no longer an issue;<sup>64</sup>
- The large majority of cases touching on corporate fiduciary duties involve the closely-held PRC corporate form – the limited liability company (*youxian*

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*Fiduciary Duties as Tort Liability in Chinese Courts*, in ENFORCEMENT OF CORPORATE AND SECURITIES LAW – CHINA AND THE WORLD 185 (Nicholas Calcina Howson & Robin Huang (Hui) eds., 2017)

<sup>62</sup> The already published bases for these research observations can be found in *Doctrine That Dared Not*, *supra* note \_\_, *Corporate Law in the People's Courts*, *supra* note \_\_, and *Pathway to Minority Shareholder Protection* *supra* note \_\_. I have updated that research for this chapter, with the expert help of Jason Zhu, Michigan Law School, JD 2018.

<sup>63</sup> Although, there will be slip-ups even with clear legal authorization in existence. *See*, for example, the case reported in *Pathway to Minority Shareholder Protection*, *supra* note \_\_, at 284 (footnote 100 and accompanying text) (the People's Court boldly allows a derivative action even though the claims arose before 2006, but then rejects the underlying substantive fiduciary duties breach claim against defendant directors and officers because "... even though the... defendants may have been in breach of their duty of care [interestingly, the opinion uses both the post-2006 enshrined term of art "*qinmian yiwu*" and the Taiwan statutory term of art "*zhuyi yiwu*"], the breach of that duty and resulting liability to the company [for damages] is a separate legal relationship (*lingwai de falu guanxi*)."

<sup>64</sup> It would be an issue if any People's Court saw fit to apply openly-declared "business judgment rule" presumptions in adjudicating at least duty of care cases, but as noted below there are very few duty of care claims in reported People's Court opinions.

*zeren gongsi*);<sup>65</sup> cases involving the joint stock form (or companies limited by shares (*gufen youxian gongsi*)) are extremely rare, and even those are limited to closely-held companies limited by shares without a public listing; the strict ban on adjudicating cases involving claims against corporate fiduciaries for widely-held (i.e., with many shareholders), much less listed, companies limited by shares (i.e., with in the eyes of the Chinese Party State *too* many shareholders) continues;

- The derivative action as a vehicle for the bringing of fiduciary claims is now used a good deal, but in a manner that hues closely to the 2006 PRC Company Law Article 152 requirements (with all of its defects) and solely with respect to the close company form, limited liability companies (*youxian zeren gongsi*), and never for companies limited by shares, closely-held or listed;
- The derivative action continues to be employed at closely-held limited liability companies for what the Anglo-American system calls “oppression” claims, whereby a controlling shareholder has harmed its dominated subsidiary (and thus the minority interest in the subsidiary) and breached its 2006 PRC Company Law Article 20 duty not to harm the firm (or minority shareholders);<sup>66</sup>

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<sup>65</sup> But, as might be expected, never with respected to the directly state-owned sub-species of the limited liability company used as the investor for the PRC’s state-owned groups, the “wholly state owned company” (see 2006 PRC Company Law, arts. \_\_).

<sup>66</sup> As alluded to above, Article 152 of the 2006 PRC Company Law is extremely appropriate for the PRC’s controlling shareholder dominated firms because it

- Fiduciary litigation concerning limited liability companies and (a few) closely-held companies limited by shares centers largely on duty of loyalty claims;
- It is far more difficult to find People's Courts opinions adjudicating duty of care claims as 2006 PRC Company Law "duty of care" claims. The possible reasons for this include: (i) the failure of private claimants to pursue these (now) legally-authorized claims; (ii) the People's Courts refusal to render "case establishment" with respect to such claims even if they are raised; (iii) hesitation on the part of the People's Court judges to wield, with confidence, such a complex doctrine, especially in the absence of authority for a business judgment rule; and (iv) easy substitution of claims adjudication under Article 4 of the 1986 GPCL commanding "good faith" (and "fair dealing") in the commercial realm;
- However, the foregoing bullet point does not assert that there is a *complete absence* of explicitly duty of care claims adjudication in China at present – my own recent research provides evidence of some volume of duty of care cases, many of which are focused on intentional wrongdoing by orthodox fiduciaries – *e.g.*, stealing or misappropriation of the corporate seal and thus (in China's customary enterprise legal person law) corporate authority – or

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facilitates these claims by including "others" in the list of defendants, thus "others" besides the normally- understood fiduciaries (directors, supervisory board members and officers) which now regularly includes the control parties alluded to in Article 20 of the Company Law.

what the Delaware lawyer might understand as a breach of the duty to act in “good faith”;

- And there is evidence of straight-up 2006 PRC Company Law Article 148 duty of care claims and adjudications, which present an extremely compelling picture of PRC People’s Court judges striving to understand and articulate critical aspects of what underlies the duty of care (including failure to inform one self before making a decision), the appropriate standard for duty of care breaches, business judgment rule presumptions, and much more. (An Appendix to this chapter contains my translations of opinion excerpts where Chinese People’s Court judges address duty of care claims in such cases.)<sup>67</sup> These instances are compelling precisely because it has long been assumed by observers Chinese and foreign that China’s People’s Court judges are unable to explicate and apply a paradigmatic common law/equity courts doctrine like duty of care in the alien circumstance of China’s present political economy.

In the separate realm of formal (*i.e.*, State Administration of Industry and Commerce (SAIC)-registered) PRC partnerships, there is a notable lack of cases involving alleged breach of fiduciary duties between partners (including duty of loyalty type claims), much less by specific partners – acting on their own, or on behalf of the partnership enterprise – with fiduciary breach claims against managing partners. This situation is somewhat ironic because, as noted above, the Chinese People’s Courts have been very busy using partnership principles, including what

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<sup>67</sup> See Appendix 1 – “PRC People’s Court Duty of Care Adjudication (Opinion Excerpts)”

seem to be understood as universal principles of fiduciary duties among partners, when (i) adjudicating disputes between equity investors in enterprises formally established as PRC limited liability companies, in effect rejecting the applicability of corporate law to Chinese corporations, or (ii) in rejecting use of the corporate derivative action with respect to the same enterprises because the claims asserted are understood as horizontal claims between co-partners/investors and not vertical claims by shareholders against a centralized management institution called the board.<sup>68</sup> There is no evidence whatsoever of claims or resulting adjudications arising from the partnership context that most lends itself to fiduciary claims because of real separation of ownership and management and keen information asymmetries: the limited partner's right to sue a limited partnership General Partner – either directly or on behalf of the limited partnership -- for “neglect” under the 2006 PRC Partnership Law's Article 68(vii) described above. One 2011 study of specifically this mechanism failed to find even one example of its use in China up until January of that year.<sup>69</sup> My own further research to late 2017 has revealed nothing further, other than a 2016 Guangdong Province Basic People's Court opinion denying the attempt by a limited partner to use the Article 68(vii) quasi-derivative action against a General Partner.<sup>70</sup> At this point we can only

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<sup>68</sup> See, for example, the many cases between 1997 and 2008 discussed in Corporate Law in the People's Courts, *supra* note \_\_, at 359 (footnote 90) and 362-3, and Pathway to Minority Protection, *supra* note \_\_, at 252-3 and 283-4, regarding rejection of “vertical” corporate derivative claims in favor of “horizontal”, partner to partner, claims against co-investors.

<sup>69</sup> See Lin Lin, *Limited Partners' Derivative Action: Problems and Prospects in the Private Equity Market of China*, 2 Hong Kong L.J. 201, 210 (footnote 40) (2011)

<sup>70</sup> See Xiang Qun v. Guangzhou International Purchasing Center Company Limited et al. Re: Guangzhou Kaide Hefeng Investment Limited Partnership,

speculate regarding the lack of limited partner quasi-derivative fiduciary claims against General Partners of limited partnerships, which may be a result of the relative rarity of (wholly domestically-invested) limited partnerships in the PRC, passivity and litigation adversity among limited partner investors, lack of sophistication and/or legal rights consciousness among such investors, competence deficiencies in the receiving People's Courts, or the collective action and financing constraints detailed above in connection with corporate fiduciary litigation generally.

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Guangdong Province Guangzhou Municipal Tianhe District People's Court, (2015) *huitianfajinminchuzi* 5340 (July 22, 2016) (disallowed because the plaintiff limited partner is suing for its investment losses allocated through the limited partnership, not the losses experienced by the limited partnership itself because of the general partner's failure to pursue remedies accruing to that limited partnership as an unpaid lender with a third party itself).

## **Meanings**

What do these research findings tell us about corporate fiduciary duties and the private enforcement of those duties against orthodox fiduciaries in contemporary China, and indeed about the PRC's governance and legal systems more broadly?

First, it seems clear that the corporate form, and the fact of separation of ownership and management, conjures the demand for and application of basic fiduciary duties principles, even in a political economy that has very little experience with the corporate form of enterprise, much less the private firm, and even where there is no clear legal authority for such duties and their enforcement. China's experience to date shows that something like fiduciary duties for the individuals who populate the centralized decision-making body of the firm will be demanded by equity investors, and enforced by state institutions like courts, even in the absence of an explicit or jurisprudential basis for such duties or any expectation that the enforcement institutions are perfectly competent, autonomous or politically independent. If development is in part co-evolutionary, and about weak institutions sustaining early markets, which developing markets then loop back to nurture stronger institutions, which create stronger and more efficient markets, and so on,<sup>71</sup> then in China corporate fiduciary duties claimed by private investors without any legal basis and enforced by wobbly state actors (courts and/or regulators) might constitute such an initially weak, but over the long term useful, "institution".

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<sup>71</sup> See Yuen Yuen Ang, *HOW CHINA ESCAPED THE POVERTY TRAP* (2016).

Second, corporate fiduciary duties require, eventually, a certain kind of institution to ensure broad and expert application and enforcement of such duties, especially in an environment like China's "corporatization without privatization" program where control parties (whether directors or controlling shareholders) have overwhelming political as well as economic clout. At a minimum, that institution (whether or not a court of law) must have the requisite competence, autonomy, and political independence to reliably apply and enforce these doctrines. Where that state institution lacks any or all of the requisite competence, autonomy or political independence, these duties, whatever their source, may not be applied or enforced, in whole or in part, and thus may have their greatest value in the realm of symbolism and the communication of "modernity", conformity with "international (or more properly, global capital markets) standards", and assurances for incurious or ill-informed equity investors. The critical question for China is the future cost of long-standing non-application and enforcement of these legal duties, even if their existence and occasional enforcement brings the symbolic and declaratory benefits sketched out above in the short term. One might suppose there is a very deep cost associated with the sapping of all credibility in the institution arising from non-enforcement by weak or incompetent institutions.

Third, and as the PRC Party State has recognized in another context (securities law suits on false or misleading disclosure) a real private right of action for *all* shareholders (whether seeking protection of their own interests, or the interest of the injured firm), enabled by a viable derivative action, is essential for enforcement of corporate fiduciary duties. It is simply not feasible, given resource

(and competence and political) constraints, to rely on a state administrative agency like a corporate law or a securities regulator to identify and enforce against all of the illegal and corporate fiduciary duty-breaching behavior across a large and complex national economy, much less a national political economy like China's which is still in the middle of a chaotic and ever-shifting transition. "All" shareholders here means investors in closely-held vehicles and public investors in widely-held companies limited by shares. In today's China, all investors in Chinese firms theoretically have this private right of action, but the right is in reality limited to investors in closely-held firms because of the well-understood ban on cases involving widely-held companies limited by shares or publicly-listed companies (and their fiduciaries). Again, the question for the Chinese system across a broad range of legal claims (*e.g.*, securities law claims, environmental torts, labor, etc.) is the long-term effect of continuing to obstruct private claims and enforcement (as opposed to the far more manageable idea of public enforcement).

Fifth, the Chinese case reminds us that it is difficult to evaluate the truth of what many Anglo-American common law lawyers hold to be true in this area: that private law-based fiduciary duties and enforcement require a common law-style system of jurisprudence, authoritative precedents applied to varying factual circumstances, doctrine distilled from both of the foregoing (*e.g.*, business judgment rule presumptions) and courts acting "in equity" to be fully realized. In the Chinese case, so few cases involving the enforcement of fiduciary duties at widely-held companies with the desired factual complexity, acute separation of ownership and management and information asymmetry have made it past the "case

establishment” block, that observers just cannot say how necessary the common law /equity courts systems are. At the same time, it is possible to say that there is no doubt whatsoever that in a context like China’s, self-enforcing, mandatory, rules work better to enforce the principles that stand behind much of corporate fiduciary duties law than very uncertain reliance on state institutions applying contestable standards *ex post*.<sup>72</sup>

Sixth and finally, there is the set of questions that are conjured from the Law and Development and Law and Finance literatures. (Too) simply put, those two bodies of literature have asserted that in the absence of common law-style explanation and enforcement *ex post* of corporate fiduciary duties standards by a competent, autonomous and politically independent judiciary, and as triggered by private claims far greater than what a resource and attention-constrained state regulator might pursue, capital formation will be inhibited (investors won’t part with their investment capital) and the economic efficiency and development that would result from such capital formation will be negatively impacted. On this idea, China, as in many other areas, remains a real puzzle – for the modern PRC is commonly thought to have “no” or a radically deficient legal system, and it is well-known from reports like this chapter that fiduciary duties in particular are not widely or expertly enforced in the Chinese courts, and yet the PRC has seen historically-unprecedented capital formation and economic growth in the past

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<sup>72</sup> I have elaborated on this point elsewhere, see Nicholas Calcina Howson, “Quack Corporate Governance” as *Traditional Chinese Medicine – The Securities Regulation Cannibalization of China’s Corporate Law and a State Regulator’s Battle Against Party State Political Economic Power*, 37 SEATTLE U. L. REV. 667, 689-99 (2014),

several decades. Of course, it is hard to test empirically what the lack of common law enforced fiduciary duties has meant for China over this period – *i.e.*, there is no control nation which is like the PRC but that has a functioning common law system *cum* equity courts and a jurisprudential tradition interpreting and applying corporate fiduciary standards, nor has the Delaware Chancery Court ever been invited to decamp permanently to the Municipality of Chongqing. Great scholars continue to attack this particular “China Puzzle” with gusto and insight, many focusing on the involvement of “the state” as promoters of capital formation and a guaranty against expropriation by... the state.<sup>73</sup> However, in this small corner of the China Puzzle, we can state the following: the lack of corporate fiduciary duties applied by common law-styled judicial institutions sitting “in equity” with the requisite competence, autonomy and independence has not strangled capital formation and economic development in the PRC. This is not to deny any importance or value for the quintessentially common law/equity courts mechanism that corporate fiduciary duties are. It is only to say that, at this point in the history of post-Revolutionary and Reform era China, the value of the thing may lie largely in symbolic communication to audiences domestic and foreign, pretty costless assurances to investors participating in Chinese issuers seeking capital on the global capital markets, and self-assurances about China’s attainment of “modernity” and/or conformity with perceived global standards. Whether the set of institutions associated with legal corporate fiduciary duties, as applied, will have a more

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<sup>73</sup> See, for instance, Donald C. Clarke, *Economic Development and the Rights Hypothesis: The China Problem*, 14 AM. J. COMP. L. 459 (2003), and Ang, *supra* note

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substantive value and thus traction in China's ongoing development is the question for the future.

## Appendix 1 – PRC People’s Court Duty of Care Adjudication (Opinion Excerpts)

... Regarding the question of whether or not in this case the Defendant engaged in behavior that violated the duty of care (*qinmian yiwu*). The duty of care of directors, supervisory board members and senior management personnel means that directors, supervisory board members and senior management personnel must in the course of performing their duties and making, and with the interest of the company always as their standard, not be grossly negligent or make major mistakes, and undertake their responsibilities by fully complying with their reasonable duties of prudence (*jinshen*) and attention (*zhuyi*) in an appropriate way. In rendering judgment as to whether or not directors and other senior managers have conformed to their duty of care, we must further distinguish three aspects: (i) [the fiduciary] must have acted in good faith (*shanyi*); (2) when handling company affairs [the fiduciary] has a duty of attention of the normally [*yibanxing*] prudent person handling his own affairs in similar circumstances and with a similar status; (3) there is a basis to believe that [the fiduciary] is undertaking his duties in a manner that serves the best interest of the company. In the period where the Defendant was completely responsible for the Plaintiff company’s operations and was the specific manager [for the offending transaction], ... he only entered into an oral agreement with the other party... to the transaction, and so after [the Defendant] left the employ of the Plaintiff he could not provide the Plaintiff any documents or materials agreed by the other party. According to commonly understood operational knowledge, if one uses oral transaction agreements... as soon as a dispute breaks out with the transaction counter-party, there is no way to confirm the rights and obligations of the transacting parties.... Thus, the Defendant should have had every reason to understand that the use of an oral agreement was not consistent with business judgment directed to serving the best interest of the company; instead, he paid no heed to the existence of business risks [arising from contracting orally], and did not perform his duties in a way that he could have believed served the best interest of the company in a good faith (*shanyi (chengshi)*).

*Shanghai Chuanliu Electric Machinery Specialty Equipment Company Limited v. Li Xinhua*, Shanghai Minhang District People’s Court (October 19, 2009) minminer(shang)chuzi 1724; upheld on appeal to Shanghai No. 1 Intermediate People’s Court (February 24, 2009) huyizhongminsanshang zhongzi 969.

According to the stipulations of Article 148 of the [2006] PRC Company Law, company directors, supervisory board members and senior management personnel have a duty of care (*qinmian yiwu*) to the company. Directors are the managers of the company elected and appointed by the shareholders of the company, and have extensive power to undertake management of the company representing [the interests of] the shareholders. Whether or not the directors’ management of the company is appropriate determines whether or not the shareholders’ and the company’s rights and interests are able to be protected, and even determines the fate and future of the company. ... Therefore, at the time he negotiated the terms of

the agreement, [the Defendant] as the chairman of the board of directors and general manager of the company should have, based upon the knowledge, competence and experience it is reasonable to expect a board chairman or general manager to have, thought about whether [a contract timing stipulation] was achievable... [The Defendant] as chairman of the board should have fulfilled his duty of prudence and attention (*jinsheng zhuyi yiwu*) with the same knowledge capabilities and management acumen of an ordinary (*putong*) corporate manager in the same position. [The opinion continues to locate the Defendant's breach of the duty of care in the Defendant's failure to fully inform himself before making a decision (in this case, signing a contract creating impossible to fulfill obligations for the entity he owes a fiduciary duty to.)

*Jiangsu Sunan Special Equipment Group Company Limited v. Zhao Haihua*, Jiangsu Province Suzhou Municipal Intermediate People's Court (June 18, 2014) suzhongshangzhongzi 1724.